

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

City of Vernon, California)	Docket No. EL00-105-007
)	
California Independent System)	Docket No. ER00-2019-007
Operator Corporation)	

**INITIAL BRIEF OF
THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

Charles F. Robinson
General Counsel
Anthony J. Ivancovich
Senior Regulatory Counsel
Geeta O. Tholan
Regulatory Counsel
The California Independent System
Operator Corporation
151 Blue Ravine Road
Folsom, CA 95630
Tel: (916) 351-2207
Fax: (916) 351-4436

David B. Rubin
Michael E. Ward
Julia Moore
Swidler Berlin Shereff Friedman, LLP
Suite 300
3000 K Street, NW
Washington, DC 20007
Tel: (202) 424-7500
Fax: (202) 424-7643

TABLE OF CONTENTS

I.	Procedural History	1
II.	Commission Standard for Review of Vernon TRR	3
III.	TRR Issues	4
A.	The MAP and MPP Entitlements and Associated Contracts with LADWP Should be Fully Included in Vernon’s TRR for the Period from January 1, 2001 Forward	4
1.	Factual Background	4
2.	The Commission Has Established that All Integrated Network Facilities Under ISO Operational Control Should Be Included in a Utility’s Transmission Revenue Requirement	6
3.	The MAP and MPP Entitlements Were Under the ISO’s Operational Control from January 1, 2001 Onward	6
4.	The MAP and MPP Facilities Are Integrated Network Facilities	10
B.	Rate of Return	11
1.	Capital Structure	11
2.	Return on Equity	11
3.	Debt Rate	11
C.	Allowance for Funds Used During Construction (“AFUDC”).....	11
D.	Ratemaking Treatment for California Oregon Transmission Project (“COTP”)...	11
E.	Capitalized Administrative and General (“A&G”) Costs Associated with Transmission Entitlements.....	12
F.	Depreciation Rate.....	13
IV.	CONCLUSION.....	13

TABLE OF AUTHORITIES

COURT CASE

Pacific Gas and Electric Co. v. FERC.,
306 F.3d 1112 (D.C. Cir. 2002).....3

COMMISSION DECISIONS

American Elec. Power Serv. Corp.,
44 FERC ¶ 61,206 (1988), *reh’g denied*, 45 FERC ¶ 61,408, *reh’g denied*, 46 FERC ¶ 61,382
(1989).....6

California Indep. Sys. Operator Corp.,
94 FERC ¶ 62,016 (2001).....2

California Indep. Sys. Operator Corp.,
94 FERC ¶ 61,141 (2001).....2

California Indep. Sys. Operator Corp.,
94 FERC ¶ 61,148 (2001)..... 2-3

City of Azusa, et al.,
101 FERC ¶ 61,352 (2002).....3

City of Azusa, et al.,
106 FERC ¶ 61,143 (2004).....3

City of Vernon,
93 FERC ¶ 61,103 (2000).....2

City of Vernon,
94 FERC ¶ 61,344 (2001).....2

City of Vernon, et al.,
101 FERC ¶ 61,353 (2002).....3

Northeast Texas Elec. Coop., Inc., et al.,
108 F.E.R.C ¶ 61,084 (2004).....6

Pacific Gas & Elec. Co.,
104 F.E.R.C ¶ 61,226 (2003).....6

Pacific Gas & Elec. Co.,
106 F.E.R.C ¶ 61,144 (2004).....6

Pacific Gas & Elec. Co.,
108 F.E.R.C ¶ 61,297 (2004).....6

REGULATION

Designation of Electric Rate Schedule Sheets,
FERC Stats. & Regs., Regs. Preambles ¶ 31,096 (2000)2

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

City of Vernon, California)	Docket No. EL00-105-007
)	
California Independent System Operator Corporation)	Docket No. ER00-2019-007
)	

**INITIAL BRIEF OF
THE CALIFORNIA INDEPENDENT SYSTEM
OPERATOR CORPORATION**

**To: The Honorable Carmen A. Cintron
Presiding Administrative Law Judge**

The California Independent System Operator Corporation (“ISO”)¹ hereby submits its Initial Brief in this proceeding.

