

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Curt Hébert, Jr., Chairman;  
William L. Massey, and Linda Breathitt.

California Independent System Operator  
Corporation

Docket No. ER00-2019-003

City of Vernon, California

Docket No. EL00-105-002

## ORDER DENYING REHEARING

(Issued February 21, 2001)

In this order, we deny rehearing of two orders issued October 27, 2000 related to implementation of a new Transmission Access Charge by the California Independent System Operator Corporation (ISO).

Background

In an order issued May 31, 2000, the Commission accepted for filing, subject to refund, suspended, and established hearing and settlement judge procedures for the ISO's proposed Transmission Access Charge (TAC) methodology and related tariff revisions.<sup>1</sup> Included in the ISO's TAC proposal was a requirement that non-public utility entities such as local, publicly-owned electric utilities (referred to as Governmental Entities) that become Participating Transmission Owners in the ISO submit their high voltage Transmission Revenue Requirement (TRR) to the ISO. The ISO proposed that if an objection were raised regarding a Governmental Entity's proposed TRR, then the justness and reasonableness of the TRR would be evaluated by a Revenue Review Panel (RRP) in accordance with the standards established by the Commission pursuant to the Federal Power Act (FPA) and, if applicable, the standards established by the ISO Governing Board. In addition, the ISO proposed that the decision of the RRP be final and not subject to further review. The May 31 Order specifically found that the ISO's proposal that the RRP's decision would be final and non-appealable was inconsistent with the Commission's statutory responsibilities. In addition, the May 31 Order instructed the

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<sup>1</sup>California Independent System Operator Corporation, 91 FERC ¶ 61,205 (2000), reh'g pending (May 31 Order).

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parties, with the assistance of a designated settlement judge, to negotiate the appropriate regulatory review authority of the TRR of non-public utility entities who become Participating Transmission Owners.

#### Orders at Issue

On October 27, 2000, the Commission issued two orders related to the implementation of the ISO's TAC methodology. In the first order, the Commission approved the ISO's compliance filing revising, in pertinent part, procedures for review of non-public utility TRRs.<sup>2</sup> The filing modified the ISO's tariff to make decisions of the RRP subject to review and acceptance by the Commission, and provided an alternative procedure whereby non-public utilities could file their TRRs directly with the Commission. The TAC Compliance Order found that the alternative filing procedure was an acceptable means of implementing our guidance in the May 31 Order.

In the second order, the Commission found that the proposed rate methodology and resulting TRR filed by the City of Vernon, in accordance with the ISO's alternative filing procedure, were just and reasonable as modified.<sup>3</sup> Vernon had requested a Commission determination that its TRR, as approved by its rate setting body, the Vernon City Council, was proper for purposes of Vernon becoming a Participating Transmission Owner in the ISO. Upon becoming a Participating Transmission Owner, Vernon would turn over operational control of its transmission lines and associated facilities, and be reimbursed by the ISO through the TAC for such facilities. Vernon claimed that it presented its TRR to meet any standard the Commission might apply, up to and including the Federal Power Act's just and reasonable standard. As part of its proposed TRR, Vernon utilized proxy numbers for its rate of return on common equity and depreciation rates that were identical to those of Southern California Edison Company (SoCal Edison), the IOU in the same geographic TAC area as Vernon. In addition, Vernon used SoCal Edison's methodology for developing administrative and general (A&G) expenses and a cash working capital allowance.

The Commission accepted Vernon's overall approach with two modifications. First, the order determined that Vernon "should use [SoCal Edison's] capital structure so

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<sup>2</sup>California Independent System Operator Corporation, 93 FERC ¶ 61,104 (2000) (TAC Compliance Order).

<sup>3</sup>City of Vernon, California, 93 FERC ¶ 61,103 (2000) (Vernon TRR Order).

as to be consistent with [SoCal Edison's] cost of capital,"<sup>4</sup> and second, that Vernon's inclusion of an unused transmission capacity adjustment was inconsistent with the costs included in SoCal Edison's TRR.<sup>5</sup>

Both the TAC Compliance Order and the Vernon TRR Order explained that the purpose of the Commission's review of the TRR of non-public utility entities "is to determine whether their proposed rate methodology, in the context of participation in a Commission jurisdictional public utility ISO, will result in a just and reasonable component of the ISO's rates."<sup>6</sup> The Vernon TRR Order approved Vernon's use of SoCal Edison's rate methodology, as it used ratemaking principles consistent with those used by IOUs, but stated that it was not prescribing a single approach for analyzing the TRRs of Governmental Entities and would consider each Governmental Entities' specific rate proposal based on the facts of each case.

#### Requests for Rehearing

The Public Utilities Commission of the State of California (California Commission), Transmission Agency of Northern California (TANC), Modesto Irrigation District (Modesto), Pacific Gas and Electric Company (PG&E), the M-S-R Public Power Agency and the Cities of Santa Clara, Redding, and Palo Alto, California (Cities/M-S-R), and Vernon requested rehearing of the Vernon Order. TANC, Modesto, Cities/M-S-R, and PG&E also requested rehearing of the TAC Compliance Order.

