108 FERC ¶ 61,297
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Pacific Gas and Electric Company — Docket Nos. ER99-2326-006
EL99-68-006

OPINION NO. 466-B

ORDER DENYING REHEARING

(Issued September 22, 2004)

1. This is the third in a series of orders on review of the Initial Decision in this proceeding.[1] In Opinion No. 466, the Commission reversed the Initial Decision and held that the determination of which facilities were properly included in the Transmission Revenue Requirement of Pacific Gas and Electric (PG&E) should be based solely on whether control of the facilities had been turned over to the California Independent System Operator Corporation (ISO).[2] In Opinion No. 466-A, the Commission reconsidered the issue and granted rehearing, on the ground that determining the rate treatment of PG&E's facilities solely on whether the ISO had assumed operational control was contrary to our precedent.[3] We then went on to resolve the proper rate treatment of the facilities in question. The California Department of Water Resources State Water Project (DWR) filed a timely request for rehearing of Opinion No. 466-A. As discussed below, we deny rehearing. Our order benefits customers by assuring that the Commission's transmission pricing policies are consistently applied.

[1] Pacific Gas and Electric Co., 97 FERC ¶ 63,014 (2001).

[2] Pacific Gas and Electric Co., Opinion No. 466, 104 FERC ¶ 61,226 (2003).

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

Background

2. Because Opinion Nos. 466 and 466-A provide detailed accounts of the factual background of this proceeding, we will accordingly limit our discussion. In a 1999 rate filing (the TO-3 filing)[4] made to recover the costs of transmission facilities operated by the ISO, PG&E proposed to designate as network transmission facilities approximately $132 million worth of gross plant (primarily the Diablo Loop, Morrow Bay Loop and Moss Landing Loop facilities) which had previously been classified as "generation ties" or "generation step-up transformers" within PG&E's transmission system.

3. Establishing the framework for his analysis of PG&E's facilities, the presiding judge stated that the Commission had historically favored "all costs associated with a particular facility to be rolled-in to network transmission rate base insofar as any degree of integration with the transmission grid could be demonstrated."[5] However, based on the Commission's decisions in *Kentucky Utilities Company* [6] and *Northern States Power Company* [7] the judge believed that the Commission now favored allocating facilities by taking into account the role they performed in supporting generation and ancillary services. Applying this standard, he noted that while the Diablo, Morrow Bay and Moss Landing Loop facilities "performed at least some network transmission function," they primarily functioned as generation ties, and thus should be excluded to that extent from PG&E's Transmission Revenue Requirement.[8] The judge excluded another $17 million worth of PG&E's facilities from the Transmission Revenue Requirement for the same reason, but found that the remaining $26 million worth of facilities were dedicated entirely to network transmission service and therefore recoverable.[9]

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[4] This was PG&E's third Transmission Owner (TO) rate filing. Because of settlements arising from PG&E's preceding and subsequent TO filings, the TO-3 rate is effective only for a ten month locked-in period (from May 31, 1999 through March 31, 2000). *See* 97 FERC at 65,054 & n.3.

[5] 97 FERC at 65,061 (citation omitted).

[6] 85 FERC ¶ 61,274 at 62,111 (1998) (*Kentucky Utilties*).

[7] 64 FERC ¶ 61,324 (1993), *reh'g denied*, 74 FERC ¶ 61,106 (1996) (*Northern States*).

[8] 97 FERC at 65,061-62.

[9] *Id.* (citation omitted).

4. In Opinion No. 466, we reversed the Initial Decision on the theory that the judge had erred in deciding which facilities were to be included in PG&E's Transmission Revenue Requirement "based on whether these facilities should be classified as transmission or generation under our pre-ISO precedent."[10] Rather, the Commission concluded, the deciding factor should be whether the facilities had been transferred to the control of the ISO: "If control was turned over, the facilities should be included in the TO-3 base. If it was not, they must be excluded."[11]

5. Opinion No. 466-A granted rehearing. On further analysis, the Commission concluded that its precedent proscribed making ISO operational control the determining factor for classifying PG&E's facilities. We therefore went on to decide the appropriate rate treatment for the facilities. In so doing, the Commission emphasized that its policy continued to favor the rolled-in method of transmission cost allocation "given a finding that the system operates as an integrated whole."[12] In this context, Opinion No. 466-A explained that *Kentucky Utilities* and *Northern States* were inapposite to the facts presented here.[13]

