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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

California Independent System Operator Corporation	)))))	Docket Nos. ER00-2019-006, ER01-819-002 and ER03-608-000

BRIEF OPPOSING EXCEPTIONS OF THE CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION

Charles F. Robinson
Anthony J. Ivancovich
California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, California 95630
(916) 608-7135

David B. Rubin
Michael E. Ward
Jeffrey W. Mayes
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7500

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Pursuant to Rule 711 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.711, the California Independent System Operator Corporation ("ISO") respectfully submits its Brief Opposing Exceptions.

EXCEPTIONS OPPOSED

The ISO opposes the following Exceptions:

Party	Exception
California Department of Water Resources/ State Water Project ("SWP")	1. Initial Decision "[r]ejects time-sensitive rates, which were expressly set for hearing, on the erroneous grounds of precedent derived from "interim" rates which, according to the Tariff, were to be supplanted in a procedure that demanded consideration of an off-peak methodology."
	2. Initial Decision "[d]eclines to consider, as outside of the scope of this case, the "treatment of Existing Contract Rights for holders who decide to become new Participating Transmission Owners" as applied to SWP—a matter expressly determined by the Commission to be within the scope of this case."
	3. Initial Decision "[r]efuses, on grounds of the ISO's alleged need for flexibility, to impose upon the ISO the requirement set forth in the Hearing Order and in Commission precedent and regulations that the ISO fully explain its allocation of "commensurate" FTRs upon contract conversion."
City of Vernon ("Vernon")	1. "The Presiding Judge erred in denying Vernon's motion for leave to file supplemental testimony contesting the ISO's change in the methodology for disbursements of HVAC revenues to PTOs from pro rata, based upon relative Transmission Revenue Requirements ("TRR'), to the actual gross loads of each PTO entity's retail functions."

	2. “The disbursement of H'VAC revenues based upon such gross loads is unjust, unreasonable, and unduly discriminatory. Moreover, it is inconsistent with the overall Transmission Access Charge ("TAC") methodology and principles approved by the Commission in the orders in these dockets, and by the Presiding Administrative Law Judge in the March 10, 2004 Initial Decision.”
	3. “Disbursement of HVAC revenues by actual gross loads provides improper incentives for PTOs to understate their projected gross loads in order to overcollect their TRRs. It also discourages New PTOs from participating in the ISO. 18 CFR § 385.510. *Exh. J-4. See* Tr. 1686.”
Modesto Irrigation District (“MID”)	1. “The Initial Decision erred in effectively ruling that the burden of proof does not lie with the applicant.”
	2 “The Initial Decision erred in stating that a balance of benefits and burdens is a useful framework through which to analyze the TAC proposal;
	3 “The Initial Decision erred in ruling that phantom congestion exists.”
	4. “The Initial Decision erred in its description of the causes of the condition described as phantom congestion;
	5. “The Initial Decision . . . erred in not rejecting the cost-shift cap on the basis that the cost-shift cap constitutes undue discrimination between Original Participating Transmission Owner (“OPTO”) and New Participating Transmission Owner (“New PTO”) transmission”
Pacific Gas and Electric Company (“PG&E”)	1. “The Presiding Judge erred by refusing to allow PG&E to present evidence that a portion of costs associated with Reliability Services should be included in TAC rates.”
	2. “Having incorrectly excluded that issue and PG&E’s evidence, the Initial Decision errs by failing to order that a portion of the costs associated with Reliability Services be included in TAC rates.”
	4. “The Initial Decision errs because it does not require the ISO to include firm transmission rights allocation guidelines in the ISO Tariff.”
	7. The Initial Decision errs because it prohibits PTOs from including system interconnections in their High Voltage Transmission Revenue Requirements.
Southern Cities	The Initial Decision errs in concluding at PP 174 and 175 that the ISO’s differential treatment of “new” High Voltage transmission facilities for purposes of calculating the Transition Charge is appropriate.

State Water Contractors/ Metropolitan Water District ("SWC")	1. "The ID errs in failing to rule on the justness and reasonableness of the ISO's proposed flat MWh-based transmission Access Charge ("TAC") based on the misconception that the Commission's approval of the ISO's initial, interim TAC design precludes consideration of the justness and reasonableness of the ISO's proposed replacement TAC rate design in this proceeding."
	2. "The ID errs in failing to evaluate the ISO's proposed flat MWh-based TAC rate design and to rule that the ISO's proposed TAC rate design proposal is unjust, unreasonable and unduly discriminatory."
	3. "The ID errs in deferring consideration of the justness and reasonableness of the ISO's proposed flat MWh-based TAC rate design until the ISO introduces a locational marginal pricing scheme."
	4. "The ID errs in failing to find the ISO's proposed flat MWh-based TAC rate design does not reflect cost-causation."
	5 "The ID errs in failing to find the ISO's proposed flat MWh-based TAC rate design fails to provide appropriate price signals."
	6. "The ID errs in failing to find 12 Coincident Peak ("CP") pricing a just, reasonable, and not unduly discriminatory rate design for the ISO TAC."
	7. "In the alternative, the ID errs in failing to find time-of-use pricing a just, reasonable, and not unduly discriminatory rate design for the ISO TAC."
Transmission Agency of Northern California ("TANC")	1. "The Presiding Judge erred in finding that 'it is axiomatic that phantom congestion exists.'"
	2. "The Presiding Judge erred in finding that phantom congestion exists, and that it is caused by 'a disparity between the ISO's scheduling timelines in the day-ahead and hour-ahead markets and the scheduling timelines accorded existing rights holders in their existing contracts.'"
	3,4. "[T]he Presiding Judge erred in not rejecting the 'cost shift' cap on the basis that the ISO's proposal for the inclusion of a 'cost shift' cap in the transmission Access Charge proposal is unduly discriminatory."
	6. "The Presiding Judge erred in finding that the provisions of the ISO Tariff relating to the netting of Usage Charges against Usage Charge revenues associated with FTRs received under Section 9.4.3 (specifically the definitions of New FTR Revenue and Transmission Revenue Credit) are just, reasonable and not unduly discriminatory."

The ISO also responds to the following Exception:

Southern California Edison Company ("SCE")	If the I.D. eliminated the 32-32-8 ratio for the OPTOs to share the TAC cost shifts, it erred.

REBUTTAL OF POLICY CONSIDERATIONS

The Policy Considerations Warranting Review described by the parties identified above mirror their substantive arguments. As such, they are rebutted in the ISO's arguments below.

SUMMARY

SWP contends that the initial Access Charge was only an interim rate and the Presiding Judge erroneously placed the burden of proof on SWP and SWC on the issue of time sensitive rates. That the initial transmission Access was "interim" does not deprive it of its status as a filed rate that can only be revised, other than at the ISO's instigation, pursuant to Section 206 of the Federal Power Act. SWP legal and factual arguments to the contrary are based on non-record and irrelevant evidence and inapposite legal authority. Moreover, it is neither fair nor accurate to state that SWP, after repeated deferrals, has been denied the opportunity to litigate time-of-use rates or that the Presiding Judge improperly ignored the ISO's failure to its Tariff mandate to consider time-sensitive rates. SWP's arguments why the Presiding Judge was compelled to require the ISO to adopt time-of-use rates misstate both relevant case law and the record.

SWC's cost causation argument against the Initial Decision is that costs must be borne by the class of customers that caused them to be incurred in the first instance. This is not a limitation that the Commission accepts. The

Commission has accepted the principle that "'[p]roperly designed rates should produce revenues from each class of customers, which match, as closely as practicable, the costs to serve each class of individual customers.'" While this fundamental idea of matching costs to customers is often referred to in terms of cost causation, it has also often been described in terms of the costs which "'should be borne by those who benefit from them.'" *California Indep. Sys. Operator Corp.,* 103 FERC ¶61,114 at P 26 (2003) (citations and footnotes omitted). SWC citations to support its contrary theory are inapt.

SWC's factual argument that coincident peak pricing is compelled because peak demand drives transmission expansion fares no better. The facts would not support a conclusion that peak end use customers so overwhelmingly drive the need for transmission construction and expansion that they should either bear all transmission costs or at least the brunt of them.

SWC also contends that the Access Charge is not economically efficient because it fails to send an appropriate price signal. The transmission Access Charge does not provide a price signal and is not intended to do so. While it does reflect the average embedded cost of the transmission system, the primary function of the Access Charge is to recover without distorting the market that portion of the Transmission Revenue Requirements that is not already paid for by Congestion charges and FTR auction revenues. The price signal—regarding transmission use, not Energy use—is provided by Congestion charges.

To the extent that SWC is asking the Commission to reject the ISO's proposal because it does not send an appropriate price signal and that price

signal cannot be supplied by Congestion charges, SWC is asking the Presiding Judge to ignore established Commission precedent. To the extent that SWC is asking the Presiding Judge to reject the ISO's proposal because it does not send an appropriate price signal and that price signal cannot be supplied by the ISO's current Congestion charge methodology, it still provides no basis to find the transmission Access Charge is not just and reasonable. The ISO's Congestion management methodology is before the Commission in another proceeding in which the Commission can ensure that Congestion charges fulfill their role.

SWP contends that the ISO should be required to amend the ISO Tariff to provide for compensation of in-kind reliability support provided under its Existing Contracts if it were to become a Participating TO. These contentions are not within the scope of this proceeding, and SWP's citations to the effect that they are do not even address the issue. SWP's efforts to portray the as indifferent to reliability are taken entirely out of context. Further, SWP mischaracterizes the Initial Decision, which simply imposes on SWP the same requirements imposed on any other potential New Participating TO.

Both MID and TANC challenge the Presiding Judge's reliance on the May 31, 2000, order for the conclusion that phantom Congestion exists. They contend that this reliance is inconsistent with the Commission's July 10, 2003, Order on Rehearing and her own bench ruling. The Commission's Order on Rehearing, however, is not inconsistent with the Commission's initial conclusion, and nothing precludes the Presiding Judge from so finding. MID and TANC also contend that the Presiding Judge erred in her conclusions regarding the cause of

phantom Congestion. The Presiding Judge's conclusions are not only consistent with prior Commission precedent, but are also carefully documented by record evidence.

The Initial Decision rejected the cost shift cap on the basis that the impact of the cost-shift on retail rates was not sufficiently significant to justify mitigation. Although the ISO does not agree with that determination, it has not taken exception. MID and TANC however, take exception on the basis that the Presiding Judge should also have found that the cost shift cap is discriminatory. The Commission should reject those Exceptions. The Access Charge proposal as filed included a number of other transition mechanisms to mitigate cost shifting among Participating TOs and to facilitate the entry of New Participating TOs. The ISO considered these transition mechanisms to be integral parts of the balanced compromise proposal adopted by the ISO Governing Board. The cost shift cap is one of those mechanisms.

The proposed Access Charges does treat New Participating TOs differently; it also treats some New Participating TOs differently than others; and its treats Original Participating TOs differently; and it treats some Original Participating TOs differently than others. This treatment is justifiable, however, because these groups are not all similarly situated, but rather bring to the ISO different circumstances. Moreover, to the extent that they are similarly situated, the goals of expanding the ISO Controlled Grid while avoiding abrupt cost shifts justify transitional distinctions. Indeed, the differential treatment afforded certain New Participating TOs carries with it not only the cost cap, but also benefits; if

differential treatment were not justified, then the benefits would be impermissible. The cost shift cap is simply part of this overall balance.

The ISO's positions of the remaining exceptions are as follows. (1) PG&E and SWP contend that the ISO Tariff should set forth the methodology for determining the number of FTRs awarded New Participating TOs under Section 9.4.3 of the ISO Tariff. The Presiding Judge properly found that because, before those FTRs are issued, they will be published and there will be an opportunity to protest, all parties rights will be sufficiently protected. (2) TANC's Exception to the Presiding Judge's approval of the limitation on the netting of FTR revenues against usage charges is flawed by its failure to take into account the benefits it would received as a New Participating TO from the award of Section 9.4.3 FTRs. (3) PG&E's arguments that the Access Charge should recover these reliability services costs are beyond the scope of this proceeding because the Commission has already concluded that it is just and reasonable that these costs be recovered from PG&E's customers. If it is just and reasonable to allocate these costs to PG&E's customers, then it is per se not unjust or unreasonable that the ISO does not allocate these costs on a grid-wide basis through the Access Charge. (4) With regarding the Presiding Judge's rejection of Vernon's supplemental testimony, Vernon's lack of knowledge of its comparative recovery of its Transmission Revenue Requirement provides no good cause the delay in filing testimony regarding the methodology itself. (5) The Presiding Judge properly rejected PG&E's exception to the ISO's definition of High Voltage Transmission Facilities because PG&E did not demonstrate that the ISO's

proposal was not just and reasonable. (6) The Presiding Judge's citations of authority and framework for analysis are consistent with Commission precedent. (7) The Initial Decision does not disturb the provisions of Amendment No. 27 that provide for the Original Participating TOs to share the cost shift in a ratio of 32:32:8.

