

MEMORANDUM

TO: Nancy Rader, CalWEA
FROM: Scott Hempling, Law Offices of Scott Hempling, P.C.
DATE: July 11, 2005
RE: Thoughts on FERC's Antelope Decision

This memorandum discussed the FERC's decision on SCE's request for favorable rate treatment of the Antelope Project upgrades.¹

Part I provides an overview of the FERC decision.

Part II contains my comments on the decision.

Part III contains my comments on the concurrence of Commissioner Brownell.

Part IV offers suggestions for next steps.

An **Appendix** contains descriptions of the three upgrade segments at issue.

I. Overview of Decision

In this case, SCE asked FERC to "roll in" to its transmission rates the cost of the Antelope Project.² The Antelope Project consists of three upgrades to SCE's transmission system. SCE labels these upgrades Segment 1, Segment 2 and Segment 3.³

In addition to roll-in, SCE sought, for all three segments, FERC's commitments for full recovery of prudently-incurred costs, regardless of whether potential wind generation develops or SCE abandons or cancels one or more of the segments. SCE sought this commitment because FERC has a precedent requiring a utility to bear half the prudent cost of a project where the project is abandoned or canceled due to lack of demand. The intent of this policy is to assure that utilities manage their business risks carefully rather than view the ratepayer as the guarantor of all cost recovery.

¹ *Southern California Edison Company*, "Order on Petition for Declaratory Order," Docket No. EL05-80-000, 112 FERC para. 61,014 (July 1, 2005).

² "Roll-in" is the term of art used to describe the inclusion of particular costs in the cost of service used to set a utility's rates. In the context of upgrades caused by interconnecting generators, the opposite of "roll-in" is "direct assignment." Direct assignment means the interconnecting generator pays for the upgrade; "roll-in" means that all transmission users (including the interconnecting generator or its customer) pay for the upgrade.

³ These three segments are described in the Appendix to this memorandum.

A. Segments 1 and 2

FERC approved roll-in because the upgrades are integrated with, and operate in parallel with, the transmission network. FERC stated (para. 36, citing SCE's affidavit submitted by Jorge Chacon):

"36. Segments 1 and 2 are upgrades to existing, high-voltage, network transmission facilities or upgrades that will operate in parallel with existing high-voltage, network transmission facilities and these two segments will be transmission facilities that can be fully integrated with the CAISO-Controlled Grid when constructed and placed under CAISO Operational Control."

"37. Segment 1 includes a new 25.6 mile 500 kV transmission line between the existing Antelope and Pardee substations, single and double circuit towers that will be energized initially at 220 kV, and an expansion of the Antelope substation to accommodate the new 500 kV rating. Segment 2 includes a new 17.8 mile 500 kV transmission line between the existing Antelope and Vincent substations and upgrades such as transformers, circuit breakers, and disconnect switches necessary at both substations to terminate the new transmission line. These two segments are not radial in nature, and will be part of the looped transmission system where the energy would flow from their substations (from Antelope to Pardee substations for Segment 1 and from Antelope to Vincent substations for Segment 2), but can be reversed depending on the season and the generation on line. These new facilities will be integrated with the existing Big Creek 220 kV corridor and the available capacity of these facilities will be used for multiple purposes, e.g., serve load and increase transfer capacity for existing generation facilities."

"38. According to SCE, Segments 1 and 2 will provide additional benefits to the transmission grid; for example, they will increase the transfer capability, eliminate or mitigate thermal and transient stability problems under certain conditions, and can be relied upon for CAISO scheduling purposes. No other party disputes this assertion. In addition, the CAISO will be able to provide service to Participating Transmission Owners as well as other transmission customers over the two segments. Segments 1 and 2 will provide capability and reliability benefits to the transmission grid and could be relied on for coordinated operation of the grid. Therefore, we find that Segments 1 and 2 are network upgrades, the costs of which are discussed further below, and may be recovered through SCE's TRR."

FERC promised that there will not be a prudence disallowance if there is cancellation or abandonment should sufficient wind generation not appear. Para. 58 ("We will, however, grant

SCE's request and allow it to recover 100 percent of the prudent cost (as discussed above) of Segments 1 and 2 even if these facilities are abandoned or cancelled.").