I. Procedural History

On June 30, 2000, the City of Vernon, California (“Vernon”) submitted to the ISO its notice of intent to turn over Operational Control of its transmission facilities and Entitlements to the ISO. On August 30, 2000, Vernon filed a Petition for Declaratory Order that the Transmission Revenue Requirement (“TRR”) approved by the Vernon City Council was acceptable for inclusion in the ISO’s transmission Access Charge (“TAC”), which would allow Vernon to become a Participating Transmission Owner (“Participating TO”),² initiating Docket No. EL00-105. Several parties filed motions to intervene and comments and/or protests of Vernon’s TRR filing.

¹ Unless otherwise defined, capitalized terms are used as defined in the ISO Tariff (Item by Ref. 2) Appendix A.

² Under the ISO Tariff, a Participating TO is defined as: “A party to the TCA...who has placed its transmission assets and Entitlements under the ISO’s Operational Control in accordance with the TCA.” Item by Ref. 2 at Original Sheet 338. As a Participating TO, Vernon is reimbursed by the ISO for the transmission assets it turns over to ISO Operational Control based on its TRR through the TAC.

On October 27, 2000, the Commission issued an order finding Vernon's proposed rate methodology and resulting TRR, as modified, to be just and reasonable. *City of Vernon*, 93 FERC ¶ 61,103 (2000). The modifications required by the Commission were designed to bring Vernon's rate methodology more in line with that of Southern California Edison ("SCE"). 93 FERC at 61,285. Vernon made a filing in compliance with this order on November 9, 2000. The Commission issued an order accepting Vernon's compliance filing as it related to Vernon's TRR on March 28, 2001. *City of Vernon*, 94 FERC ¶ 61,344 (2001).

On November 1, 2000, the ISO filed an Application to Transfer Operational Control Over Non-Jurisdictional Transmission Facilities under Section 203 of the Federal Power Act in Docket No. EC01-14-000. In this filing, the ISO sought authorization for the transfer of Operational Control of Vernon's facilities effective January 1, 2001. The Commission approved transfer of Operational Control of Vernon's transmission facilities and Entitlements by order issued on January 9, 2001.³

On December 21, 2000, the ISO filed a revised Transmission Control Agreement ("TCA") between the ISO, the existing Participating Transmission Owners (Pacific Gas and Electric Company, San Diego Gas & Electric Company, and SCE), and Vernon in Docket No. ER01-724.⁴ The Commission accepted the TCA by order issued February 21, 2001.⁵

Several parties requested rehearing of the October 27 Order approving Vernon's TRR. The Commission issued an order denying rehearing on February 21, 2001. *California*

³ *California Independent System Operator Corp.*, 94 FERC ¶ 62,016 (2001) ("January 9 Order"). The ISO filed a letter on February 28, 2001, informing the Commission that the transfer of Operational Control had been consummated effective January 1, 2001.

⁴ The TCA as executed by Vernon has been identified as Item by Ref. 3. Because the Commission directed the ISO to re-file the TCA in a format consistent with Order No. 614, *Designation of Electric Rate Schedule Sheets*, FERC Stats. and Regs., Regs. Preambles ¶ 31,096 (2000), this document is dated March 23, 2001 (the date of this re-filing). It nonetheless is substantively the same as that filed on December 21, 2000.

⁵ *California Independent System Operator Corp.*, 94 FERC ¶ 61,141 (2001).

Independent System Operator Corp., et al., 94 FERC ¶ 61,148 (2001).⁶ The October 27 Order was then appealed to the Court of Appeals for the District of Columbia Circuit (“DC Circuit”). On October 15, 2002, the DC Circuit remanded the proceeding to the Commission for an explanation of the standard that the Commission would apply when reviewing the revenue requirement of a non-jurisdictional entity (*i.e.*, Vernon) to be included in a rate of a jurisdictional entity (such as the ISO) to ensure that the jurisdictional entity’s rates will be just and reasonable under section 205 of the Federal Power Act. *Pacific Gas and Electric Company v. FERC*, 306 F.3d 1112 (D.C. Cir. 2002). On December 23, 2002, the Commission issued an order on remand initiating settlement proceedings. *City of Vernon, et al.*, 101 FERC ¶ 61,353 (2002).⁷

Settlement proceedings with regard to Vernon were unsuccessful, and the Commission established hearing procedures on Vernon’s TRR by order issued February 17, 2004. *City of Azusa, et al.*, 106 FERC ¶ 61,143 (2004). On February 23, 2004, the Chief Administrative Law Judge issued an order severing the Vernon proceeding from those involving the Southern Cities and assigning the Vernon proceeding to Presiding Administrative Law Judge Carmen A. Cintron for hearing and decision.