ARGUMENT

I. The Presiding Judge Properly Concluded That the Transmission Access Charge Need Not Incorporate Time-of-Use or Coincident Peak Rates. SWP Exception No. 1, SWC Exception Nos. 6,7.

The ISO's proposed transmission Access Charge is a megawatt-hour-based charge. SWP and SWC argued that the ISO had the burden of establishing that the proposal was just and reasonable in the absence of time-of-use or coincident-peak rates, and had not met that burden. I.D. at PP 49, 51. The Presiding Judge rejected those arguments, and SWP and SWC challenge the Initial Decision on numerous bases. I.D. at PP 59–60.

A. The Presiding Judge Properly Considered Evidence Regarding Time-of-Use and Coincident Peak Rates. SWP Exception No. 1, SWC Exception Nos. 1,2,3.

On Exceptions, SWP contends that the Initial Decision "flies in the face" of the Commission's order that time-of-use rates be among the issues litigated. SWP Br. at 16. In support of this contention, SWP repeats its arguments that the ISO's initial Access Charge was only an interim rate. Accordingly, SWP contends, the Presiding Judge erroneously placed the burden of proof on SWP and SWC on the issue of time-of-use and coincident peak rates. According to SWP, "having had the issue of time sensitive rates 'deferred,' to use Staff's word, from 'interim' case to 'interim' case over the years since 1998 until this TAC

Docket, SWP and the Water Contractors confront an ID's conclusion that the issue has already been decided—evidently in the 'interim' cases in which, at the time, the issue was deferred." *Id.* at 20.

SWP's arguments ring no more true on Exceptions than before. The ISO's initial transmission Access Charge may well have been "interim," and the ISO has so acknowledged, but that does not deprive it of its status as a filed rate that can only be revised, other than at the ISO's instigation, pursuant to Section 206 of the Federal Power Act. SWP's arguments to the contrary hold no water. SWP asserts (at 17–18 & n.33) that it "established" that the rates have no precedential value, citing its own comments to prove that settlement rates have no precedential value. Based on non-record evidence that is not otherwise part of this docket, it contends that the ISO concurred. *Id.* at 18. It then notes that the Commission "similarly" announced that it was not prescribing or making recommendations regarding the successor rate methodology. *Id.* at 18. *Every* step of this portion of SWP's argument fails.[1] First, SWP has been given no authority by the Federal Power Act or settlement to establish the precedential value of rates.[2] Second, the ISO *did not* concur with SWP's analysis of the rates

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[1] SWP's description of two interim rates is also inaccurate. The ISO's initial rate was developed through two phases of filings with the Commission, first by the three Investor Owned Utilities, and later by the ISO. The Commission first approved the rate in concept and later approved tariff language. *See Pacific Gas and Elec. Co.*, 77 FERC ¶ 61,204 (1996); *Pacific Gas and Elec. Co.*, 80 FERC ¶ 61,128 (1997); *Pacific Gas and Elec. Co.*, 81 FERC ¶ 61,122 (1997).

[2] SWP's assertion at that time that the rates were essentially a "legislative settlement" can only be described as self-serving, in light of the controversy involved in the ISO's proposals. Moreover, the California legislature has no authority to set transmission rates, whether by settlement or otherwise. *Public Utilities Comm'n of Rhode Island v.*

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as settlement rates with no precedential value. SWP is not only using non-record evidence for this assertion, which the Commission (like the Presiding Judge) should thus disregard, but taking the material out of context. In the cited material the Trustee for the ISO *is quoting* SWP's position, and simply stating that the ISO would not object to a Commission order that they have no precedential value (which order did not ensue).[3] As the Commission has stated in the context of the Natural Gas Act:

> Once the Commission accepted the [rate] method, and no one sought rehearing, it became the lawful method [of the pipeline]. Any party seeking to change it, other than the pipeline, bears a section 5 burden of proof. It *does not matter how the rate or practice became the existing rate*, whether by a merits decision in a contested case or by an uncontested settlement, it is the existing rate and any party challenging [that] must bear a section 5 burden of proof.

Williams Natural Gas Co. 77 FERC ¶ 61,277 at 62,209 (1996) (emphasis added) (footnote omitted). Section 5 is, of course, the counterpart to Section 206 of the Federal Power Act ("FPA"), and the FPA and the Natural Gas Act are to be interpreted in parallel. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981). Third, the Commission's decision not to prescribe, i.e., dictate, or recommend the successor rate has no logical relationship to whether the current

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Attleboro Steam & Elec. Co., 273 U.S. 83, 86 (1927); *New York v. FERC*, 535 U.S. 1, 19–20 (2002).

[3] "DWR asks the Commission to condition its approval of the temporary rates on finding that they are (1) fair and equitable settlement rates; (2) not to be cited as having precedential effect… The first two conditions—that the Commission condition its approval of the temporary rates on finding that the rates are fair and equitable settlement rates and that the approvals are not to be cited as having precedential effect—are not objectionable." *Pacific Gas & Electric Co.*, Docket No. EC96-019-003, ISO/PX Reply

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rate it is approving is a filed rate that is subject to Section 206 protections. Such a statement could be made about any rate approval.

SWP's contentions have no more legal support than factual support. SWP criticizes the Presiding Judge for dismissing as inapposite without greater explanation SWP's legal authorities for its proposition regarding the interim nature of the ISO's initial Access Charge. SWP Br. at 20–21. When the inapplicability of an authority to the circumstances at hand is patent, no more is necessary. In *South Georgia Natural Gas Co.*, 73 FERC ¶ 61,354 (1995), a 125-percent load factor, which represented an increase from the previous 100-percent load factor, was put in place by a partial settlement subject to subsequent litigation in the same proceeding. The Commission noted that it was clear to all parties that the 125-percent load factor remained subject to investigation and that the only effect of the settlement was to waive the right to refunds. *Id.* at 62,105–06. The matter being litigated was the original increase. In contrast, Amendments No. 27 and No. 49 are new Amendments adopting a new transmission rate methodology. Nothing from the original rate is being litigated in this proceeding, and no party had such an expectation.

In *Tennessee Gas Pipeline Co.*, 59 FERC ¶ 61,045 (1992), the Commission did not rule on whether the settlement "interim" rates were "settled rates" for the purpose of Section 5 of the Natural Gas Act. In that case, the settling parties were also agreeing on successor rates to be filed. 59 FERC at 61,193-94. Those rates differed from the settlement rates (otherwise, there

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Comments at 228 (June 23, 1997).

would be no need to file them). The settling parties attempted through the settlement to place the normal burden of proof that would apply to the utility on those who challenged the successor rates. There is nothing remarkable about the Commission's rejection of that effort.

Notwithstanding SWP's repetitions, it is neither fair nor accurate to state that SWP, after repeated deferrals, has been denied the opportunity to litigate time-of-use rates. First, SWP has been quite selective in presenting its history of deferral. In its Reply Brief below, the ISO pointed out the rulings of the Initial Decision cited in *Southern Cal. Edison Co.*, 86 FERC ¶ 63,014 at 65,154 (1999) cited by SWP have been vacated by the Commission. 92 FERC ¶ 61,070 at 61,253 (2000). Since SWP continues to cite the decision, and refer to deferral of the issue of time-of-use rates, however, it is important to note the result of the litigation of time-of-use rates in that proceeding:

> DWR's proposal as developed on this record does not make the case for the adoption of TOU rates in this proceeding. Moreover, DWR has not shown a reasonable basis for departing from SCE's proposed rate methodology. The evidence indicates that the ISO's CMS provides adequate price signals to divert transmission away from periods of congestion and increases use of the overall transmission system. DWR and Vernon have failed to demonstrate why DWR's TOU proposal presents a preferable alternative. This determination however, does not preclude appropriate consideration of this issue respect to overall ISO policies in a future ISO Tariff proceeding with in the light of greater experience (sic). Accordingly, DWR's proposal is rejected at this time.

86 FERC at 65,154. This is not a deferral. It is a statement that SWP did not make its case at that time but may attempt to make its case in future ISO Tariff amendments.

Further, despite SWP's lament, the decision it criticizes did not deprive it of any opportunity. The ruling concerned only the burden of proof, and that burden is established by the Federal Power Act. Under Sections 205 and 206, the public utility has a right to establish its rate, and if its rate has been shown to be just and reasonable, the burden is on a party that wishes to change the rate to show that it is no longer just and reasonable.

SWP presented two witnesses and 95 exhibits in support of time-of-use rates. It asked over 241 data requests (not including numerous subparts). It cross-examined ISO witnesses for four days. Tr. at 578–639, 890–918, 1162–85, 1355–66. The Presiding Judge evaluated that evidence. In the end, however, SWP simply did not make its case.

SWC mischaracterizes the Initial Decision when it makes similar arguments (at 10–22). SWC's assertions of error in this regard are no better founded than those of SWP. It points to the fact that state law and the Commission obligated the ISO to propose a new Access Charge, and that the Tariff required the ISO to consider time-differentiated rates, and asserts that if follows that such rates must be at issue. Unlike SWP, SWC acknowledges (at 15–17), that the ISO Board considered Demand-based rates, and concludes that it should therefore be an issue in this proceeding. It also points (at 17–21) to Commission orders indicating that time-differentiated rates should be considered

in this proceeding. All these arguments, however, are beside the point. The Presiding Judge did not rule that she could not consider evidence and argument from SWC and SWP that the ISO proposal is not just and reasonable. *See* SWC Br. at 10. Rather, she explicitly ruled that SWC and SWP had not shown that the ISO's rate proposal is not just and reasonable. I.D. at P 304. She did not preclude a challenge to the flat megawatt-hour-based component of the ISO's proposal, SWC Br. at 10. As noted above, the issue was extensively litigated, and the Presiding Judge not only discusses the record in the Initial Decision (at PP 293–304), but also actively participated in the discussion of the methodologies at hearing (Tr. at 1946:5–1947:21, 2060:10–2066:7). She simply ruled that, in light of the Commission prior approval of such a methodology, the burden was on those making the challenge. I.D. at 56–59.

SWC's arguments that the Commission's prior ruling regarding the ISO's megawatt-hour-based Access Charge is no longer applicable because of changed circumstances should also be disregarded. Although the Access Charge itself is different, it remains a volumetric megawatt-hour-based charge combined with a Congestion charge. There is no change in this paradigm. To the extent there are any issues or questions with the ISO's Congestion Management systems, they are being addressed in a separate proceeding and do not undermine the Commission's conclusions that the ISO's volumetric, megawatt-hour-based Access Charge, when combined with Congestion Management, is just and reasonable. I.D. at P 59, *citing Pacific Gas and Elec. Co.*, 80 FERC ¶ 61,128 (1997).

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B. The ISO's TAC Proposal Is Consistent with the ISO Tariff. SWP Exception No. 1.

SWP also contends that the Presiding Judge improperly "ignore[d] the ISO's failure to comply with FERC-approved Tariff language mandating consideration of time-sensitive rates." SWP Br. at 21. Although former Section 7.1.6 of the ISO Tariff did require the ISO Board, in developing the transmission Access Charge, to consider the introduction of off-peak rates nothing in the section requires that the ISO justify a failure to include off-peak rates in its Access Charge rate and the Presiding Judge thus had no reason to address this issue.