FERC deferred ruling on whether the size of Segments 1 and 2 is prudent; SCE can re-ask for this ruling after it obtains a certificate of convenience and necessity from the California PUC. See para. 57:

"... The CPUC has not completed its review for the certificate(s) of public convenience and necessity. Nor has the CAISO, as regional system operator, weighed in on all aspects of this project. Accordingly, we will defer on the issue of advance prudence with regard to the appropriate sizing of Segments 1 and 2 until after the CPUC has granted SCE the necessary certificate(s) of public convenience and necessity" (also noting, in n.43, that "SCE is not seeking an advance prudence call on the actual cost of the Antelope Project")."

B. Segment 3

FERC denied all of SCE's requests because the facility is a gen-tie which does not benefit the network. FERC expressly relied on SCE's own statements:

Given the information provided by SCE, we find that Segment 3 is not a network upgrade and therefore, not eligible for rolled-in rate treatment. Further, as noted by various intervenors, these appear to be generation-tie facilities, and our precedent has been that it would be improper to shift the costs of such facilities from the interconnection customers to all users of the transmission grid. In addition, SCE has neither shown that all users of the CAISO-Controlled grid will receive the benefits of these facilities nor how Segment 3 will provide benefits to the grid. We also do not have a determination from CAISO on whether these facilities should be transferred to its Operational Control."

Para. 42 (emphasis added). The "information provided by SCE" included (as summarized by FERC):

[para. 22] "SCE characterizes Segment 3 as a generation-tie line, the cost of which is ordinarily paid by interconnecting generators. However, it contends that such a policy is a barrier to entry for wind resources located in remote areas for several reasons: (1) the large capital outlays are not feasible and add unacceptable financial risk; (2) incremental transmission upgrades based on first-in-queue is ineffective for locations where renewable resources tend to locate; and (3) clustering of interconnection applications to have jointly-owned or jointly-funded transmission upgrades is unlikely."

[para. 24] "SCE says that the lines and substations are high voltage (initially operated at 220 kV, with an actual rating of 500 kV), will reach approximately 35

miles from the last point on the existing 220 kV grid to the second new substation, and will extend the grid to a large concentration of potential renewable resources from the Tehachapi region that the CPUC has found necessary to meet the state's renewable procurement objectives."

[para. 40] ... "[T]o take advantage of economies of scale, SCE has designed the Segment 3 facilities to serve the multiple interconnection customers that may develop generation projects in the Tehachapi area. And, although Segment 3 facilities are high voltage facilities, they do not operate in parallel with existing transmission facilities."

FERC then added, at n.33:

"We note that SCE has stated that if the Commission does not allow recovery of the cost of the Antelope Project in general transmission rates, the CPUC is to allow SCE to recover the reasonable transmission costs in retail rates. Cal.Pub.Util.Code sec. 399.25(b)(2)."⁴

II. Comments on the Decision

A. Segments 1 and 2

FERC promised not to penalize SCE by disallowing costs in case of abandonment or cancellation. FERC here used its legal flexibility to help wind without committing legal error. FERC could have said "let's wait until cancellation or abandonment occurs and then see what the facts were." FERC had no obligation to grant SCE's request. FERC precedent in fact requires the utility to absorb half the cost of abandonment or cancellation. But FERC interpreted this precedent flexibly. The reason why FERC has historically held a utility 50% accountable for abandonment or cancellation is that these decisions are within the utility's control, and FERC

⁴ This footnote is odd (separate from mis-citing the relevant provision, which is sec. 399.25(b)(4)). It has no legal relevance. Whether the Federal Power Act allows recovery from transmission ratepayers is legally unaffected by state law. Under the FPA, transmission ratepayers pay for an upgrade if they receive benefits from it upgrade. FERC found there are no transmission ratepayer benefits from the upgrade; therefore they cannot be forced to pay for it. State law has nothing to do with it.

wants utilities to exercise control carefully, sharing risks with its customers. Here, SCE correctly argued, and the FERC correctly agreed, that the reasons for cancellation or abandonment would be outside the utility's control. The reasons would include generators not appearing in sufficient number, or appearing and then disappearing.

Since the events leading to a decision to abandon or cancel would be outside the utility's control, FERC granted SCE's request to be insulated from the traditional 50% cost disallowance.

Contrast FERC's reasoning with interest group arguments made by some intervenors. Had FERC said "we're granting SCE's request because we want to help renewables," FERC would have committed legal error. Outside of PURPA, FERC has no legal authority to single out a form of electric generation for special treatment.⁵ Instead FERC stuck with its non-renewables precedent but used a legitimate opening.