6. Opinion No. 466-A thus decided the appropriate allocation of the facilities under our traditional rolled-in policy. With respect to the Diablo, Morro Bay and Moss Landing Loops, we observed that the judge had agreed that "each indisputably performs a critical network transmission function."[14] In this regard, the Commission took notice that "these 500kV and 230kv transmission lines form a parallel path on a separate corridor to the major north/south path (Path 15), which separates the northern and southern zones of California."[15] We found further evidence that these facilities performed transmission functions in the testimony of PG&E's witness Mr. Jenkins. The Commission, therefore, reversed the judge's conclusion that costs of these facilities should be excluded from PG&E's Transmission Revenue Requirement.

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[10] Opinion No. 466 at P 13.

[11] *Id.* (footnote omitted).

[12] Opinion No. 466-A at P 22.

[13] *Id.* at P 20 – 22.

[14] *Id.* at P 14 & n.28, quoting 97 FERC at 65,061.

[15] *Id.* at P 14.

7. Concerning the appropriate rate treatment of the $17 million worth of what the judge termed "dual-function" facilities, Opinion No. 466-A also reversed the Initial Decision. While the judge once more agreed that "each of the facilities at issue performs at least *some* network transmission function," he excluded them from PG&E's Transmission Revenue Requirement.[16] However, because these units do serve a network function, the Commission concluded that they should be included in PG&E's Transmission Revenue Requirement.

8. Finally, Opinion No. 466-A affirmed the presiding judge's holding that the third group of facilities (worth approximately $26 million) exclusively served PG&E's transmission system and should thus be rolled into PG&E's transmission rate base. In so doing, we rejected DWR's contention that Mr. Jenkins' testimony, on which the judge relied, was unreliable.

9. In its request for rehearing, DWR contends that Opinion No. 466-A fundamentally erred on three grounds concerning its finding that the disputed facilities should be classified as transmission. First, DWR asserts that Commission policy no longer permits all PG&E facilities performing any network function, however slight, to be rolled into a single transmission rate. Second, DWR contends that Opinion 466-A wrongly ignored that the Commission has long allowed PG&E to employ a subfunctional, rather than a rolled-in, approach to allocating the cost of its transmission facilities. Third, DWR argues that the Commission erred in relying on PG&E's evidence concerning the nature of its facilities. We discuss each of these theories below.

Discussion

10. On rehearing, DWR objects to the Commission's statement in Opinion No. 466-A that its policy has been to favor rolled-in pricing for transmission facilities. However, DWR does not attempt to distinguish our discussion of *Kentucky Utilities* and *Northern States*. Rather, DWR maintains that our traditional policy is "directly at odds" with "the directive of Orders 2003 and 2003-A[17] that options other than rolled-in rates are appropriate."[18] According to DWR, these orders:

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[16] *Id.* at P 23, quoting 97 FERC at 65,061 (emphasis in original; citations omitted).

[17] Standardization of Generator Interconnection Agreements and Procedures, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs., Regulations Preambles ¶ 31,146 (2003), *order on reh'g*, Order No. 2003-A, 69 Fed. Reg. 15,932 (March 26, 2004), FERC Stats. & Regs., Regulations Preambles ¶ 31,160 (2004), *reh'g pending*.

[18] DWR Request for Rehearing at 7.

> establish[ed] policies for pricing of generation "interconnection facilities" (also sometimes referred to as generation tie, gen-tie or direct connection facilities) and for network facilities whose purpose, as PG&E has admitted in its subfunctionalized rate design . . . is the case with the facilities at issue here, is to carry generator output.[19]

11. The Commission denies rehearing concerning this claim. DWR's theory assumes the very point it is intended to prove, namely, that the facilities in question are indeed "interconnection facilities." In fact, as we discuss below, there is clear record evidence that they are not. Thus, DWR's argument is based on an incorrect factual premise.

12. The legal premise of DWR's position is likewise incorrect. The Commission has specifically explained that in Order No. 2003, it "did not intend to abandon any of the fundamental principles that have long guided our transmission pricing policy."[20] For non-independent transmission providers, Order No. 2003 contemplates pricing transmission primarily on a rolled-in basis, permitting transmission providers to recover upgrade costs by charging the interconnection customer the higher of either average embedded costs or incremental cost rates.[21] Order No. 2003 does envision permitting independent transmission providers to utilize a "more creative and flexible approach," which includes the *option* of direct assignment of interconnection costs under certain circumstances.[22] However, Order No. 2003 does not, as DWR seems to believe, mandate an incremental pricing policy with respect to any facilities.