Moreover, there is no basis for SWP's claim that the ISO violated this requirement. Mr. Pfeifenberger testified, under cross-examination by SWP's counsel, that time-of-use rates were examined as part of the TAC Working Group. Tr. at 896:9–14. As Mr. Pfeifenberger pointed out to SWP's counsel, *see* Tr. at 897:23–898:13, Exh. ISO-5, a memorandum from Ms. Le Vine to the ISO Board, presented the various options for the transmission Access Charge and management's recommendations. Among the information included is the following:

- Some Stakeholders favor a peak/off peak structure. Given current congestion patterns, this is not appropriate. Management does [sic] [not] believe the peak/off-peak question should be revisited until after we have data for some period after Critical Mass is obtained, when congestion patterns could change.

Exh. ISO-5 at 8.

- A description of the parties' confidential positions is included in the Executive Session documents.

Id at 9.

- Time-of-use and seasonal rates often are meant to provide market incentives to levelize Demand over time. With respect to transmission, however, the appropriateness and effectiveness of time-of-use pricing is questionable given that 1) a significant portion of the experienced congestion occurs during off-peak hours and off-peak months; and 2) congestion charges already provides [sic] market incentives for Transmission demand. While time-of-use Access Charge may provide additional price signals to further reduce transmission congestion, we believe that any such benefit does not justify the additional administrative burden at this time.

Id., Attachment A at 6.

It is notable that Mr. Pfeifenberger's more recent analysis provides evidence of the validity of the ISO management's recommendations.

The ISO Board was thus presented with significant policy reasons for rejecting time-of-use rates. Moreover, despite SWP's effort to belittle the fact, the opposition to time-of-use rates by all but two stakeholders is also a relevant factor in the choice between alternative just and reasonable rates. *See New England Power Pool and ISO New England, Inc.*, 105 FERC ¶ 61,300 (2003). The ISO Board more than adequately fulfilled its responsibilities under former Section 7.1.6 of the ISO Tariff.

C. SWP Presents No Basis to Reject the Presiding Judge's Findings. SWP Exception No. 1.

SWP offers four arguments why the Presiding Judge was compelled to require the ISO to adopt time-of-use rates.

First, SWP cites (at 22) *Union Electric Co. v. FERC*, 890 F.2d 1193, 1998 (D.C. Cir. 1989), for the proposition that "a FERC-approved rate methodology is not reasonable if it fails to differentiate cost-causation and thus pricing between on-peak and off-peak transmission users." *Union Electric,* of course, says nothing of the sort. *Union Electric* concerns rates for generating capacity, not

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transmission. *Union Electric* does not speak at all about the propriety of time-of-use rates in transmission ratemaking.

Indeed, to the ISO's knowledge, the D.C. Circuit has never addressed the propriety of a time-of-use component for a transmission rate. The court has reviewed cases involving the assessment of transmission capacity charges to non-firm service, and remanded such cases to the Commission, citing the passage from Alfred Kahn that SWP and the *Union Electric* court quote.[4] The D.C. Circuit, however, has explicitly recognized that this does not reflect a Commission policy on transmission ratemaking:

> With respect to non-firm versus firm rates, the cases cited by the petitioners as demonstrating a previously established discounting policy actually establish that FERC addresses this issue on a case-by-case basis. For example, in *Kentucky Utilities Co.*, 15 F.E.R.C. ¶61,002 (1981), FERC said that the utility could not allocate capacity costs to non-firm transmission service since such service did not factor into the utility's capacity decisions. In contrast, in *Central Maine Power Co.*, 60 F.E.R.C. ¶61,285 (1992), . . . FERC also upheld the utility's decision not to offer non-firm rate discounts on several contracts. Indeed, . . . FERC's pre-Order 888 Transmission Pricing Policy Statement, 59 Fed. Reg. 55,031 (1994), does not expressly require non-firm rates to be priced below firm rates in all cases. . . . Additionally, the petitioners charge that FERC's acceptance of firm rates for non-firm service conflicts with this court's decision in *Fort Pierce Utilities Authority v. FERC*, 730 F.2d 778, 788-89 (D.C.Cir.1984); but in that case, this court merely noted that FERC had failed to reconcile its decision to allocate capacity costs to non-firm transmission service with its previous refusal to do so in Kentucky Utilities, and remanded for further consideration.

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[4] *Louisiana Pub. Serv. Comm'n v. FERC*, 184 F.3d 892 (D.C. Cir. 1999); *Fort Pierce Util. Auth. v. FERC*, 730 F.2d 778 (D.C. Cir. 1984).

Transmission Access Policy Study Group v. FERC, 225 F.3d 667, 732 (2000). Indeed, if it were the case that "a FERC-approved rate methodology is not reasonable if it fails to differentiate cost-causation and thus pricing between on-peak and off-peak transmission users," then the Commission could approve no volume-based rate; yet it has done so for the California ISO and the New York ISO as well as for portions of the rates of other ISOs and RTOs. Exh. SWC-23; Tr. at 2075:3–2078:19.

As a follow-up to its mis-reliance on *Union Electric,* SWP cites (at 23) a Commission's order on the ISO's charges for Unaccounted for Electricity, *California Indep. Sys. Oper. Corp*., 101 FERC ¶61,219 at P 17 (2002) as rejecting reliance on a particular cost allocation merely because it was chosen at start-up and is embodied in the tariff. Again, by ignoring the facts, SWP misunderstands entirely the legal import. The order cited is a *rehearing order* of the initial order approving the ISO, *California Indep. Sys. Oper. Corp.,* 81 FERC ¶ 61,122 (1997). The allocation methodology approved in the initial order is of course entitled to no deference in a rehearing order. The arguments the Commission was addressing concerned how the proposed methodology would fit into the overall UDC Service Area scheme of the ISO Tariff and have nothing to do with Section 206 burdens of proof.

Second, SWP questions the Presiding Judge's statements regarding the advantages of locational marginal pricing for the implementation of time-of-use pricing. The ISO does not agree with the statements of the Presiding Judge in this regard, and believes that the record supports the conclusion that the ISO's

volumetric Access Charge methodology would remain just and reasonable when combined with locational marginal pricing. *See generally*, ISO Initial Br. at 79; ISO Reply Br. at 53–58, 63–69.

The ISO cannot, however agree with SWP's subsequent reiteration of its erroneous prior arguments below that would virtually force every utility to adopt a form of time-of-use pricing. For example, the Commission orders cited by SWP do not support a requirement that a transmission owner "demonstrate at a hearing that its proposed rates are just and reasonable as applied to off-peak transmission service." The passage quoted by SWP (at 23–24) actually describes the relief sought by the customer. *Wisconsin Power & Light Co.*, 74 FERC ¶ 61,159 (1996). In *Wisconsin Power & Light*, the Commission set for hearing *under Section 206*, i.e., with the burden on the Commission or the customer, the question of whether the utility should be required to offer discounted non-peak non-firm service to a customer that was in a "unique position" to request such service. *Commonwealth Edison Co. v. American Electric Power Service Corp.*, 72 FERC ¶ 61,070 (1995), was also a complaint case and involved the same customer. Neither case was decided on the merits. In further support of the "mandate" for allocation of costs according to system peak, SWP cites only a footnote in Order No. 888-A regarding a customer's load-ratio cost responsibility for network service under the *pro forma* Open Access Tariff and a Commission decision of very specific detail regarding a proposed change to a modified Appalachian rate methodology. Neither speaks to nor supports the existence of any mandate. Finally, although the Commission's

Proposed Rulemaking on Standard Market Design ("SMD") proposed coincident peak transmission rates[5] the SMD remains only a proposal, and more important, in its subsequent White Paper, the Commission stated that it would not propose to be as proscriptive as in the SMD, would not require strict adherence to all aspects of the SMD, and would leave room for regional variations in transmission rates. *See White Paper: Wholesale Market Power Platform* at 5-6 (April 28, 2003).

Third¸ SWP contends that the Presiding Judge ignores the fact that California's retail transmission users currently enjoy a time-sensitive 12-CP transmission rate design. SWP has apparently chosen to ignore the evidence. The record is clear that typical retail transmission rates are not time-of-use or coincident peak. See Exhs. ISO-54–56. Tr. at 1957:11–1960:1, 2070:10–21.

Fourth, citing cost factors and events that are wholly unrelated to this proceeding, SWP asks the Commission to disregard its responsibilities under the Federal Power Act in order to achieve SWP's concepts of cost-efficiency so that SWP—which acknowledges that it has already shifted all possible usage to off-peak[6]—will enjoy lower transmission rates. The Presiding Judge rejected this argument, as should the Commission.

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[5] *Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design*, FERC Stats. & Regs. ¶ 32,563 at 34,317 n.103 (2002).
[6] Tr. at 1840:7–15.

D. SWC Has Not Shown that the ISO's Proposal Is Not Just, Reasonable and Not Unduly Discriminatory.

1. First Transmission Pricing Principle and Cost Causation. SWC Exception Nos. 2 and 4.

SWC's discussion about the first Transmission Pricing Principle is flawed by both its erroneous assumption about the meaning of the principle and its excessively narrow interpretation of cost causation.[7] The basic thesis of SWC's cost causation argument is that costs must be borne by the class of customers that caused them to be incurred in the first instance. This is not a limitation that

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[7] Although SWC is correct that the ISO transmission Access Charge must be consistent with principles of cost causation and that the ISO bears the burden of showing that the transmission Access Charge proposal is just and reasonable, SWC's implication that the ISO bears a burden of showing that its proposal is just and reasonable "in the absence of time-of-use or co-incident peak rates" is, as discussed above, not correct. SWC goes on to assert that the ISO has failed to supply "a complete discussion of how the proposal is intended to take account of the pricing principles" as required by the Commission's Transmission Pricing Principles. SWC Br. at 37. This requirement of a "complete discussion" specifically "tak[ing] account of the pricing principles" only applies to "non-conforming" proposals, *Inquiry Concerning Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act: Policy Statement*, FERC Stats. & Regs. ¶ 31,005 at 31,148 (1994). SWC contends that the ISO's proposal is non-conforming because it does not price transmission based on the cost of providing transmission service (i.e., does not meet the first Transmission Pricing Principle) and that the ISO has not provided other information required of non-conforming proposals. *Id.* SWC perpetuates this incorrect characterization even thought the ISO pointed out the error in its Reply Brief at 60–61. For the purpose of the first Transmission Pricing Principle, a proposal is based on the cost of the transmission service provided if it yields revenues equal to, but not in excess of, the transmission owner's transmission revenue requirement. This is apparent from the Commission's evaluation of the ISO's predecessor transmission Access Charge, which evaluation is equally applicable to the current proposal:

> A 'conforming' pricing proposal must generate revenues that do not exceed the transmission owner's revenue requirement. The ISO's proposal satisfies this principle. The combined revenues received by any transmission owner from access charges and congestion charges would not exceed its embedded cost revenue requirement.

Pacific Gas & Elec. Co., 80 FERC ¶ 61,128 at 61,430 (1997). Any assertion that the ISO's proposal is non-conforming is contrary to both the meaning of the first Transmission Pricing Principle and the Commission's prior decision.

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the Commission accepts. For example, if an interconnection request requires transmission system upgrades that benefit all users of the grid, the Commission generally requires that the costs be assigned to all users of the Grid, not just to the entity requesting the interconnection. *See, e.g., Western Mass. Elec. Co.*, 66 FERC ¶ 61,167 (1994), *aff'd, Western Mass. Elec. Co. v. FERC*, 165 F.3d 922 (D.C. Cir. 1999). Citing *Western Massachusetts* for the proposition that "[e]ven if a customer can be said to have caused the addition of a grid facility, the addition represents a system expansion used by and benefiting all users due to the integrated nature of the grid," the Commission has explicitly noted, "This treatment does not violate cost causation principles." *Removing Obstacles to Increased Electric Generation And Natural Gas Supply In The Western United States*, 96 FERC ¶ 61,155 at 61,674 (2001). *See also California Indep. Sys. Operator Corp.*, 97 FERC ¶ 61,149 at 61,648 (2001).

In Docket No. ER01-313, the Presiding Judge rejected the limited readings of cost causation principles, and, in its order on the Initial Decision, the Commission affirmed her analysis:

> [Cost causation] principles . . . have authoritatively been described thusly: "Properly designed rates should produce revenues from each class of customers, which match, as closely as practicable, the costs to serve each class of individual customers." While this fundamental idea of matching costs to customers is often referred to in terms of cost causation, it has also often been described in terms of the costs which "should be borne by those who benefit from them." Indeed, in a recent order rejecting arguments that ISO-related costs should not be assigned to PG&E's existing contract customers, the Commission expressly stated:

> > Concerning the application of cost causation principles . . . enhanced reliability and market development resulting from industry restructuring are benefits that are distributed across the spectrum of Energy participants.
>
> Thus, the Initial Decision accurately characterized cost causation and received benefits as alternate means of expressing the same concept.