The size of the facility gave FERC pause. See para. 57. FERC cannot award a blank check. The FPA does not allow FERC to make transmission ratepayers pay for a facility of any size, just because the state of California orders that size. FERC has an independent obligation to assure that transmission ratepayers are not paying for more facility than they need. It is one thing to say that an upgrade stimulated by an interconnecting generator will increase reliability and therefore benefit all transmission users; it's another thing to make transmission customers pay for more capacity than is needed by the full load. FERC therefore withheld full approval until the PUC issues a certificate of public convenience and necessity. Para. 57. This statement does not mean that FERC will necessarily approve all costs just because the PUC has granted the certificate; it means that FERC wants to see a full record supporting the size before acting. CalWEA should therefore consider participating in the CPCN proceeding to ensure that this record is provided.

B. Segment 3

On Segment 3, SCE left FERC unable to show flexibility.

To the extent FERC looked only at SCE's submission and forgot about CalWEA's, FERC's decision was correct, and easily predictable. There is no budging on the principle that transmission rates can reflect only those investments that benefit the transmission ratepayer. Once SCE characterized Segment 3 as performing only a gen-tie function, as a non-network

⁵ It is true that FERC is trying to make transmission costs more reasonable for intermittent power: but FERC's legal technique for doing so -- the right technique -- is not "we like renewables" but "we are not going to allow transmission owners to impose penalties on intermittency which are excessive in relation to the effects of intermittency. In other words, FERC continues to focus on assigning costs fairly. The benefit to wind from FERC's intermittency decisions is that FERC stepped in rather than leave the matter to transmission providers who were less committed to resolving the problem.

facility not integrated with the grid, there was no way for FERC to avoid denying the request for roll-in. For the many opponents of SCE's filing, SCE's submission made defeating us on Segment 3 a simple matter of quoting SCE. It then took FERC exactly one paragraph to explain itself.

FERC cannot lawfully assign to transmission customers any costs which do not produce benefits for those costs. This principle is not arguable or negotiable. FERC's powers are limited by statute. Transmission rates must be just and reasonable. Courts have found that rates are not just and reasonable if they include costs which are not associated with benefits to the ratepayer.

When we talk of benefits to the ratepayer, we are talking about the ratepayer buying the service at issue -- here, transmission service. It makes no difference to the transmission ratepayer -- in his role as transmission ratepayer -- that the state is attracting more generation or increasing the diversity of that generation. These concerns are not Federal Power Act concerns.

There is no lawful way to create a "third category," as SCE sought to do. Under the Federal Power Act, there are only two categories of facility: the facility either benefits the network or it does not. The unmovable principle is that you cannot make transmission ratepayers pay for something unless it gives them benefits. Yes, there can be multiple ways to show network benefits. But there must be network benefits: otherwise, no roll-in. To say "there are no network benefits but there are plenty of other reasons to charge transmission ratepayers" is asking FERC to do the legally impossible.

The only way for a roll-in argument to have survived SCE's submission was for FERC to disregard it, in favor of an alternative submission. That was the purpose of CalWEA's submission of Whit Russell's affidavit, explaining the network benefits of Segment 3.

III. Comments on the Concurrence of Commissioner Brownell

Comm. Brownell's concurrence asserts that the proposal would have greater chance of success if the proposal comes from the CA ISO, using Order 2003's "independent entity" variation. If the CA ISO takes this route, the CA ISO should explain that Segment 3 will provide network benefits of the type typically required by FERC as a prerequisite for roll-in. Otherwise, we are likely to see a repeat of FERC's initial rejection.

The majority rejected SCE's submittal not because SCE is a non-independent transmission provider, but because the submittal disclaimed any network benefits. The majority's brief explanation of its rejection said nothing about independent vs. non-independent status.

Comm. Brownell's concurrence does not address the network benefits problem. The concurrence states that these facilities were not envisioned by Order 2003, in that they are sized in advance to accommodate multiple generators. It describes this type of a facility as a "multiple-use on-ramp to the CAISO Grid, rather than as sole-use interconnection facilities." This description does not rescue the facility from the majority opinion, which rejects roll-in because the benefits of the line are not network benefits. That more than one generator uses the line, and that the advance construction and financing of the line is "beyond the means of any one developer," does not respond to the majority's view (which itself is supported by decades of FERC and court opinions) that roll-in requires benefits to the transmission network, not to the interconnecting generators.

Recognizing the necessity of network benefits, the concurrence makes this attempt to save Segment 3:

"Segment 3 facilities would provide benefits to all users of the CAISO Grid by creating the potential to interconnect significant new and diverse supplies of energy. Therefore, I believe that this proposal would have satisfied the independent entity variation standard in Order No. 2003, had it been made by the CAISO...."