The hearing was held from September 21 through September 27, 2004.

II. Commission Standard for Review of Vernon TRR

The ISO takes no position on this issue.

⁶ This order related to requests for rehearing in both the EL00-105 docket and the TAC docket, ER00-2019.

⁷ Also on December 23, 2002, the Commission issued an order consolidating the proceeding with similar proceedings involving the cities of Anaheim, Azusa, Banning, and Riverside, California (“Southern Cities”). *City of Azusa, California, et al.*, 101 FERC ¶ 61,352 (2002).

III. TRR Issues

A. The MAP and MPP Entitlements and Associated Contracts with LADWP Should be Fully Included in Vernon's TRR for the Period from January 1, 2001 Forward

1. Factual Background

As described by, *inter alia*, Staff witness Edward Gross, Vernon has certain Entitlements on the Mead-Adelanto Project ("MAP") and the Mead-Phoenix Project ("MPP"), together with certain associated contracts with the Los Angeles Department of Water and Power ("LADWP"). Ex. No. S-16 at 5-6. Vernon witness Mohammed Beshir further explains that the MAP consists of a 202-mile 500 kV line between Marketplace and Adelanto Substations and associated facilities, and the MPP consists of a 260-mile 500 kV line between the Westwing and Marketplace Substations with a tie at the Mead Substation and associated facilities. Ex. No. VER-39 at 5. The MAP and MPP transmission facilities are outside of the ISO Control Area (Ex. No. ISO-1 at 6; Ex. No. S-16 at 6), and, as such, they presented certain challenges to the ISO in making them a part of the ISO Controlled Grid, as they were not part of the initial network model.⁸

For example, unlike the case of facilities inside the ISO Control Area, or those ISO Controlled Grid facilities previously modeled outside the ISO Control Area, for the ISO to schedule transactions on the MAP and MPP Entitlements through the ISO's Scheduling Infrastructure or "SI", it is necessary for the ISO to develop software to establish Scheduling Points at the nexus of for the MAP and MPP Entitlements and LADWP contracts with the ISO Control Area. This is the result of the radial branch group methodology employed by the ISO for

⁸ The software system used by the ISO's Scheduling Coordinators to schedule use of the ISO Controlled Grid automatically.

transactions on lines outside the ISO Control Area. Branch groups terminate initiate at Scheduling Points. Ex. No. ISO-1 at 6. The radial branch group methodology is described in Ex. No. ISO-2.

Although the ISO had intended to create Scheduling Points for the MAP and MPP Entitlements upon assuming Operational Control of the Entitlements, and took actions preparatory to creating such Scheduling Points (Ex. No. ISO-1 at 6), the ISO was forced to delay the creation of such Scheduling Points due to the California Energy crisis, which placed great demands and an increased workload on ISO employees. As Ms. Le Vine described, ISO personnel had all they could do to fulfill their primary mission of keeping the lights on during the period surrounding Vernon's joining the ISO. Ex. ISO-1 at 6; Tr. 529, 566. Nonetheless, the ISO intended to develop the Scheduling Points once the ISO had the opportunity to devote attention to them. As Ms. Le Vine testified, the ISO believed that at any point during the two-year disputed period between January 1, 2001 and December 31, 2002, it would have taken the ISO about three months to establish Scheduling Points. Tr. 579-80.