California Indep. Sys. Operator Corp., 103 FERC ¶ 61,114 at P 26 (2003) (footnotes omitted).

SWC cites two appellate cases to support its theory. *Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511 (D.C. Cir. 1984), is an unremarkable case that does little to support SWC's theory. This case did not present any issue about assigning cost responsibility. The discussion SWC cites concerns the cross-subsidization involved in charging similarly situated classes different prices for the same service. As SWC acknowledges, *Louisiana Pub. Serv. Comm'n v. FERC*, 184 F.3d 892 (D.C. Cir. 1999), is a much more recent case concerning Commission precedent specifically regarding interruptible rates. As noted in the discussion, *supra* Section I.C, the D.C. Circuit, in the same year, acknowledged that no particular result was compelled. Moreover, the Court of Appeals for the D.C. Circuit has also upheld Commission policy of rolling in the cost of transmission expansion caused by generator interconnections, a result that is flatly inconsistent with SWC's theory of cost causation. *Western Mass. Elec. Co. v. FERC*, 165 F.3d 922 (D.C. Cir. 1999).

SWC's factual argument that coincident peak pricing is compelled because peak demand drives transmission expansion fares no better. The facts would not support a conclusion that peak end use customers so overwhelmingly

drive the need for transmission construction and expansion that they should either bear all transmission costs (via coincident peak pricing) or at least the brunt of them (via time-of-use rates).

As an initial matter, one cannot equate on-peak Energy end use or Demand, with peak transmission usage. For example, if a north–south path has a rated capacity of 3200 MW, and there is a 4500-MW Demand in the South being served by 4500-MW Generation in the North, and a 4000-MW Demand in the North being served by 4000-MW Generation in the South, then there is 8500 MW of peak Energy end use, a net flow of 500 MW, and the path still has 2700 MW of *unused* transmission capacity. There is no Congestion and no problem with utilization of transmission capacity. In contrast, if there is a 4000-MW Demand in the South being served by 4000-MW Generation in the North, and a 500 MW-Demand in the North being served by 500-MW Generation in the South, then there is only 4500 MW of peak Energy end use, but the net flow of 3500 MW is greater than the path capacity. In this case, the path has 0 MW of unused capacity, is congested, and is unable to serve the entire Demand. Additional capacity is needed to serve the off-peak Demand in the presence of Congestion, but no additional capacity is needed to serve the on-peak Demand in the absence of Congestion. SWP witness Wilson recognized and agreed with these facts. *See* Tr. 1975:15–1976:22.

Congestion is thus an important measure of transmission usage, and often a more appropriate one than peak end-use Demand. To evaluate the arguments for time-of-use and coincident peak rates, ISO witness Pfeifenberger performed a

study of all major transmission paths in California from April 1998 through March 2003 and demonstrated conclusively that there is no correlation between on-peak Demand and Congestion. Exh. ISO-36 at 7:8–11:14; Tr. at 1000:12–19.[8] Although counsel for SWC showed on cross-examination that there is also no correlation between off-peak Energy use and Congestion (Tr. at 966:24–970:23),[9] he simply reinforced the conclusion that the need to expand transmission in order to relieve Congestion cannot be associated with any level of Energy use, whether peak or off-peak.[10]

SWC witness Russell attempted to counter these facts by arguing that transmission expansion is driven primarily by reliability concerns, and that reliability concerns are driven by on-peak Demand. Exh. SWC-24 at 5:1–7:17. In support of his conclusion, Mr. Russell offered a summary table of the ISO's transmission upgrade projects, Exh. SWC-25, that showed a majority of the ISO's transmission upgrades were for reliability purposes, from which he concluded that transmission upgrades are driven by on-peak Demand. For his

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[8] The data showed that Congestion frequently occurred during off-peak hours and on some paths, such as Path 15 in the North-South direction, Eldorado, Path 26, and Palo Verde, more often during off-peak hours than during peak load hours. The data also showed that Congestion prices frequently were higher during off-peak hours than during peak load hours. For example, in the Hour-Ahead Market, the average price of off-peak Congestion consistently has exceeded the average price of on-peak Congestion on Path 15. ISO-36 at 9:1–10:9.

[9] Using certain criteria for cost and frequency that he established to define whether Congestion is significant and prevalent, counsel for SWC showed that Congestion was not significant or prevalent in most of the off-peak periods in which Mr. Pfeifenberger's studies identified Congestion as having occurred. Exh. SWC-31; Tr. at 1000:21–1001:1.

[10] Using counsel's own criteria, Congestion was neither significant nor prevalent in most of the on-peak periods in which Mr. Pfeifenberger's study identified Congestion as having occurred. Indeed, as Mr. Pfeifenberger explained, based on counsel's criteria, on two major paths (Mead and Path 15) Congestion was never more prevalent during peak

conclusion that reliability concerns are driven by on-peak Demand, Mr. Russell relied primarily on his own knowledge, on certain planning documents of the Participating TOs, and on portions of WECC Planning Criteria. SWC-1 at 26:8–28:21; SWC-24 at 9:6–10:16; Tr. at 2096:17–2097:1. The facts, however, did not support his analysis.

First, the evidence available demonstrated persuasively that peak Demand is not the sole driving force of reliability transmission planning, but only one of many factors in the ISO's transmission planning process for reliability purposes. Ms. Le Vine testified that for transmission planning purposes, the ISO studies eight scenarios for reliability purposes, on-peak and off-peak Load conditions in each of the four seasons. Tr. at 682:17–22. Even the WECC Planning Criteria upon which Mr. Russell relied are clear that transmission planners must consider the reliability of the transmission system at all times. Tr. at 2104:19–2105:19; Exh. ISO-58 at 3, 7 and 10. Further, the planning documents of the Participating TOs upon which Mr. Russell relied plainly establish that significant portions of the transmission systems of the Participating TOs experience reliability problems during off-peak periods and need to be analyzed from a reliability perspective under both peak and off-peak Load conditions. Tr. at 2092:10–2100:24. Moreover, ISO planning documents indicated that enhancing reliability is only one of six considerations in planning for transmission expansion. Exh. ISO-57.

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periods; and on 4 out of 7 major paths Congestion was never more prevalent during peak hours in the last four years. Exh. ISO-43; Tr. at 1001:19–1002:21.

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Second, Mr. Russell's analysis of the ISO's transmission expansions was flawed. On cross-examination, Mr. Russell acknowledged that several of the high voltage transmission projects he analyzed in Exh. SWC-25 were projects in areas that had been identified by Participating TOs as areas that are stressed during low-Load conditions or are areas that are analyzed under off-peak as well as on-peak Load conditions. Tr. at 2094:8–16, 2095:12–2096:1, 2096:7–12. Mr. Russell admitted he had made no effort to determine whether the need for these projects had been analyzed under low-Load or off-peak conditions, or to determine whether the need for these projects was driven by reliability concerns during on-peak or off-peak periods. *Id.* Accordingly, there was no basis to conclude that these projects were driven solely or primarily by on-peak Demand. In addition, Mr. Russell stated that he considered as on-peak Demand reliability-driven transmission expansions that were identified as due to Generator Interconnections. Tr. at 2090:21–2091:9. Generator Interconnections, however, are generally initiated by Generators, not by the ISO or Participating TOs. ISO Tariff § 5.7.2, Exh. J-2. The only logical assumption is that a Generator's investment is mostly economically motivated, and that the decision to enter the market depends more upon the ability to displace more expensive Energy than on a desire to enhance grid reliability. Again, there was no basis to conclude these projects are driven solely or primarily by on-peak Demand. Mr. Russell's count of reliability-related and, by his reasoning, on-peak Demand-driven high voltage transmission projects also included projects identified as needed for

voltage support. Tr. at 2094:23–24. He later stated, however, that voltage support is primarily an off-peak concern. Tr. at 2106:13–18; Exh. ISO-58 at 34.

Neither SWP nor SWC have denied that Congestion-driven, or economically driven, transmission expansions constitute a significant portion of the ISO's transmission expansion projects. Major examples include the recent expansion of Path 15, Exh. ISO-36 at 19:6–8, and the planned expansion of Path 26, Exh. ISO-60. As Mr. Pfeifenberger's analysis showed, during a significant portion of the ISO's operational history these two major transmission paths have been heavily congested during off-peak periods. Exh. ISO-37.

Accordingly, the evidence regarding SWC's cost causation argument can be summarized as follows. First, the majority of ISO transmission expansion projects are driven by reliability concerns; but a significant number are driven by economics, Generator Interconnections, and other reasons that have no correlation to on-peak Demand. The exact split is unclear. Second, some of the reliability-driven transmission expansion projects may have been driven by off-peak concerns; the number is unclear from the record, but the existence of such projects further militates against a strong correlation of transmission expansion with on-peak Demand. Third, on-peak Demand is a very significant factor in ISO transmission planning for reliability purposes, but it is only one of many factors. In short, on-peak Demand is *one of many factors* that drive *a portion* of the ISO's high voltage transmission expansion. Based on this evidence, SWC would have the Commission conclude that the ISO's transmission Access Charge violates

cost causation principles because it is not built *entirely around that one factor*: on-peak Demand. There is no precedent or logic for such a conclusion.

The pieces just do not add up. Mr. Russell calculated that $400 million out of $1.4 billion of transmission expansion projects were economically driven. SWC Br. at 43. That means, by Mr. Russell's reckoning, only about 70 percent were reliability driven. However, Mr. Russell included in that 70 percent Generator Interconnections. As the ISO noted in its Initial Brief (at ISO Br. 72), there is a high likelihood that these are economically (from the Generator's viewpoint) driven. SWC acknowledged (at 39) that two of seven PG&E local areas are reviewed based upon off-peak conditions (Exh. SWC-1, App. I at 11:26-27), and all of PG&E's 500 kV network is reviewed under off-peak conditions (Exh. SWC-24 at 10, Tr. at 2092:10--15). SCE also uses spring off-peak conditions to develop its transmission expansion plan. SWC Br. at 39. Yet, when asked specifically about projects in areas that are reviewed under off-peak conditions, Mr. Russell acknowledged he had not determined whether the reliability-related expansion was driven by on-peak conditions, off-peak conditions, or both. Tr. at 2094:3-2097:1. When these factors are considered, it becomes clear that, of the 70 percent of the cost of transmission expansions that Mr. Russell claimed were reliability related, the amount that were peak Demand driven cannot be shown by the evidence. It could be 60 percent of the total cost of transmission expansion, 50 percent, even 40 percent. Yet from this evidence, SWC would have the Commission Judge conclude that off-peak transmission users do not cause the ISO to incur transmission costs on their behalf.

SWC has not shown that the ISO's proposal violates the First Transmission Pricing Principle or is inconsistent with cost causation. The Presiding Judge should so find.

2. Third Transmission Pricing Principle and Economic Efficiency. SWC Exception No. 5.

SWC contends that the Access Charge is not economically efficient because it fails to send an appropriate price signal. According to SWC, it masks the true cost of use of the grid during on-peak periods, leading to over-consumption during those periods; and it also leads to under-consumption during off-peak periods, when increased demand can be accommodated at no or low incremental cost. SWC Br. at 46. SWC confuses peak Energy demand with peak utilization of the transmission system. As shown above, however, Congestion—which reflects the maximum use of the transmission system—can occur during off-peak Energy periods. Mr. Pfeifenberger's study establishes that Congestion is just as likely, and on some paths more likely to occur off-peak as on-peak. *See* Exh. ISO-36 at 7:8–11:14. SWC cites the ISO's Market Analysis Reports from April 2002 through September 2003 and concludes that Congestion is much more frequent and costly on-peak. SWC Br. at 54. It is questionable whether these reports support a conclusion that Congestion is "much" more frequent and costly on-peak, and the reports cover a period that is approximately 25 percent of the period covered by Mr. Pfeifenberger's study. What cannot be denied, in light of Mr. Pfeifenberger's study, even taking into account these reports, is that Congestion is not correlated with on-peak Energy use, and in fact occurs frequently off-peak. When Congestion occurs off-peak, increased

Demand cannot be accommodated at no or a low incremental cost in the off-peak period for Energy, contrary to SWC's assumption.