This passage has two problems. First, it does not distinguish this facility from any non-integrated gen-tie. Any gen-tie interconnects new generation; but an interconnection role alone does not create network benefits. For network benefits to exist, the transmission ratepayer must benefit in his role as a transmission customer, not in his role as a power customer.

Second, the next sentence does not follow from the first. The second sentence implies that the interconnection of new generation somehow interacts with independent entity status to support roll-in. But as discussed above, the ability to roll-in depends on network benefits; roll-in has nothing to do with independent status. FERC created the independent entity variation option because independent entities have no incentive to discriminate. See Order 2003 at para. 822 ("RTO or ISO should be treated differently because an independent RTO or ISO does not raise the same level of concern regarding undue discrimination."). The discrimination of concern to FERC was discrimination by a generation-owning transmission provider against independent generators. Here, SCE is seeking to have its own ratepayers bear costs that generators might otherwise provide. SCE's proposal does not involve discrimination against generators. The independent entity standard has nothing to do with this matter (as evidenced by the absence of any mention of the issue in the majority's decision).

Conclusion: Since the independent-nonindependent distinction had no effect on the majority's decision (nor should it have, because roll-in depends on network benefits, not on who controls the line), it is necessary for the CA ISO, if it does make the refiling, to adjust the Segment 3 plan so that network benefits are clear. Moreover, the "independent entity variation" is not available to shift non-network costs from generators to transmission customers. The requirement that transmission customers bear costs only to the extent those costs benefit the

network is rooted in the FPA's "just and reasonable" requirement. The flexibility granted by Order 2003 to independent entities cannot violate that standard.

IV. Possible Next Steps on Segment 3

There are three possible ways to pay for Segment 3: transmission ratepayers, retail ratepayers, and interconnecting generators.

A. Transmission ratepayers

Allocating Segment 3 costs to transmission ratepayers requires a FERC decision. FERC can make this decision only if it finds benefits to transmission ratepayers. FERC will make that finding only if it views Segment 3 as integrated with the transmission network. Having read only SCE's position on this point, FERC adopted SCE's view that Segment 3 is non-network.

CalWEA's submission possibly can solve this problem. Our filing included an affidavit from engineer Whit Russell. The affidavit sought to create a factual basis for a finding that Segment 3 would be integrated with the network. FERC appears to have misplaced CalWEA's filing. Although it listed CalWEA along with the other intervenors, it did not summarize our positions although it summarized the positions of others. FERC opinions always summarize the unique positions of each intervenor. We should seek rehearing for purposes of having the Commission take our affidavit into account. If we do seek rehearing, by statute we must do so no later than August 1, 2005.

It would be better, however, to have SCE (and its witness Jorge Chacon) (or the CA ISO) adopt some version of Whit's views. FERC will have difficulty accepting our position because it has already gone on record accepting SCE's position. Our opponents will argue in Court that FERC changed its mind arbitrarily. If it's SCE that modifies its position, we have a better shot. SCE's modification would take the form of a revised application. It could submit this revised application in two possible ways: (a) in the present proceeding, as a petition for rehearing (due 30 days after FERC's order); or (b) by initiating a new proceeding. If SCE chose (a), and if the modifications were substantial, FERC likely would issue a new public notice allowing new interventions and opportunities for comments.

My recommendation is to try to persuade SCE and Mr. Chacon that they are looking too narrowly at the FERC criteria for network treatment. It is not a black-white situation, i.e., gen-tie v. network. Although there is not clear precedent, I think we can fairly argue that a facility can have a gen-tie role but also play an integration role. But we need SCE (or the CA ISO) to agree to help, rather than offer arguments which FERC cannot legally accept, ever.

What we should not do is repeat arguments that are legally irrelevant. The following arguments, as paraphrased below by FERC, invite FERC to reject Segment 3 again, using

language that will be unhelpful in the future. These arguments also expose, and emphasize, the absence of evidence from SCE that Segment 3 has network benefits.

[para. 23] "... SCE suggests creating a new "narrow and specific category of transmission facilities," i.e., trunk facilities that would include projects like Segment 3. SCE argues that the costs of high-voltage (220 kV or higher) trunk facilities to interconnect and integrate large concentrations of potential renewable generation resources located in a limited geographic area, but a reasonable distance from the existing grid, should be eligible for rolled-in rate treatment. SCE suggests that this new policy should apply where it is consistent with a state's requirement to procure energy from renewable resources and where the state has determined, through its state regulatory authority or RTO/ISO, that the upgrades are necessary to meet its policy objectives."