TANC, Modesto and Cities/M-S-R (collectively, Municipals) argue with respect to both orders that the Commission exceeded its authority by reviewing the TRRs of non-public utilities, specifically, municipalities. They assert that the Commission did not merely "evaluate" Vernon's TRR in the Vernon TRR Order and thus improperly exercised ratemaking authority. With respect to the TAC Compliance Order, they contend that the

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<sup>4</sup>Id. at 61,286.

<sup>5</sup>The Commission also directed Vernon to work together with the ISO to develop a new Transmission Owner tariff (TO Tariff) that conformed with the findings in the order, and then submit the TO Tariff to the Commission. A separate order addressing Vernon's compliance filing in Docket No. EL00-105-003 is being issued contemporaneously with this order.

<sup>6</sup>TAC Compliance Order at 61,289. See also Vernon TRR Order at 61,285.

Commission does not have the jurisdiction to review, revise or reject the TRR of municipal utilities, and thus overstepped its jurisdiction.

PG&E, on the other hand, objects that the TAC Compliance Order fails to require non-public utilities to file rate schedules and detailed cost of service data under Part 35 of the Commission's regulations, and applies a standard of review over their rates different from that required by the Federal Power Act (i.e., that the rates are just and reasonable), without explaining why. PG&E describes the standard applied to non-public utilities as "far less demanding" than the Federal Power Act's just and reasonable standard, thereby leaving ISO customers without adequate protection.

SoCal Edison and PG&E charge that the Commission's finding that Vernon's TRR is just and reasonable is not based on substantial evidence, because Vernon did not submit adequate cost support on which to base such a finding, and because the Commission did not address parties' challenges to Vernon's rate elements. They assert that relying on SoCal Edison's methodology as a proxy for Vernon's rates was arbitrary and capricious.

SoCal Edison, PG&E, and the California Commission object to Vernon's use of SoCal Edison's 11.6 percent return on equity. SoCal Edison contends that the Vernon TRR Order lacks reasoned decision making because it does not explain why the use of a neighboring IOU's return on equity could produce a reasonable rate of return for Vernon, a municipal utility. The California Commission argues that the return on equity for Vernon should be commensurate with returns for entities with similar risks, explaining that Vernon does not have comparable risks to SoCal Edison, is not similar in size, does not pay dividends, and can incur lower debt costs.

A number of the parties also object to approval of the following cost-of-service elements: (1) A&G expenses; (2) regulatory commission expense; (3) depreciation rate of 3.2 percent; (4) average high voltage transmission costs; and (5) internal labor ratio.

Finally, Vernon and the California Commission request rehearing regarding the issue of Vernon's unused transmission capacity.

#### Discussion

##### A. Commission's Authority to Review TRRs of Non-Public Utilities

We disagree with the Municipals that our analysis of Vernon's TRR expands our regulatory jurisdiction under sections 205 and 206 of the Federal Power Act, and it was

not our intention to do so. Rather, in response to Vernon's request for expedited treatment, we evaluated Vernon's proposed TRR as a means of ensuring that the costs ultimately charged by the ISO are just and reasonable. The Federal Power Act requires us to ensure the justness and reasonableness of the ISO's rates, and we cannot reach this result if we absolve from our review the portion of the ISO's costs incurred with respect to Vernon.

On the other hand, PG&E and SoCal Edison's allegation that we have enunciated a standard of review for non-public utilities that fails to satisfy the mandates of section 205 of the Federal Power Act is unavailing because the Commission lacks jurisdiction over non-public utilities under that provision. We believe the approach we took properly balances our duty to ensure the justness and reasonableness of the ISO's rates with the fact that Vernon itself is not jurisdictional for purposes of FPA section 205.

**B. Finding That Vernon's Proposed TRR Was Just and Reasonable**

A number of parties, including the California Commission, SoCal Edison, and PG&E, request rehearing of our finding that Vernon's proposed rate methodology and high voltage TRR, as modified, are just and reasonable. Specifically, these parties assert that the Commission erred in either not (1) setting Vernon's TRR for hearing to allow discovery to determine whether Vernon's TRR is just and reasonable or (2) requiring Vernon to submit additional information so as to allow for a thorough review of Vernon's TRR. We disagree. Vernon's petition included testimony and detailed workpapers that permit a thorough analysis of Vernon's proposed TRR. Specifically, Vernon supplied workpapers showing the yearly gross plant balances, capital additions, depreciation reserves, depreciation expense, property taxes, and O&M expenses for all transmission projects in which Vernon has ownership interests from their dates of operation through the 1999 test year. These workpapers were accompanied by sworn testimony of Vernon's expert witness as to their accuracy. These expenses constitute approximately \$8.3 million or approximately 82 percent of Vernon's adjusted TRR of \$10.2 million.