A further cause for delay in establishing the Scheduling Points was the anticipated addition of other New Participating TOs for whom Scheduling Points in the same area would need to be developed.⁹ Due to the nature of the radial branch group scheduling model, it was reasonable for the ISO to wait until these entities turned over Operational Control of their shares of relevant facilities prior to developing modeling for Vernon's Entitlements on a stand-alone basis. It was simply more efficient to design a model and Scheduling Points looking at these facilities as a whole than to try to do so in a piecemeal fashion, once it became clear that the Southern Cities also would be joining the ISO. For these reasons, Scheduling Points for the

⁹ The then-anticipated Participating TOs (who have now indeed joined the ISO) were the Southern Cities.

Vernon Entitlements were not operational until January 1, 2003, the date on which the Southern Cities joined the ISO. Tr. 569; 580.

2. The Commission Has Established that All Integrated Network Facilities Under ISO Operational Control Should Be Included in a Utility's Transmission Revenue Requirement

The Commission has established clear criteria governing the determination of whether facilities of a Participating TO should be included in its TRR. In Opinion No. 466,¹⁰ the Commission held that “[t]he relevant question now is simply whether operational control of the facilities was transferred to the ISO. If control was turned over, the facilities should be included in the [TRR].” Opinion No. 466 at P 13. Opinion No. 466-A¹¹ revised that determination in part, holding that “issues relating to the utilities’ Transmission Revenue Requirements would be resolved in their individual tariff filings,” Opinion No. 466-A at P 10, and that only integrated network facilities were eligible for inclusion in the TRR, Opinion No. 466-A at P 22.¹² In Opinion No. 466-B, the Commission elaborated on this point by stating that “ ‘any degree of integration is sufficient’ ” to justify rolled-in rate treatment.¹³ As discussed in greater detail below, this test has been satisfied.

3. The MAP and MPP Entitlements Were Under the ISO's Operational Control from January 1, 2001 Onward

¹⁰ *Pacific Gas and Electric Co.*, Opinion No. 466, 104 FERC ¶ 61,226 (2003).

¹¹ *Pacific Gas and Electric Co.*, Opinion No. 466-A, 106 FERC ¶ 61,144 (2004).

¹² The ISO notes that no party to this proceeding argues that the MAP and MPP facilities are not an integrated part of the grid.

¹³ *Pacific Gas and Electric Co.*, Opinion No. 466-B, 108 FERC ¶ 61,297 (2004) at P 19, quoting *Northeast Texas Electric Cooperative, et al.*, Opinion No. 474, 108 FERC ¶ 61,084, at P 48 & n.66 (2004) (emphasis supplied by Order No. 466-B), citing *American Electric Power Service Corp.*, Opinion No. 311, 44 FERC ¶ 61,206 at 61,478 (1988), *reh'g denied*, Opinion No. 311-A, 45 FERC ¶ 61,408 (1988), *reh'g denied*, Opinion No. 311-B, 46 FERC ¶ 61,382 (1989).

The ISO Tariff defines Operational Control as:

The rights of the ISO under the Transmission Control Agreement and the ISO Tariff to direct Participating TOs how to operate their transmission lines and facilities . . . for the purpose of affording comparable non-discriminatory transmission access and meeting Applicable Reliability Criteria.

ISO Tariff Appendix A, Master Definition Supplement, at Third Revised Sheet No. 336.

The ISO thus obtains Operational Control through the TCA. As described in the Direct Testimony of Vernon witness Baker Clay (Ex. No. VER-7 at 16-17), Vernon filed a Petition for Declaratory Order for approval of its proposed TRR on August 30, 2000, initiating the instant proceeding. Vernon then executed the TCA, through which Vernon became a Participating TO. As described by ISO witness Deborah Le Vine,

The Transmission Control Agreement is the agreement executed by all Participating Transmission Owners (“Participating TOs”) and the ISO to establish the relationship between the ISO and the Participating TOs with respect to Operational Control, interconnections, maintenance and outage coordination, and information regarding the transmission facilities and Entitlements of those Participating TOs.

Ex. No. ISO-1 at 4. As further explained by Ms. Le Vine, the Commission accepted the TCA executed by Vernon on February 21, 2001, effective January 1, 2001. Ex. No. ISO-1 at 4; Tr. 571. Included in the TCA Appendix listing the facilities being turned over to ISO control were its interests in the MAP, the MPP, and associated contracts with LADWP.