As discussed above, the transmission Access Charge does not provide a price signal and is not intended to do so. While it does reflect the average embedded cost of the transmission system, the primary function of the Access Charge is to recover without distorting the market that portion of the Transmission Revenue Requirements that is not already paid for by Congestion charges and FTR auction revenues. Exh. ISO-36 at 14. As the Commission has recognized, the price signal—regarding transmission use, not Energy use—is provided by Congestion charges. *Pacific Gas and Elec. Co., et al.*, 80 FERC ¶ 61,128 at 64,429 (1997).

SWC contends nonetheless that Congestion charges provide an inadequate price signal. SWC first notes that the ISO's Usage Charges apply only to inter-zonal Congestion, and contends that congestion does not and cannot measure the use of the entire ISO grid. SWC Br. at 78. The ISO recognizes that its management of Intra-Zonal Congestion needs improvement, and, as noted above, the Commission has already approved the ISO's MD02 Congestion Management proposal to address such issues. It is incorrect, however, to say that Intra-Zonal Congestion Charges send no signal. They are a location- (i.e., zone) and time-specific charge that, over time, can provide Market Participants with scheduling flexibility the information needed to avoid the charges. *See* Tr. at 910:15–20. Persistent Intra-Zonal Congestion Charges also indicate the need for transmission upgrades within any congested zones. It is

also significant, as Mr. Hansen testified, that 90 percent of ISO Congestion charges are Inter-Zonal. Exh. SCE-29 at 24:11–12.

SWC contends that Inter-Zonal Congestion charges, i.e., Usage Charges, are inadequate because they cannot easily be predicted and because Scheduling Coordinators can only revise their schedules to address Congestion in the Day-Ahead Market. SWC Br. at 48–49. This contention is not true; Congestion is managed in both the Day-Ahead and Hour-Ahead Markets. The Commission also apparently believes otherwise. In its order on Standard Market Design, the Commission stated, "The adoption of a market-based locational marginal pricing (LMP) transmission congestion management system is designed to provide a mechanism for allocating scarce transmission capacity to those who value it most, while also sending proper price signals to encourage short-term efficiency in the provision of transmission service as well as wholesale energy, *and to encourage long-term efficiency* in the development of transmission, generation and demand response infrastructure." *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, FERC Stats & Regs. ¶ 32,563 at P 10 (2002). (emphasis added). Similarly, in approving the ISO's Congestion Management proposal in MD02, the Commission stated, "We believe that the use of LMP will resolve perverse incentives in the current design and promote efficient short and long-run behavior." *California Indep. Sys. Operator Corp.,* 105 FERC ¶ 61,140 at P 47 (2003).

In addition, Mr. Pfeifenberger testified to his belief that Congestion prices were a significant contribution to a long-term price signal regarding transmission investments. Tr. at 914:24–915:6. He also testified that adding time-of-use will not meaningfully improve the price signal. Tr. at 915:11–14. Mr. Pfeifenberger also testified that, if a combination of a flat access charge and congestion pricing were found to be inadequate, time-of-use or coincident peak pricing would not provide an answer. An Access Charge, in order to send an appropriate price signal, would have to be location and direction sensitive, as are the ISO's Congestion charges. Exh. ISO-36 at 21:1–4; Tr. at 940:23–941:7.

Further, while SWC is correct that Scheduling Coordinators can only adjust their schedules in response to Congestion charges in the Day-Ahead market, it is only focusing on part of the process. Scheduling Coordinators also submit Adjustment Bids for the Day-Ahead and Hour-Ahead Markets, by which they notify the ISO of the value they place on the transaction, and the ISO adjusts the schedules on their behalf based on those values. ISO Tariff §§ 2.2., 7.2.4 et seq., Exh. J-2. Moreover, Scheduling Coordinators can make incremental changes in the Hour-Ahead Market that impact Congestion Management. In the longer term, Scheduling Coordinators purchase or receive[11] FTRs to hedge against Congestion costs. ISO Tariff §§ 9.1–9.2, Exh. J-2. Congestion price signals are thus sent Hour-Ahead, Day-Ahead, and yearly.

[11] In accordance with Section 9.2.4 of the ISO Tariff, New Participating TOs are allocated FTRs commensurate with the transmission rights that are turned over to ISO Operational Control.

SWC also contends that FTRs dilute the price signal from Congestion, both because the auction revenue reduces the transmission Access Charge to a greater degree when greater Congestion is anticipated and auction prices are higher and because they insulate the holder from the costs of Congestion. SWC Br. at 56-57. SWC admits, however, that the FTR holder does have an incentive to avoid a Congested path so as to avoid Usage Charges (and thus profit from the Usage Charge revenues), SWC Br. at 57, but again relies upon the difficulty in predicting Congestion to suggest that the price signal is inadequate. Market Participants, however, can and do consider the likelihood of Congestion every time they submit an Adjustment Bid or schedule a transaction, just as Market Participants must consider the (also difficult to forecast) price of real time Energy and Day-Ahead capacity in deciding whether to buy Energy or capacity in those markets or on a longer term forward basis and in determining what to pay for such a forward contract. In addition, in the act of purchasing an FTR, Market Participants are incurring certain Congestion costs much like a forward Energy contract locks in an Energy price. No one questions the notion that forward Energy contracts in effectively competitive markets provide a useful price signal, so the same holds true for FTRs.

SWC's next argument is that the transmission Access Charge and Congestion management charges do not, together, provide proper price signals relating to the need for transmission expansion. SWC Br. at 57-61. SWC quotes Mr. Pfeifenberger (Tr. at 934:4-20) to the effect that the price signal sent is not explicitly based on long-run marginal costs. SWC Br. at 57-58. SWC is forced to

admit that Mr. Pfeifenberger also testified that time-of-use or coincident peak prices are not based on long-run marginal costs either. *Id.* at P 83 n.14. Although SWC asserts that time-of-use pricing and 12-CP pricing "better" reflect the long-run marginal costs of transmission, it offers no authority or explanation why. SWC cannot because no witness so testified. The only discussion of the matter is Dr. Wilson's admission that SWP's proposal is *not* based on long-run marginal costs. Tr. at 1977:11–19.

SWC quotes an ISO filing regarding Amendment No. 50 to the ISO Tariff, highlighting the quotations that the "belief that spot prices should be relied on to encourage investment is suspect" and that "a supplier relying on Congestion rents to recover its fixed costs will be in serious trouble if the price signals those Congestion rents send actually provoke the investment that relieves the Congestion." SWC Br. at 58-59, citing Exh. SWP-41 at 2. "Congestion rents" here refer to the higher prices that may occur in the ISO's real time Energy market in the presence of Intra-Zonal Congestion. Congestion charges, and the ISO's situation, are not remotely analogous to the described circumstance. Congestion charges are a deliberate mechanism in the ISO Tariff, not a result of market power or limitations placed on supply sources. If the ISO invests in transmission to relieve Congestion, reducing Congestion revenues, the Participating TOs continue to receive their Transmission Revenue Requirements through the transmission Access Charges. SWC's contention that, once the investment occurs, users of the grid that did not cause the expansion subsidize those that did under a MW/h charge once again ignore the fact that all users of

the grid, including the expansion, benefit from the grid and therefore cause the costs to be incurred. *California Indep. Sys. Operator Corp.*, 103 FERC ¶ 61,114 (2003).

SWC concludes its discussion of the third Transmission Pricing Principle by contending that any price signal sent by Inter-Zonal Congestion management is short-term, and again citing *Electric Consumers Resource Council v. FERC*, this time as a case in which the court found unjust and unreasonable a rate that focused on the short-term. The court, however, did nothing of that sort. The court found, as SWC quotes, that "The Commission fails to explain why a short-term focus is acceptable to discuss the potential effects of this short-term approach." 747 F.2d at 1515. Moreover, even if one assumes the Commission is incorrect, and Congestion management cannot send long-term price signals, the case is not enlightening. The case did not concern price signals, but whether one of the Commission's rationales - an unexplained decision to focus on the short term was sufficient to justify ignoring the actual proportion of demand and energy costs simply because there was currently excess capacity - was sufficient to support its order.

To the extent that SWC is asking the Commission to reject the ISO's proposal because it does not send an appropriate price signal and that price signal cannot be supplied by Congestion charges, SWC is asking the Presiding Judge to ignore established Commission precedent. To the extent that SWC is asking the Presiding Judge to reject the ISO's proposal because it does not send an appropriate price signal and that price signal cannot be supplied by the ISO's

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current Congestion charge methodology, it still provides no basis to find the transmission Access Charge is not just and reasonable. The ISO's Congestion management methodology is before the Commission in another proceeding in which the Commission can ensure that Congestion charges fulfill their role.

II. The Presiding Judge Properly Evaluated SWP's "Reliability Support Obligations." SWP Exception No. 2.

SWP contends that the ISO should be required to amend the ISO Tariff to provide for compensation of in-kind reliability support provided under Existing Contracts if the Existing Rights holder were to become a Participating TO. I.D. at 261. The Presiding Judge rejected these arguments. SWP asserts (at 27–29) that the Presiding Judge should be reversed because the Initial Decision places SWP "at risk of providing extensive uncompensated reliability support under the TAC scheme." According to SWP, "[a]s the record makes clear, SWP receives the highest priority firm transmission service (a product not available from the ISO except to the extent that FTRs offer an incomplete hedge against congestion costs) in exchange for its reliability support under its contract with PG&E. . . . Under contract conversion, SWP would receive *no* benefits and have no rights under the ETC." Id. at 28. SWP's half-statement of the consequences of conversion of Existing Rights[12] omits the Presiding Judge's reasonable resolution of the issue. If the reliability support services are indeed a quantifiable part of the compensation that SWP pays PG&E under its Existing Contract, then SWP can seek to recover the costs of those services through its Transmission Revenue

[12] The ISO Tariff does not provide for conversion of Existing Contracts, but only of the transmission rights under those contracts.

Requirement following conversion of its Existing Contract. If the reliability support services are not a quantifiable part of that compensation, then compensation for those services is not related to the transmission Access Charge. SWP's attacks on this resolution are baseless.

A. The Presiding Judge's Conclusions Do Not Contradict Previous Commission Orders

SWP cites two decisions that it claims are Commission directives that issues concerning its reliability services be resolved in this docket. In neither case did the Commission so direct. In Paragraph 10 of the Commission's rehearing order on Amendment No. 46, *California Indep. Sys. Oper. Corp.*, 102 FERC ¶ 61,146 (2003), the Commission notes such concerns of SWP. In paragraph 11, however, the Commission also notes "California DWR claims that the Commission has unduly discriminated against entities such as California DWR by shifting costs away from MSS beneficiaries to entities that are not granted such favorable treatment." The *only* reference to this docket in the Commission response involves the latter: "We clarify that these cost causation and allocation issues are best raised in Docket Nos. ER00-2019-000, *et al.*" *Id.* at P 16. In the initial order on Amendment No. 46, *California Indep. Sys. Oper. Corp.*, 100 FERC ¶ 61,234 (2002), which SWP inexplicably cites as responding to its comments in the rehearing order, the Commission merely states that issues raised in this docket regarding Metered Subsystems are not prejudiced by the resolution of Amendment No. 46.

The second case cited by SWP, *Morgan Stanley Capital Group v. California Indep. Sys. Oper. Corp.*, 96 FERC ¶ 61,354 at 62,339 n.10 (2001),

merely states that this docket will address the treatment of Existing Contract Rights (capitalized). Existing Rights, under the ISO Tariff, are specifically transmission rights—consistent with the Presiding Judge's description of the scope of this docket.

Although SWP states that the Commission's comment in *Morgan Stanley* was "in response to SWP's concern that it cannot reasonably be expected to convert its contracts when the ISO offered no mechanism for the continued provision of reliability support," SWP Br. at 29, the Commission *never mentioned* SWP's concerns. The footnote in question appeared after the following two sentences: "We find that MSCG has raised material issues of fact that warrant an evidentiary hearing. Therefore, we will institute an investigation on the complaint." *Id.* at 62,349.