13. DWR next argues that Opinion No. 466-A is defective in that it fails to explain the Commission's "departure from current, controlling precedent holding that 'more accurate' subfunctionalized rate treatment is appropriate for the PG&E facilities in question."[23] No change in circumstances warrants this purported change in policy, DWR

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[19] *Id.* at 8.

[20] Opinion No. 2003-A at P 580 & n.105, citing Inquiry Concerning the Commission's Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act, Policy Statement, FERC Stats. & Regs., Regulations Preambles ¶ 31,005 (1994).

[21] *Id.*

[22] *Id.*

[23] *Id.* at 15, quoting Pacific Gas & Electric Co., Opinion No. 356, 53 FERC ¶ 61,146 at 61,520-21 (1990).

insists, because the "facilities in question were no less part of the integrated grid under subfunctionalized rates than they are today – no significant reconfiguration has occurred."[24]

14. DWR's position is without merit. At the outset, as we explained in Opinion No. 466-A, the Commission has generally and routinely authorized rolled-in pricing for transmission facilities.[25] Indeed, in a decision issued on July 29, 2004, the Commission emphasized that, in determining whether the costs of facilities should be rolled into transmission rates,

> [i]t is still our policy, as it has been for many years, to prohibit direct assignment of network facilities. Due to the integrated nature of the transmission network, network facilities benefit all network users.[[26]]

15. As Opinion No. 466-A also explained, our policy concerning rolled-in pricing for transmission facilities has been repeatedly affirmed by the courts.[27] As recently as July 16, 2004, the District of Columbia Circuit once again upheld the application of the rolled-in methodology for transmission pricing.[28] In so doing, the court emphasized that it has "never required a ratemaking agency to allocate costs with exacting precision."[29] Thus, to the extent that the DWR's argument here is that rolled-in pricing must be rejected because a subfunctionalized method might arguably more precisely allocate costs, its claim has already been rejected.

16. As DWR indicates, PG&E did previously employ a subfunctionalized rate methodology for its transmission facilities. However, DWR is wrong that the Commission made a finding that this methodology tracked costs more accurately than a

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[24] *Id.* at 17 (internal quotation marks omitted).

[25] *E.g.*, American Electric Power Service Corp., 101 FERC ¶ 61,211 at P 12 (2002); Otter Tail Power Company, 12 FERC ¶ 61,169 at 61,420 (1980).

[26] Northeast Texas Electric Cooperative, Inc., *et al.*, Opinion No. 474, 108 FERC ¶ 61,084 at P 47 (2004).

[27] *E.g.*, Western Massachusetts Electric Co. v. FERC, 165 F.3d 922, 927 (D.C. Cir. 1999).

[28] Midwest ISO Transmission Owners v. FERC, 373 F.3d 1361 (D.C. Cir. 2004).

[29] *Id.*, slip op. at 11, citing Sithe/Independence Power Partners, L.P. v. FERC, 285 F.3d 1, 5 (D.C. Cir. 2002).

rolled-in method. Rather, Opinion No. 356 describes *PG&E's rate filing* as containing this claim: "PG&E states that the subfunctionalized method tracks the costs associated with providing transmission services more accurately than the more traditional system-wide "rolled-in" method."[30] We then explained that not only had no party in the proceeding contested the subfunctional methodology, but also that "the merits of PG&E's subfunctional methodology, as compared to a system-wide 'rolled-in' methodology, have never been litigated."[31] The Commission went on to note:

> PG&E is free to continue the use of its subfunctional methodology or to propose a rolled-in rate in future proceedings. . . However, we will continue to evaluate the appropriateness of this or any other pricing methodology on a case-by-case basis.[[32]]

In sum, DWR is incorrect in alleging that the Commission has endorsed a subfunctional methodology for PG&E and is now changing course.[33]

17. Furthermore, it is unclear what significance we are meant to derive from the former classification of the transmission facilities in question under the subfunctional methodology. Because certain of the facilities were previously subfunctionalized as "generation tie" within the transmission rate base does not *ipso facto* remove them from transmission under the current rolled-in methodology. On the contrary, such reasoning ignores the fact that PG&E's subfunctional methodology classified *transmission* facilities, the costs of which were consistently recovered in PG&E's *transmission* rates.[34]

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[30] Opinion No. 356, 53 FERC at 61,521 (footnote omitted).