As described above, Vernon turned its interests in MAP and MPP over to the Operational Control of the ISO effective January 1, 2001, through a Section 203 filing made in Docket No. EC01-14. The Commission accepted the transfer of Operational Control in the January 9 Order. Also in the January 9 Order, the Commission directed the ISO to notify the Commission when the disposition of the jurisdictional assets was consummated. The ISO filed a letter on February 28, 2001, duly notifying the Commission that this had taken place as of January 1, 2001.

In short, Vernon took every legally necessary step to turn the relevant Entitlements over to the ISO's Operational Control, just as it did with regard to the rest of its transmission facilities, and the ISO took every legally necessary step for assuming such Operational Control effective January 1, 2001.

Operational Control as defined by the ISO Tariff involves rights and authority. Operational Control does not require that ISO personnel personally push buttons or turn switches on Vernon facilities. It would not be possible for the ISO to exercise control in this manner, particularly on facilities outside the ISO Control Area, nor would it be desirable. Ms. Le Vine's testimony describes that for facilities outside the ISO Control Area, such as Vernon's MAP and MPP Entitlements, Operational Control consists largely of coordinating schedules and outages with the applicable Control Area Operator, in this case, LADWP. Ex. No. ISO-1 at 5. Operational Control, as explained by Ms. Le Vine, is *the right* to direct the actions of Vernon in these matters. As evidenced by the ISO's response to Staff-ISO-1, included in the record as Ex. No. S-17:

The critical factor is that effective January 1, 2001, the ISO had the right at all times to direct the scheduling and outage coordination on the MAP and MPP. As a result, the ISO at all times had Operational Control of that capacity. As explained in Data Responses SCE-ISO-25 through SCE-ISO-32, external factors delayed the ISO's establishment of the software and mechanism necessary for the ISO to implement the scheduling rights provided by Vernon turning over Operational Control to the ISO.

Throughout the disputed period from January 1, 2001 through December 31, 2002, the ISO at all times had the authority to direct Vernon as to how to schedule its Entitlements. Ms. Le Vine testified that "The ISO Tariff definition of Operational Control relies upon the ISO's authority to use the lines, and is not affected by a temporary obstacle to that use." Ex. No. ISO-1 at 7.¹⁴

¹⁴ Although there was discussion on the record as to what constitutes a "temporary" obstacle, as discussed above, the ISO estimated that it would have taken three months to establish the necessary Scheduling Points once

The ISO's legal authority to schedule on MAP and MPP also means that arrangements could have been made for Market Participants to use those lines if there had been any demand. There was none. Ms. Le Vine presented evidence – which remains unchallenged – that *no* Market Participants requested access to the Vernon Entitlements during the time before the Scheduling Points were established. As noted by Vernon witness Mr. Clay, “[t]here is no testimony that any Market Participant had unfulfilled requirements because of the lack of scheduling points, or any quantification of damages from any alleged discrimination.” Ex. No. VER-16 at 23. This is true in spite of the fact that Market Participants were on notice that the facilities were being turned over to ISO Operational Control – through Vernon's initial notice of intent to become a Participating TO submitted on June 30, 2000, through Vernon's TRR filing and the TCA filing; through numerous Market Notices sent out by the ISO regarding ISO Governing Board meetings held to discuss Vernon's joining the ISO, etc. Tr. 528-29. As Ms. Le Vine points out, “It's not that California was blind to all this going on.” Tr. 528. Thus, although Market Participants were on notice that the MAP and MPP facilities had been transferred to the ISO, and the ISO had “the ability to schedule on it if so desired . . . there was no squeaky wheel. Nobody asked to schedule on it.” Tr. 572.

SCE witness James Cuillier argues that TRR recovery depends on the mere opportunity for a Market Participant to use the facilities in question – whether or not the Market Participant had any desire or need to do so. In his view, the fact that no Market Participant asked to use the facilities between January 1, 2001 and December 31, 2002 has no bearing on whether Vernon should recover. In fact, Mr. Cuillier stated that his opinion would remain the same even if no Market Participant desired to use the facilities *since* January 1, 2003 – *i.e.*, the period for which

software design had commenced. Tr. 579-80. It would be hard to dispute that a delay of three months would be anything other than a “temporary” delay.

the Scheduling Points are available. Tr. 867. Thus, in SCE's view, the mere *opportunity* to use the lines, regardless of whether a single Market Participant took advantage of this opportunity, is the *sine qua non* of including their costs in the TRR for the period prior to January 1, 2003.