B. The Presiding Judge Properly Concluded that Issues Regarding Non-Transmission Related Services and Costs Be Resolved Through Contract Negotiations or in a Separate Docket

As discussed in the ISO's Motion to Strike, filed on April 22, 2004, rather than address the facts and legal issue, SWP has chosen instead to portray the ISO's position as indifference to reliability and unwillingness to negotiate. SWP's rhetoric is pure politics. The ISO's commitment to reliability is clear, and needs no defense. Beyond the Motion to Strike, the ISO will only respond to two matters raised by SWP. First, SWP continues to take out of context the ISO's statement in its Initial Brief that "the record would not support a conclusion that SWP is providing services that, *were SWP not otherwise obligated to provide them under its Existing Contract*, the ISO would want or need them." ISO Initial

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Br. at 58 (emphasis added). The ISO's statement is simple. Consider a simple analogy. If a landlord is paying for security services, it makes sense for the renter to accept those services. If the security service provider is no longer required to provide the services and the landlord is no longer paying, it is only incumbent upon the renter to seek other bids for the security services or to see if different types of systems would provide better security. *Any other course of action would be detrimental to both reliability and cost-efficiency.* If SWP terminates its Existing Contracts and is the best source of the reliability services it currently provides, the ISO will have no reasonable choice but to procure those services at fair compensation.

Second, SWP's 1999 "inquiry" about joining the ISO, *see* Exh. SWP-28 at 12–18, is not an inquiry but in essence a series of demands. The fact that the ISO has not written a formal response is not surprising, because the demands could not be met without a wholesale revision of the ISO structure—including, for example, the time-of-use rates that are the subject of litigation in this proceeding. Indeed the evidence in the proceeding does not address whether the ISO has engaged in discussion with SWP regarding Participating TO status.

C. Contrary to SWP's Argument, the Presiding Judge Would Not Require SWP to File a Transmission Rate Case to Be Compensated for Reliability Support

Despite repeated Commission decisions, as noted in the Initial Decision, SWP refuses to recognize that, as a Participating TO, it is not just a customer, but also a transmission provider. I.D. at P 368. It must file a Transmission Owner Tariff and Transmission Revenue Requirement in order to recover the costs of its Existing Contract. If the costs of providing reliability support are part

of those costs, then it may be able to recover those costs through the Transmission Revenue Requirement, but it is the costs of the Existing Contract—not the compensation for reliability support—that is at issue in such a filing. As discussed above, to the extent that reliability support services are not part of the payment for the transmission services, then SWP would be compensated separately from its Transmission Revenue Requirement. Indeed, SWP is already paid handsomely for the provision of services to the ISO. *See* Exhs. ISO-49 to 52.

SWP citation of special accommodations in Amendment No. 48 for a contribution to upgraded transmission capacity does not advance its cause. As in this instance, as was the case with Southern Cities, with the City of Vernon, and with TransElect, when a entity was prepared to make a significant contribution to the ISO by becoming a Participating TO or otherwise, and concluded negotiations, the ISO proposed a tariff amendment to make the appropriate accommodations. SWP is simply not similarly situated; it is not seeking to negotiate a resolution with the ISO, but is demanding that the Commission impose SWP's chosen resolution on the rest of the ISO Market Participants.

III. Phantom Congestion

A. The Presiding Judge Properly Concluded that Phantom Congestion Exists. MID Exception No. 3; TANC Exception No. 1.

Both MID and TANC challenge the Presiding Judge's reliance on the May 31, 2000 order for the conclusion that phantom Congestion exists. They contend that this reliance is inconsistent with the Commission's later July 10,

2003, Order on Rehearing indicating that a full record on phantom Congestion should be developed and her own similar conclusion in a bench ruling. The Commission's Order on Rehearing, however, is not inconsistent with the Commission's initial conclusion, and nothing precludes the Presiding Judge from so finding. The Commission did not abandon its initial conclusion, it merely asked that a record on issue concerning phantom Congestion—of which there were many—be developed. Tellingly, neither MID nor TANC acknowledge that the Commission's statement of its position regarding phantom Congestion in an order on the ISO's Market Redesign proposal ("MD02"), subsequent to the bench ruling and prior to the Initial Decision. *California Indep. Sys. Oper. Corp*., 105 FERC ¶61,140 at PP 201–02 (2003).

As the ISO noted in its Initial Brief below, no Intervenor in this proceeding disputes the fact that increased participation in the ISO would make additional capacity available to the ISO for scheduling Day-Ahead and Hour-Ahead and that, conversely, under current procedures the ISO cannot schedule new firm use on a Day-Ahead and Hour-Ahead basis on capacity that is reserved for Existing Contracts. Neither does any Intervenor deny that Congestion appears Day-Ahead and Hour-Ahead when transmission users schedule more capacity on a given path in a given hour than is available on that path in that hour, regardless of whether the capacity on that path subject to Existing Contracts is scheduled. Yet some Intervenors inexplicably resist the logical conclusion from those facts that Congestion that appears in the Day-Ahead or Hour-Ahead Markets may not be real, i.e., that if the unscheduled Existing Contract capacity on which the ISO

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could not schedule is sufficient to accommodate the ISO's curtailed transactions, then the path is not fully utilized. Whether one calls it phantom Congestion or something else, it is a phenomenon that cannot be denied.[13]

Both MID's and TANC's arguments focus on whether the ISO has a right to use the facilities on which such Congestion occurs.[14] MID in particular speaks of a "two-pipe" system. Part of the purpose of the design of the transmission Access Charge, however, was to attract New Participating TOs so as to ameliorate the wasteful non-use of significant amounts of installed transmission capacity on the basis that the ISO's concern relates to "Non-PTO pipe." MID Br. at 16–17. Thus the focus on phantom Congestion herein is not some effort to usurp rights, but simply for the Commission to consider whether the general benefits to consumers that follow additional participation in the ISO, i.e., increasing the amount of capacity that is "PTO pipe," are such that special incentives to encourage such participation are justified. The Commission should therefore affirm the Presiding Judge's conclusion.

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[13] MID devotes three pages to asserting that the ISO "conflates two unique conditions in framing its 'phantom congestion' fiction," asserting an ISO use of phantom Congestion to refer to a real time condition. Because MID includes no citations whatsoever for this supposed ISO position, the ISO cannot respond.

[14] Although not particularly relevant to this proceeding, it is worth noting that the Commission has recently reaffirmed the ISO's ability to schedule on Existing Contract capacity in real time, disproving MID's effort to equate contract rights with physical ownership. *California Indep. Sys. Oper. Corp.,* 105 FERC ¶61,314 at P 17 (2003).

B. The Presiding Judge Properly Found that Phantom Congestion Is Caused by "a Disparity Between the ISO's Scheduling Timelines in the Day-Ahead and Hour-Ahead Markets and the Scheduling Timelines Accorded Existing Rights Holders in Their Existing Contracts." MID Exception No. 4, TANC Exception No. 2.

MID and TANC also contend that the Presiding Judge erred in her conclusions regarding the cause of phantom Congestion. The Presiding Judge's conclusions are not only consistent with prior Commission precedent (see I.D. at P 80) but are also carefully documented by record evidence. Contrary to TANC's contention (at 25), the question of how the disparity between timelines arose historically is not particularly relevant: of course, the Existing Contracts preceded the ISO. Phantom Congestion arose because of the coexistence of two different paradigms, regardless of which arose first, and is relevant to this proceeding to the extent that the elimination of phantom Congestion is a benefit to be considered in evaluating the Access Charge. The ISO does not believe additional argument is necessary.

The ISO does believe it appropriate, however, to respond to MID's repetition of its argument that phantom Congestion arises because the ISO prohibits the sale of transmission. Specifically, MID complains about certain provisions in the ISO Tariff and procedures related to scheduling ETC capacity that allow the ISO seven days to implement changes relating to links in the system between the ETC and the associated Scheduling Coordinator and the standing instructions from the Responsible PTO. MID Br. at 17–19, 22–25. No such changes are prerequisites for Existing Rights holders to make third party

sales of transmission.[15] As Mr. Rush testified, the Existing Rights holder merely needs to instruct its Scheduling Coordinator to schedule the transaction.

MID contends that this requires a back-to-back buy-sell transaction, which MID describes as follows on brief: "Assume that a Market Participant, such as the California Energy Resources Scheduling division ("CERS") of the California Department of Water Resources ("CDWR") wanted to purchase energy from the Pacific Northwest, but the ISO lines running north-to-south were congested. MID could, for example, purchase power from a seller in the Pacific Northwest and schedule that power into MID's system using MID's Non-PTO transmission and, at the same time, sell an equivalent amount of power to CERS in NP15 via an inter-SC trade." MID Br. at 37. As Mr. Rush explained, nothing of the kind is necessary. CERS could purchase the Energy and purchase the transmission from MID. MID would instruct its Scheduling Coordinator to schedule the transaction, and would pay according to the terms of its Existing Contract. Exh. ISO-26 at 9:23-10:5. MID would have to collect from CERS. *Id.* at 10:3–5.

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[15] The restriction on the transfer of Contract Reference Numbers ("CRNs") has nothing to do with the sale or re-sale of transmission capacity. Exh. ISO-26 at 9:23-10:3. A CRN merely associates a particular Scheduling Coordinator with a particular amount of capacity on a specific transmission path that is subject to Existing Rights. Exh. ISO-26 at 9:8-21. The Scheduling Coordinator may then schedule this capacity for anyone or no one, presumably in accordance with its own or its principal's wishes. *Id.* at 10:3-5. The seven day restriction in Operating Procedure M-423 pertains only to a change of the Scheduling Coordinator with respect to all or some portion of transmission capacity held under an Existing Contract. *Id.* at 9:8-10. Existing Rights holders may divide up their Existing Rights among Scheduling Coordinators however they choose. *Id.* at 10:3-14. The only restriction is that a particular quantity of transmission capacity must remain linked through the CRN assignment to a particular Scheduling Coordinator within 7 days of submitting a schedule.

It may be that MID is unwilling to engage in such a transaction because it remains responsible to the ISO and the Scheduling Coordinator for the transaction, and would be responsible for any charges, such as certain aspects of the GMC, associated with the transaction. Perhaps MID has some other impediment to such a transaction. Nothing in the ISO Tariff or procedures would prevent MID from selling transmission in this manner.

These unexplained advantages to MID to change the CRN such that the third party is identified to the ISO as the entity responsible for the transaction and its costs, must be weighed against the disadvantages that MID would impose on others. Mr. Rush has explained that accommodating Scheduling Coordinator in this manner would cause the ISO, and ultimately ratepayers, to incur significant costs—initially to revamp its software and procedures, but more significantly, to augment its staff to a level sufficient to handle continuing last minute Existing Contract changes. *See* Exh. ISO-26 at 9:16–18. The Commission need not address this issue here. Should MID elect to participate in the ISO, this problem too would immediately disappear along with MID's Existing Contracts, and this is, after all, the only point about phantom Congestion as it relates to this proceeding.

IV. "Cost Shift"

A. The Cost-Shift Cap Is Simply One Part of a Just and Reasonable Transition Mechanism that, Particularly When Considered in the Context of the Entire Balance of Benefits and Burdens, Does Not Unduly Discriminate Against Any Party. MID Exception No. 5, TANC Exceptions No. 3,4.

The Initial Decision rejected (at PP 148–49) the cost shift cap on the basis that the impact of the cost-shift on retail rates was not sufficiently significant to justify mitigation. Although the ISO does not agree with that determination, it has

not taken exception. MID (at 43–45) and TANC (at 41), however, take exception on the basis that the Presiding Judge should also have found that the cost shift cap is discriminatory. The Commission should reject those Exceptions.