[31] *Id.* at 61,521 n.66.

[32] *Id.* at 61,525 n.90.

[33] DWR also suggests that the Commission's regulations "expressly call for subfunctionalized cost allocation." DWR Request for Rehearing at 11, citing 18 C.F.R. § 35.13 (h) (vi) (2004). However, even a cursory reading of the relevant regulations reveals that, while our regulations do permit such a cost allocation, they certainly do not require such a method.

[34] DWR similarly faults Opinion No. 466-A for "fail[ing] to recognize that a *two*-category form of subfunctionalized rate design is currently employed on the California ISO and consequently the PG&E grid." DWR Request for Rehearing at 12 (emphasis in original). However, the rate design chosen by the ISO for its tariff is a separate and distinct matter from the question of what facilities should be included in PG&E's Transmission Revenue Requirement, which we are deciding here.

18. This brings us to questions raised by DWR concerning the evidentiary support for Opinion No. 466-A's determination that the facilities are to be included in PG&E's Transmission Revenue Requirement. DWR primarily attacks the evidence the Commission relied upon on two fronts. First, DWR maintains that the Commission erred by relying upon the rebuttal testimony of PG&E's witness Mr. Jenkins, which relies on "admittedly error-prone" maps and is unsupported by "any studies or analyses of any kind."[35] Second, DWR argues that by relying on PG&E's rebuttal testimony, the Commission violated both its own regulations concerning the burden of proof, as well as due process standards.[36]

19. The Commission denies rehearing. At the outset, we emphasize that, as Opinion No. 474 recently affirmed, in "determin[ing] whether a facility is a network [*i.e.*, transmission] facility," for purposes of the rolled-in methodology, "the Commission has stated that a showing of *any* degree of integration is sufficient."[37] It is this well-established standard that the Commission applied in the instant case. Our problem with the Initial Decision was that the judge -- having found the record "conclusive" that each of the contested facilities in all three categories performed "at least *some* network transmission function," and that "[n]o party disputes this fact,"[38] -- did not apply the proper legal standard, *i.e.*, that any degree of integration is sufficient to establish that the costs of the facilities should be treated as transmission.

20. Turning to the issues concerning the record, the Commission observes that DWR's evidentiary claims largely do not come to terms with the judge's finding that all of the facilities perform some network function. Rather, DWR's focus is on to how great an extent the facilities perform such a function, which is irrelevant to the application of the policy described above. As the judge observed, the fact that the facilities performed some network function was not in dispute during the hearing.

21. In any event, by concentrating on Mr. Jenkins' testimony, DWR ignores that the judge's specific findings (adopted by Opinion No. 466-A) that the three Loop facilities and the so-called "dual-function" facilities performed network functions is also supported

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[35] DWR Request for Rehearing at 19-20.

[36] *Id.* at 23-30.

[37] Opinion No. 474, 108 FERC ¶ 61,084, at P 48 & n.66 (emphasis supplied), 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).

[38] 97 FERC at 65,061 (emphasis the judge's; citations omitted).

by other evidence.[39] Nor does DWR acknowledge that these findings were substantiated by the Commission's institutional knowledge concerning the California grid.[40] Even without Mr. Jenkins' testimony, then, the record is sufficient to establish that the facilities performed some network function and should be included in PG&E's Transmission Revenue Requirement.

22. In any event, the Commission rejects DWR's contentions concerning the Jenkins testimony. As we observed in Opinion No. 466-A, DWR's prior attacks on this evidence did not refute its substance.[41] On rehearing, it seems to us, DWR continues to nibble around the edges without directly attacking the heart of Mr. Jenkins' testimony. For example, DWR complains that Mr. Jenkins drew his conclusions based not on an "objective ascertainment of actual use" of facilities, but by merely reviewing PG&E maps and diagrams.[42] First, the Commission cannot agree that Mr. Jenkins' reliance on maps or diagrams of the facilities inherently renders his testimony suspect. DWR has not demonstrated that the diagrams do not accurately represent the facilities in question. Rather, the testimony cited by DWR concerning errors in PG&E's maps appear to refer to the confusion about what facilities had been turned over to ISO control, not whether they correctly represented the facilities.[43] Second, we do not read Mr. Jenkins' testimony to be based solely on the contents of maps or diagrams. As the record establishes, Mr. Jenkins is an experienced electrical engineer whose primary responsibility has been PG&E's transmission system planning since 1992. While his rebuttal testimony does refer to diagrams, the substance of the testimony is obviously based on his knowledge and experience pertaining to the relevant portions of the PG&E transmission system.