While it is certainly true that the ISO, consistent with Good Utility Practice, had discretion to exercise the scheduling rights it had with regard to the Entitlements (Tr. 530), it is also true that "the squeaky wheel gets the grease", and Ms. Le Vine testified that should any Market Participant have expressed its desire to schedule on the Entitlements, the ISO would have focused its efforts on accommodating them, whether it required commencing the three-month period necessary to establish new Scheduling Points, developing a manual work-around, or even filing a tariff amendment with the Commission. Tr. 581-82. The fact remains that nobody asked. Tr. 527-28; 581.

In short, the ISO, in fact, assumed Operational Control of these facilities. The fact that the manner in which this Operational Control was exercised was by allowing Vernon to carry on scheduling the line due to the exigencies of the California Energy Crisis and the anticipation of a more efficient means of creating Scheduling Points once the Southern Cities joined the ISO in no way undermines the ISO's Operational Control. The analogy of the auto dealership raised with Staff witness Mr. Gross (Tr. 1091-92) is quite apt. While it is true that in the typical case, a person buying a new car secures title by driving it off the lot, it is also possible to secure the title by delegating an agent (in this analogy, a chauffeur) to drive the car off the lot on one's behalf. There would be no dispute that the car had changed from the dealer's hands to those of the new owner in such a case, just as the ISO assumed Operational Control of the MAP and MPP Entitlements from Vernon while still allowing Vernon temporarily to schedule the lines.

4. The MAP and MPP Facilities Are Integrated Network Facilities

Staff witness Mr. Gross argued that, under Opinion No. 466-A, in order for a Participating TO's facilities to be included in its TRR, and hence in the ISO's TAC rates, "some benefits must be demonstrated". Ex. No. S-16 at 10, citing Opinion No. 466-A at PP 23-25. Mr. Gross misstates Opinion No. 466-A. The portion of the Opinion referenced by Mr. Gross discusses the criteria for characterizing facilities as integrated, and notes that in order to be considered integrated, and hence suitable for inclusion in the TRR, facilities must provide a network transmission (as opposed to purely generation) function. The Commission reiterated this criterion in Opinion No. 466-B. There is no question in this proceeding that the MAP and MPP Entitlements serve a transmission function.

B. Rate of Return

1. Capital Structure

The ISO takes no position on this issue.

2. Return on Equity

The ISO takes no position on this issue.

3. Debt Rate

The ISO takes no position on this issue.

C. Allowance for Funds Used During Construction ("AFUDC")

The ISO takes no position on this issue.

D. Ratemaking Treatment for California Oregon Transmission Project ("COTP")

The ISO takes no position on this issue.

E. Capitalized Administrative and General (“A&G”) Costs Associated with Transmission Entitlements

The ISO takes no position on this issue.

F. Depreciation Rate

The ISO takes no position on this issue.

IV. CONCLUSION

For the reasons set forth above, the ISO respectfully requests that the Presiding Judge issue an Initial Decision adopting the positions set forth herein.

Respectfully submitted,

Charles F. Robinson	<u>/s/ Julia Moore</u>
General Counsel	David B. Rubin
Anthony J. Ivancovich	Michael E. Ward
Senior Regulatory Counsel	Julia Moore
Geeta O. Tholan	Swidler Berlin Shereff Friedman, LLP
Regulatory Counsel	Suite 300
The California Independent System	3000 K Street, NW
Operator Corporation	Washington, DC 20007
151 Blue Ravine Road	Tel: (202) 424-7500
Folsom, CA 95630	Fax: (202) 424-7643
Tel: (916) 351-2207	
Fax: (916) 351-4436	

Dated: October 25, 2004

CERTIFICATE OF SERVICE

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

Dated at Folsom, CA, on this 25th day of October, 2004.

/s/ Geeta O. Tholan _____
Geeta O. Tholan