As described by Ms. Le Vine, "[T]he Access Charge proposal as filed included a number of other transition mechanisms to mitigate cost shifting among Participating TOs and to facilitate the entry of New Participating TOs. The ISO considered these transition mechanisms to be integral parts of the balanced compromise proposal adopted by the ISO Governing Board." Exh. ISO-1 at 59:22–60:2. The cost shift cap is one of those mechanisms. As Ms. Le Vine further explained:

> The proposed methodology recognizes that the adoption of the TAC Area approach and the phased introduction of a single ISO Grid-wide High Voltage Access Charge would cause considerable cost shifting among Participating TOs. To limit the potential magnitude of these cost shifts, the proposed Access Charge methodology includes a cap on the amount by which the Access Charge responsibility payable for the withdrawal of Energy within the Service Area of each Original Participating TO can increase during each year of the ten-year transition period due to the adoption of the Access Charge methodology and the GMC/Access Charge "hold harmless" provision for New Participating TOs.
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> . . . .
>
> If the total cost shift exceeds this cap, the customers of the New Participating TOs with net benefits would contribute part of their net benefit in order to limit cost shifts to this level. . . . [T]his mitigation measure would be implemented through the Transition Charge.

Id. at 61:17–62:15. The cost-shift cap was set at $72 million total, $32 million to be borne by SCE and PG&E each and $8 million by SDG&E.

The proposed Access Charges does treat New Participating TOs differently; it also treats some New Participating TOs differently than others; and its treats Original Participating TOs differently; and it treats some Original Participating TOs differently than others. This treatment is justifiable, however, because these groups are not all similarly situated, but rather bring to the ISO different circumstances. Moreover, to the extent that they are similarly situated, the goals of expanding the ISO Controlled Grid while avoiding abrupt cost shifts justify transitional distinctions. Indeed, the differential treatment afforded certain New Participating TOs carries with it not only the cost cap, but also benefits; if differential treatment were not justified, then the benefits would be impermissible. The cost shift cap is simply part of this overall balance.

New Participating TOs are not the only parties that may be subject to a Transition Charge as part of the overall balance of costs and benefits during the transition period. Another feature of the balance is that the costs to be borne by the Original Participating TOs must at all times reflect the same proportionality as the cost cap: 32:32:8. Thus, ever since Vernon became a Participating TO, PG&E and SDG&E have been paying a Transition Charge, and SCE has been receiving a Transition Charge benefit. This is illustrated in Exh. No. ISO-21 at 17.

A third feature of the balance is the “hold harmless” provision, reflected in Section 8.6 of the ISO Tariff. If the Transmission Revenue Requirement of a New Participating TO results in a utility-specific rate that is less than the Access Charge it would pay, the hold harmless provision ensures that the New

Participating TO will only pay the utility-specific rate. The difference is made up by the Original Participating TOs through the Transition Charge as the first priority payment. ISO Tariff § 8.6, Exh. J-2. This is illustrated in Exh. ISO-21 at 20. Thus, in effect, New Participating TOs, just like Original Participating TOs, enjoy the benefit of a cost shift cap. The difference is that the cost shift cap for New Participating TOs is $0.

Thus, the Access Charge proposal exposes every Participating TO to a potential Transition Charge in order to achieve the balance of costs and benefits during the transition period. The degree of exposure varies according to each Participating TO's circumstances, according to when it becomes a Participating TO and the level of its Transmission Revenue Requirement. This is to be expected—the purpose of a transition period is to reduce abrupt costs shifts while preserving incentives for New Participating TOs, and this purpose cannot be accomplished without making rate adjustments according to the specific circumstances of particular participants. It cannot be said, however, that the ISO's proposal singles out any one class to bear the burdens of the transition period; at any particular time, that burden may fall on a different group.

MID (at 44) and TANC (at 32–40) argue that the cost shift cap denies them the ability fully to recover their Transmission Revenue Requirements through the TAC, and that once the cost-shift cap was reach, they would have to recover a portion of their revenue requirement from their native ratepayers. As was fully discussed in hearing and on brief, this in not accurate. On a "gross" basis, there is no dispute that the ISO pays out every Participating TO's full

Transmission Revenue Requirement. *See* ISO Tariff Appendix F, Schedule 3, § 10.1, Exh. J-2.

A "net" analysis recognizes that the ISO settles with Participating TOs that are also UDCs or Metered Subsystems ("MSS") on a net basis. *Id.* Appendix F, Schedule 3, § 10.2. The net settlement, however, includes not only the Transmission Revenue Requirement payment and the Transition Charge, *but also the Access Charge*. *Id.* If the Transmission Revenue Requirement payment (going to the Participating TO) is considered a positive amount, and the Transition Charge and Access Charge (coming from the UDC or MSS) are considered negative amounts, it becomes apparent that *no* Participating TO receives its full Transmission Revenue Requirement from the ISO on a net basis. On a net basis, *every* Participating TO that is a UDC or MSS must collect all or a portion of its Transmission Revenue Requirement from the ratepayers of the UDC or MSS. Indeed, the only issue in a net analysis is whether the Participating TO will be paid by the ISO or will have to pay the ISO.

A complete net analysis underscores the hollowness of the arguments against the cost caps. Before the cost cap is reached, Participating TOs with below average utility-specific rates (except for New Participating TOs, who are protected by the hold harmless provision) will, on a net basis, make payments to the ISO. *Compare* Exh. ISO-17, col. 1 with Exh. ISO-17, cols. 20 and 32. *See also* Tr. 1576:1–14. Participating TOs with above average utility-specific rates will, on a net basis, receive payments from the ISO. *Id.* Once the cost cap is reached, the Transition Charge will simply reduce those payments; even in the

hypothetical broad participation case analyzed by ISO witness Mr. Pfeifenberger, the New Participating TOs will continue to receive payments from the ISO—payments they did not receive before becoming New Participating TOs—while the Original Participating TOs will continue to make payments to the ISO. *See* Exh. ISO 21. Under such circumstances, it is difficult to understand how the cost-shift cap, as part of the overall balance of benefits and burdens, could render the ISO's proposal unduly discriminatory.

B. If the Commission Reverses the Initial Decision on a Cost Shift Cap, then ISO's Differential Treatment of "New" High Voltage Transmission Facilities for Purposes of Calculating the Transition Charge Is Appropriate. Southern Cities Exception.

In Amendment No. 49, the ISO proposed to exclude the costs of New Transmission Facilities from the calculation of the Transition Charge. Southern Cities argued that this exclusion was unduly discriminatory. The Presiding Judge rejected this argument. I.D. at P 174. Because the Presiding Judge rejected the cost shift cap, the distinction will not have an impact. Southern Cities has made (at 6–14) a conditional Exception in the event the Commission imposes a cost shift cap. The Commission should affirm the conclusion of the Presiding Judge.

The only distinction made in Amendment 49 is between Existing High Voltage Facilities, *i.e.,* those built before January 1, 2001, and New High Voltage Facilities, *i.e.*, those built after January 1, 2001. ISO Tariff, Appendix A, Definitions of New High Voltage Facility and Existing High Voltage Facility, Exh. J-2. The only two classes, then, would be those who build New High Voltage Facilities and those who own only Existing High Voltage Facilities. All Participating TOs who build New High Voltage Facilities are treated the same,

i.e. the facilities are excluded from the calculation, and all Participating TOs who own Existing High Voltage Facilities are treated the same, *i.e.,* their facilities are included in the calculation.

There are, however, differences between the two classes of Participating TOs. Participating TOs who build New High Voltage Facilities do so in conjunction with the ISO and with the approval of the ISO, as part of the ISO planning process and determination of need. The facilities are built to benefit the entire ISO Controlled Grid. Exh. ISO-33 at 13:1-5. The Existing High Voltage Facilities of Participating TOs, however, generally were not built to benefit the entire ISO Controlled Grid or as part of the coordinated ISO planning process. *Id.* at 13:5–7. Existing High Voltage Facilities may already have heavy use, and may have Encumbrances. *See* Tr. at 867:24–868:3. New High Voltage Facilities do not. The two classes, therefore, are not similarly situated, and differential treatment is not discriminatory.

Even if some class could establish differential treatment, however, the exclusion of New High Voltage Facilities from the calculation of the cost shift and the Transition Charge would be justified. The exclusion is necessary to encourage and facilitate the financing of transmission expansions. As explained by Mr. Pfeifenberger, unless New High Voltage Facilities are excluded from the calculation, the costs would generally not be borne in proportion to Gross Load, but would greatly depend on who constructs the facilities and the size of the overall cost shifts. In essence, the cost of New High Voltage Facilities would interfere with the calculation of the Transition Charge such that the Transition

Charge counter-acts the immediate ISO Grid-wide roll-in of transmission upgrades in often unpredictable ways. Exh. ISO-36 at 37:13–38:2. In an example presented by Mr. Pfeifenberger, under the Amendment No. 49 methodology, in every scenario, the costs of a transmission upgrade were allocated to the Participating TOs according to Gross Load.

In contrast, if the costs of the New High Voltage Facilities were not excluded from the calculation, the costs borne by New Participating TOs varied from 0 to 100 percent and the costs paid by the Original Participating TOs varied to the same degree. *Id.* at 40:17-41:2. Because these allocations could create significant barriers to the efficient upgrade of the transmission system—providing disincentives for transmission investments by Participating TOs with a disproportionately high allocation of the costs, while not providing proper incentives for Participating TOs with an under-proportionate (or even zero) allocation of new transmission costs—the exclusion of the costs of New High Voltage Facilities from the calculation of cost shifts and Transition Charges would justify a minor distinction in treatment of similarly situated classes, if such a distinction could be established. *Id.* at 41:6–11.

The Presiding Judge should therefore find that the exclusion of the costs of New High Voltage Facilities from the calculation cost shifts and Transition Charges does not treat New Participating TOs dissimilarly from Original Participating TOs and, further, serves to encourage the construction of new transmission by ensuring that the costs are properly allocated among Participating TOs.

V. The Presiding Judge Properly Concluded that It Was Not Necessary to Specify Criteria for the Allocation of FTRs to New Participating TOs in the ISO Tariff. SWP Exception No. 3, PG&E Exception No. 4.

Section 9.4.3 of the ISO Tariff, as proposed by Amendment No. 27, provides that, during the ten-year transition period (or a shorter period representing the term of an Existing Contract), a New Participating TO that converts Existing Rights to ISO transmission service will receive FTRs commensurate with those rights directly, without the necessity of participating in the ISO's FTR auction. Certain parties contend that the ISO Tariff should set forth the methodology for determining the number of FTRs so awarded. Id at PP 223, 225. The Presiding Judge concluded:

> The record supports a finding that due to significant differences in individual existing contracts, the ISO requires a degree of flexibility in determining the appropriate number of FTRs to award under Section 9.4.3, and that this degree of flexibility plays a significant role in ensuring the Section 9.4.3 allocation of FTRs fulfills its purpose as an inducement to expanded participation in the ISO. However, to ensure that market participants have a full opportunity to litigate the proposed award of FTRs, the ISO's tariff should be amended to require the ISO to file the proposed award with the Commission simultaneously with an amendment to the Transmission Control Agreement ("TCA") regarding each new PTO.

I.D. at 228.

Both PG&E (at 39–41) and SWP (at 48) challenge this conclusion. PG&E cites no evidence and or prejudice, but merely contends that specific standards will reduce ambiguity, decrease the chances of discrimination, and minimize disputes. None of these arguments suggest that the ISO proposal is unjust or unreasonable or that the Presiding Judge, who based her decision on the record.

The vast majority of SWP's argument is based on irrelevant, non-record evidence that the ISO has moved to strike and will not further address. A good part of what remains is inaccurate. First, the Initial Decision did not suggest that the ISO be held accountable only "after the fact" and only by complaint. SWP Br. at 39. Rather, it directed that the allocation of FTRs be included in the amendment to the Transmission Control Agreement and be challenged by protests, *i.e., before they take effect.* Second, Ms. Le Vine *never* testified that the ISO would not even provide a written statement of the derivation of the FTR allocation. She simply testified that she would have to get clearance before stating an ISO position on the issue. The ISO would of course comply with the tariff amendment as the Commission requires.

SWP's only real argument is that the Presiding Judge's ruling is contrary to the "rule of reason," which permits omission from the tariff only details that do not affect a customer's rights and violates the standards of conduct which mandate full disclosure of the terms for transmission access. SWP is correct that the Commission has found that FTR's significantly affect the charges for service and are within the scope of the rule of reason. The Commission made this ruling, however, in the context of FTRs that have been issued. *California Indep. Sys. Oper. Corp.,* 89 FERC ¶61,153 (1999). FTRs that have not been issued do not affect a customer's rights and do not affect terms of service. Under the Initial Decision, before those FTRs are issued, they will be published, there will be an opportunity to protest, and they will be subject to all requirements of the

Commission's Standards of Conduct. *See* I.D. at 228. That is all that is necessary.