Additionally, approximately \$1.4 million, or approximately 14 percent of Vernon's adjusted TRR, is related to transmission expenses paid to SoCal Edison and the Los Angeles Department of Water and Power under existing transmission contracts. The majority of these costs are simply a pass-through of verifiable transmission expenses incurred by Vernon under rate schedules on file with the Commission. Vernon's remaining cost elements were regulatory commission expense and A&G expense. Vernon provided detailed information regarding the derivation of the regulatory commission expense. Vernon also stated that the A&G expense allocated for recovery in its TRR (approximately \$135,000 or 1.3 percent of Vernon's total TRR) was derived

using the Commission's approved labor ratio allocation methodology. While Vernon did not supply the underlying workpapers for its A&G expense, we find that the level of this expense is not significant enough to warrant a hearing or investigation.<sup>7</sup> Accordingly, the parties' request for rehearing on this point is denied.

C. Exclusion of Unused Transmission Capacity Expense

Vernon and the California Commission request rehearing regarding Vernon's proposed recovery of costs related to unused transmission capacity. Vernon proposed to recover not only the current costs of these facilities but also its past costs related to these facilities. In the Vernon TRR Order, we disallowed the past costs but not the current costs. The California Commission asserts that the Commission should disallow the current costs as well, and that the Commission's silence as to the potential uselessness of Vernon's excess transmission capacity is arbitrary, capricious and not the product of reasoned decisionmaking. On the other hand, Vernon objects to the disallowance of the past costs. Vernon argues that the Commission's rationale for excluding such costs -- that they were "inconsistent with the costs that SoCal Edison included in its TRR" -- fails to recognize that SoCal Edison did not have such costs in its TRR because it is differently situated from Vernon.

We reject the California Commission's proposition that a further investigation on Vernon's excess transmission capacity is needed. The fact that certain facilities may be underutilized from time to time does not mean that they do not provide value (e.g., reliability) to the ISO transmission system or that the facilities are an improvident investment, and Vernon's reserving sufficient blocks of transmission capacity in anticipation of contingencies or future load growth should not now be subject to review for possible cost disallowance. By virtue of Vernon joining the ISO, any potential "excess transmission capacity" will now be available for full utilization by all load served by the ISO. We further note that adopting the California Commission's position would likely inhibit the economic expansion of the transmission grid.<sup>8</sup>

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<sup>7</sup>We also note that Vernon's A&G expense constitutes approximately 0.04 percent of the total TRR of the ISO.

<sup>8</sup>In many instances, it may be more cost effective to build facilities to accommodate future needs (due to load growth or generation resource interconnection) rather than piecemeal additions to satisfy current needs.

With respect to Vernon's rehearing on this point, we reiterate our initial finding that the inclusion of this expense is inconsistent with the costs that SoCal Edison included in its TRR, and we find that Vernon's arguments are based on speculation rather than demonstrative evidence that SoCal Edison is differently situated with respect to the incurrence and recovery of deferred transmission costs. Accordingly, the rehearing requests on this point are denied.

D. Reliance on SoCal Edison's Methodology

Vernon proposed to use the 11.60 percent equity allowance that the Commission approved for SoCal Edison in Opinion No. 445<sup>9</sup> and a capital structure based on 100 percent equity. The Commission modified Vernon's proposal and required the use of SoCal Edison's capital structure, consistent with Opinion No. 445, if an equity allowance of 11.60 percent were to be used by Vernon as a proxy for its capital costs.

PG&E, SoCal Edison, and the California Commission argue that our finding that Vernon's rate of return based on SoCal Edison's capital structure and an 11.60 percent return on common equity is arbitrary and capricious. We disagree. While we acknowledge that Vernon and SoCal Edison are different entities,<sup>10</sup> the use of SoCal Edison's return on common equity and capital structure for Vernon was consistent with its general approach to adopt rate-making utilized by SoCal Edison in proceedings before the Commission. We believe that using the rate-making methodology of SoCal Edison as a surrogate is reasonable and not arbitrary and capricious. As such, in accordance with our prior discussion in this order regarding the appropriateness of our review of Vernon's TRR, we find Vernon's use of SoCal Edison's return on common equity (granted in Opinion No. 445) and capital structure reasonable at this time and under the present conditions.

The California Commission's alternative proposal to use a cost of capital equivalent to the debt costs of other California municipals does not represent a superior proxy for Vernon. Vernon's facilities were not financed with tax-exempt debt or bonds of any kind.<sup>11</sup>

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<sup>9</sup>Southern California Edison Company, 92 FERC ¶ 61,070 (2000).

<sup>10</sup>See California Commission Request for Rehearing at 11.

<sup>11</sup>See Application at 4.

Docket Nos. ER00-2019-003  
and EL00-105-002

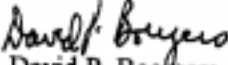
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The Commission orders:

The requests for rehearing are hereby denied, as discussed in the body of this order.

By the Commission.

( S E A L )

  
David P. Boergers,  
Secretary.