23. This brings us to DWR's procedural objections to Mr. Jenkins' testimony. DWR cites a number of cases that it maintains support its contention that Opinion No. 466-A erred by relying on PGE's allegedly improper rebuttal testimony."[44] By not

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[39] Opinion No. 466-A at P 14 & n.28, quoting 97 FERC at 65,061 (Loop facilities); *id.* at P 23 & n.40, quoting 97 FERC at p. 65,061 (dual-function facilities). Only with respect to the third group of facilities did the judge and the Commission primarily rely on Mr. Jenkins.

[40] *Id.* at P 15.

[41] *Id.* at P 18, 26.

[42] DWR Request for Rehearing at 21, citing Tr. 453-54.

[43] This is the matter referred to in Ex. DWR-11 and DWR-12 and the testimony of Mr. Irwin (Tr. 389-390), cited by DWR in its reference to Mr. Jenkins' testimony. DWR Request for Rehearing at 21.

introducing the testimony earlier, DWR reasons, PG&E failed to meet its burden of proof. But as the cited cases indicate, the question of whether the rebuttal testimony was improperly allowed is one that first must be addressed to the presiding judge. DWR does not allege that it moved to strike Mr. Jenkins' testimony. Indeed, DWR did not even claim that Mr. Jenkins' testimony was improperly admitted in its brief on exceptions to the Initial Decision.[45] Thus, it is too late in the game to attack Mr. Jenkins' testimony on this basis.[46]

24. The second element of DWR's argument is that it was somehow unduly prejudiced and deprived of due process by Opinion No. 466-A's reliance on Mr. Jenkins' filed testimony. The short answer to this claim is that DWR had full and fair opportunity to cross-examine Mr. Jenkins with respect to his testimony, and in fact did so, albeit to little substantive effect.

25. DWR's final attack on Opinion No. 466-A is that the Commission failed to address arguments originally made by DWR in its request for rehearing of Opinion No. 466, but "equally applicable to the ruling in Opinion No. 466-A."[47] These arguments are that Opinion No. 466-A erroneously allowed rolled-in ISO cost recovery for facilities admittedly not under ISO control, and improperly failed to examine PG&E's proposal "in the context of skyrocketing ISO transmission costs."[48] Neither of these arguments is

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[44] DWR Request for Rehearing at 23. In this context, DWR relies primarily on Nantahala Power & Light Co. v. FERC, 727 F.2d 1342, 1351 (4th Cir. 1984); KN Interstate Gas Transmission Co., 85 FERC ¶ 63,004 (1998), *aff'd*, 86 FERC ¶ 61,229 (1999); Southern California Edison Co., *et al.*, 50 FERC ¶ 63,012 (1990).

[45] Rather, DWR argued that the judge had erroneously disregarded alleged inconsistencies between Mr. Jenkins' testimony and PG&E's prior evidence and discovery responses (DWR Brief on Exceptions at 9-11), a substantively different argument (and one we have already refuted). *See* Opinion No. 466-A at P 26.

[46] *E.g.*, Southwestern Electric Cooperative., Inc. v. Soyland Power Cooperative, Inc., 97 FERC ¶ 61,008 at 61,028 & n.45 (2001) (citation omitted).

[47] DWR Request for Rehearing at 31-32. The remaining arguments DWR includes in this group, that the result of Opinion No. 466-A is contrary to Order No. 2003, and improperly allowed rebundling of generation-related costs, we have already dealt with in this order.

[48] *Id.* at 31.

appropriately raised here. The question of which of the subject facilities are actually under ISO control will be resolved, in accordance with Opinion No. 466, in the compliance phase of this proceeding.[49] Finally, the reasonableness of the ISO's costs is a subject that should be (and has been) addressed in the ISO's rate proceedings.

The Commission orders:

DWR's request for rehearing is hereby denied, as explained in the body of this opinion.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.

[49] Opinion No. 466, at P 14.