VI. The Presiding Judge Properly Approved the ISO's Proposal Regarding the Netting of Section 9.4.3 FTR Revenues. SWP Exception No. 3, TANC Exception No. 8

The ISO proposed in Amendment No. 49 to revise the definition of Transmission Revenue Credit and Net FTR Revenue such that the recipients of Section 9.4.3 FTRs must credit against their Transmission Revenue Requirement the positive difference between the Usage Charges paid and the Congestion revenue received for each hour. This revision ensured that the New Participating TOs receive the full benefit of the hedge against Congestion that is provided by Section 9.4.3 FTRs, but not more than that amount.

The ISO included provision for Section 9.4.3 FTRs to allow potential New Participating TOs to preserve the benefits of their Existing Rights after conversion of those rights. Section 9.4.3 FTRs are designed to provide New Participating TOs a financial hedge against Usage Charges that they would not have paid under their Existing Contracts. Exh. ISO-1 at 82:7–18. Ms. Le Vine noted the ISO's agreement (Exh. ISO-33 at 27:1-3) with SCE's witness Cuillier's explanation that Section 9.4.3 FTRs are not intended to confer a benefit beyond this particular and limited purpose. Exh. SCE-13 at 27. The purpose of Section 9.4.3 is not to protect New Participating TOs from all market risk or all Congestion cost, but only to reflect that which they enjoy under their Existing Contracts. *Id.*

To the extent that a New Participating TO is Scheduling on the paths that were subject to its Existing Rights, at or below the capacity of those Existing

Rights, the fact that it, as FTR holder, receives, pro rata, the Usage Charge (FTR) revenues associated with the path means that the Usage Charge (FTR) revenues should almost always cover the Usage Charges it pays. The exception would be the derate of a transmission line. SCE-13 at 27:9-15. As Mr. Cuillier explains, however, a line derate may have caused a pro rata reduction in the potential New Participating TOs firm rights to schedule under its Existing Contract. Exh. SCE-13 at 27. The proposal put forth on behalf of SWP and TANC would thus confer a financial advantage beyond the more proportionate benefit that Section 9.4.3 should convey. *Id.* at 29:11–13.

On Exceptions, TANC argues (at 44) that it could previously offset redispatch costs with savings from another period, so there is no reason to disallow it now. Previously, if TANC offset its redispatch costs due to derates with its revenues it was still paying its own redispatch costs. To the extent TANC now receives the income from FTRs in excess of its Congestion costs, and uses that revenue at a later period to reduce the cost of derates, it is using money that was given it at the expense of other Market Participants not for that purpose but solely for the purpose of hedging any *new* Congestion costs it might encounter as the result of becoming a Participating TO. Under such circumstances, as the Presiding Judge, TANC would unfairly be profiting at the expense of other Market Participants.

VII. The Presiding Judge Properly Excluded Testimony Regarding the Inclusion of PG&E's Reliability Services Cost in the Transmission Access Charge. PG&E Exceptions No. 1, 2.

PG&E contends (at 12–18) that the Presiding Judge improperly limited the scope of the proceeding and excluded testimony regarding the inclusion in the

transmission Access Charge of PG&E's reliability services costs, i.e., the costs of Reliability Must-Run Units and Out-of-Market dispatches to resolve transmission limitations. The Presiding Judge ruled correctly. As the ISO argued in its Motion to Limit the Scope of the Proceeding, arguments that the Access Charge should recover these reliability services costs are beyond the scope of this proceeding because the Commission has already concluded that it is just and reasonable that these costs be recovered from PG&E's customers. In *Pacific Gas and Electric Co.*, 100 FERC ¶61,160 (2002), some parties contended that the costs should not be recovered from those outside the local area directly affected. The Commission ruled, "PG&E's transmission system is the affected system. Thus, PG&E's customers should pay these costs." *Id.* at P 16.[16] If it is just and reasonable to allocate these costs to PG&E's customers, then it is per se not unjust or unreasonable that the ISO does not allocate these costs on a grid-wide basis through the Access Charge.

Moreover, the Commission has explicitly rejected allocation of reliability services costs to customers outside a utility's former control area. In its order on rehearing in *San Diego Gas & Electric Co.*, 94 FERC ¶61,200 (2001), the Commission rejected arguments that SDG&E should charge Reliability Must-Run costs to all Loads that use its transmission facilities. The Commission explicitly stated that it would "not allow local [Reliability Must-Run] costs to be assigned to

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[16] In a footnote, PG&E contends that the references in this decision are not limited to PG&E's service area. PG&E Br. at 16. The explicit language of the Commission ruling is to the contrary.

'wheeling-out' and 'wheeling through' service for load outside the ISO Control Area." *Id.* at 61,746.

Although PG&E seeks support in the Commission's admonition to SWP in *Southern California Edison Co.,* 103 FERC ¶ 61,166 at P 7 (2003), that concerns regarding the allocation of Reliability Services costs should be directed at ISO Tariff provisions, the Commission's order does not support PG&E's arguments. The changes sought by SWP do not necessarily entail the transmission Access Charge, so the Commission's order can certainly not be considered a directive that PG&E's issue be included in this proceeding. Moreover, the ISO's transmission Access Charge proposal concerns the charges for, and recovery of, the costs of *transmission facilities*, net of certain specified Transmission Revenue Credits. PG&E's proposal is not within the scope of the ISO's proposed Access Charge amendment. If PG&E wishes to change aspects of the ISO Tariff other than those that the ISO proposes to change—particularly concerning aspects of the ISO Tariff that, as discussed above, are just and reasonable under recent Commission rulings—then PG&E's remedy is to file a complaint under Section 206 of the FPA.

VIII. The Presiding Judge Properly Rejected Vernon's Supplemental Testimony. Vernon Exceptions Nos. 1–3.

Vernon contends (at 10–14) that the Presiding Judge erred in rejecting its supplemental testimony regarding the disbursement of revenues from the High Voltage Access Charge. It asserts that it was not, and could not have been, aware that it was the only Participating TO "under-collecting" its Transmission Revenue Requirement until it received certain data responses from the ISO, and

therefore had no reason to file the testimony earlier. Vernon's lack of knowledge of its comparative recovery, however, provides no good cause for the delay. First, the disbursement methodology was public knowledge. In the filing letter accompany Amendment No. 34, the ISO stated:

> In the expectation that Vernon would join the ISO effective January 1, 2001, the ISO has been working both internally and with the Original Participating TOs in developing the necessary data and changes to the billings and settlement systems to implement the new Access Charge methodology. Indeed, the ISO would like to express its sincere appreciation for the hard work of the Original Participating TOs in this regard. In a period of immense pressure on all the California Market Participants, the Original Participating TOs devoted significant time and resources to ensuring that the new Access Charge methodology could be implemented on an aggressive schedule.

In addition, the changes in the disbursement methodology were fully explained in the filing letter:

> Appendix F, Schedule 3, Section 10: This is a new section being added to Appendix F, Schedule 3, that addresses concerns over how the ISO's disbursement of High Voltage Access Charge revenues are applied to the differences between actual loads and the filed and approved test year loads that, in connection with filed and approved High Voltage Transmission Revenue Requirements, are used in determining the ISO's High Voltage Access Charge.
> Under traditional utility-specific rate making, increased revenues associated with a utility's load growth (i.e., differences between the utility's actual load and the test-year load used to determine current rates) fully or partially offset the utility's cost increases. This revenue effect associated with load growth tends to reduce the frequency of required rate cases. If the ISO had implemented the revenue disbursement originally proposed in Amendment 27, then the excess revenue above the test year load associated with the actual revenue would have been distributed to all of the Participating TOs in proportion to their High Voltage Transmission Revenue Requirement. This would have resulted in overpayment to Participating TOs who have recently filed for rate increases and underpayment to Participating TOs that had not recently filed for rate increases. The modified revenue disbursement methodology more closely retains this relationship between revenue and load variances under traditional utility-specific rate making and should result in few changes to a Participating TO's Transmission Revenue Requirement.

Second, Vernon acknowledges that it knew it was "under-recovering" its Transmission Revenue Requirement prior to receipt of the data responses in this proceeding. Vernon Br. at 16. This is all the information Vernon needed to determine whether the provisions in question were just and reasonable; the additional data on Vernon's comparative status should not affect that result. Moreover, the "under-recovery" (or more appropriately the slight diminution of the overall benefit Vernon receives by joining the ISO) was due to Vernon's own actual Load being lower than Vernon's own test year Load approved by the Commission. To remedy this mismatch, Vernon had only to file a revision to its TO Tariff updating its Gross Load. Vernon's failure to do so cannot provide good cause for the filing of supplemental testimony for finding the methodology unjust or unreasonable.

IX. The PG&E Properly Concluded that the High Voltage Access Charge Should Not Include the Costs of All Interconnections. PG&E Exception No. 7.

PG&E advocated below an exception to the ISO's definition of High Voltage Transmission Facilities, proposing that any transmission facility that links the ISO's High Voltage bulk transmission system to another Control Area, and is used to permit transfers between the two, should be deemed high voltage regardless of its voltage rating. I.D. at P. 282. The Presiding Judge rejected PG&E's proposal, citing Staff's criticisms of the proposal. *Id.* at P. 289. PG&E takes exception to the ruling, countering Staff's arguments. PG&E Br. at 48. PG&E's rebuttal of Staff's arguments is irrelevant, however. As the ISO noted in its Initial Brief, PG&E did not demonstrate that the ISO's proposal was unjust,

unreasonable, or unduly discriminatory, ISO Initial Br. at 64; the Presiding Judge specifically found that, with one exception, the ISO's proposal was reasonable, I.D. at P. 289 There is no reason, therefore, to even consider PG&E's proposal.

X. The Presiding Judge Established an Appropriate Framework for the Consideration of the ISO's Proposal

MID takes two exceptions to the Presiding Judge's discussion of burdens of proof and the framework of her analysis. It first criticizes her citation of *Public Service Co. of Indiana, Inc*. 56 FPC ¶ 3003 (1976), *reh'g granted in part*, 57 FPC 1173 (1977). MID does not claim she misstated the holding of the ruling; neither does it point to any misapplication of the holding in her rulings. It is difficult to fathom where the alleged error lies.

Second, MID takes exception to the Presiding Judge's use of a balance of benefits and burdens as a useful framework in which to analyze the ISO's proposal. In essence, MID suggests that the ISO's proposal should be evaluated according to California legislation, A.B. 1890, which directed the ISO to establish a successor transmission Access Charge. To the contrary, the Commission's deliberations are, of course, governed by the Federal Power Act and its own precedent, to which the Presiding Judge properly adhered.

XI. The Initial Decision Does Not Disturb the Distribution of the Cost Shift Among the Original Participating Transmission Owners. SCE Exception No. 6.

The ISO's transmission Access Charge proposal provides that the Original Participating Transmission Owners will share the cost shift in a ratio of 32-32-8. Southern California Edison argues that, if the Initial Decision eliminated the 32-32-8 ratio, it erred. The ISO believes that there is no based to conclude

that the Presiding Judge intended to eliminate the sharing of the cost shift. There is no question she was fully aware of this aspect of the ISO's proposal, and that it was part of the original compromise within the ISO Board. *See* I.D. PP. 4, 120, 130, 353. Yet the Presiding Judge makes no mention of it in her ruling and provides no logical or evidentiary basis for its elimination. Accordingly, the Commission should conclude that the Presiding Judge left the proportionality mechanism intact.

Respectfully submitted,

/s/ Michael E. Ward

Charles F. Robinson, Gen. Counsel
Anthony Ivancovich
Chief Regulatory Counsel
The California Independent System Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 608-7135
Fax: (916) 351-4436

David B. Rubin
Michael E. Ward
Jeffrey W. Mayes
Counsel for the ISO
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, DC 20007-5116
Tel: (202) 424-7500
Fax: (202) 424-7643

Dated: April 29, 2004

CERTIFICATE OF SERVICE

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

Dated at Folsom, California, this 29th day of April, 2004

/s/Grant Rosenblum

Grant Rosenblum
The California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, California 95630

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