[para. 25] "[T]he Segment 3 trunk facility will not be unduly discriminatory because the new category of facilities is narrowly crafted to further federal and state policies that encourage the development of renewable energy and to remove a roadblock to the construction of needed transmission. SCE notes that other states have enacted renewable portfolio standards mandating goals for the purchase of renewable energy and providing tax incentives and siting assistance. SCE also claims that the Commission has recently approved exceptions to its existing policies for intermittent renewable resources to "increase diversity in the resource base, [and] thereby improv[e] system reliability as a whole." Moreover, it points to the Commission's recently initiated proceeding in Assessing the State of Wind Energy in Wholesale Electricity Markets, Docket No. AD04-13-000, to assess options to reform transmission access for intermittent renewable resources like wind. Additionally, SCE asserts that the Commission has previously held that similar exceptions are not unduly discriminatory."

[para. 26] "SCE understands that the Commission's policy is designed to encourage efficient siting of generation resources, but renewable energy developers must locate at the site of the resource and do not have the same flexibility as other generators about location."

We need to discourage our allies from making these arguments. They have no footing in the Federal Power Act. We also need to discourage the PUC from attacking FERC for "insensitivity to the states' needs," or "insensitivity to renewable energy" or any similar argument that sometimes emanates from state commissions. FERC has no legal authority -- none -- to make transmission ratepayers pay for non-network costs in the name of "deference to states" or "support for renewables." It is possible that those making these arguments are viewing FERC as a political body that responds to interest groups. I cannot make the following statement more clear: Although FERC is not politically deaf, it is fundamentally a professional operation that aims to center its decisions on legal principles first. If we cannot argue network benefits, we will not have supporting legal principles. No amount of interest pressure or appeals to

renewables-consciousness will fix that problem. Of that fact, the FERC decision is ample evidence.

B. Other possibilities

I am omitting, for purposes of this memorandum, the following other potential solutions, which require more thought:

1. Ask the PUC for a ruling that the Section 399.25(b)(4) backstop applies to Segment 3.
2. Ask the Legislature to modify Section 399.25. Such a modification could be broad (e.g., all facilities defined as "renewable trunk lines"), or narrow (Segment 3 only).
3. Ownership by a for-profit entity other than the utility.
4. California taxpayers.
5. Municipal ownership.

Appendix

Here are FERC's descriptions of each Segment, based on SCE's submission.

Segment 1

"17. The proposed Antelope to Pardee 500 kV Transmission Project (Segment 1) includes a new 25.6 mile 500 kV transmission line between the existing Antelope and Pardee substations, interconnections at the existing Antelope and Pardee Substations and an initial expansion at the Antelope Substation. According to SCE, Segment 1 is necessary to interconnect a potential 201 MW wind generation project with a proposed in-service date of December 2006 and to accommodate generation north of the Antelope Substation. SCE states that although the 220 kV transmission line would be sufficient to interconnect the 201 MW wind generation facility, the CAISO approved the project at 500 kV to eliminate the possibility of repeatedly removing and rebuilding facilities. SCE explains that Segment 1 will replace an existing 66 kV line that runs over the majority of the preferred route between the Antelope and Pardee substations. SCE asserts that designing and building the facilities at 500 kV saves costs and reduces environmental damage that would result from repeated demolition and rebuilding in the future."

Segment 2

"18. Segment 2 consists of a new, 17.8 mile 500 kV transmission line on new right-of-way between SCE's existing 220 kV Antelope and Vincent substations. It includes upgrades such as transformers, circuit breakers, and disconnect switches at both substations to terminate the new transmission line. The line would parallel an existing transmission line corridor over its entire length between the two substations. Although the transmission line would be designed and built for operation at 500 kV, it would initially be operated at 220 kV."

Segment 3

"19. The proposed Segment 3 has four elements: (1) Substation One, a new, 500/220/66 kV substation to be located near the existing Cal Cement Substation; (2) Substation Two, a new, 220/66 kV substation to be located approximately 3.5 miles east of the City of Tehachapi; (3) a new, approximately 25-mile long 500 kV transmission line between Antelope Substation and the new Substation One, operated initially at 220 kV; and (4) a new, 9.4-mile-long 220 kV transmission line between the new Substation One and Substation Two."