

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, Linda Breathitt,
and Nora Mead Brownell.

Western Area Power Administration

Docket No. ER02-1672-000

ORDER ACCEPTING LETTER AGREEMENT

(Issued June 12, 2002)

On April 30, 2002, Western Area Power Administration (WAPA), on behalf of itself, Trans-Elect, Inc. (Trans-Elect), and Pacific Gas & Electric Company (PG&E) (collectively, Path 15 Participants or Applicants) filed a Letter Agreement, pursuant to section 205 of the Federal Power Act (FPA),¹ that constitutes the first step in a process that ultimately should lead to the addition of transmission capacity along California's Path 15 by late 2004. We will accept the Letter Agreement for filing, to become effective as of the date of this order.² Doing so promotes the construction of transmission facilities in California, particularly along Path 15. The need for additional transmission facilities in California, particularly along Path 15, has not abated since issuance of the Removing Obstacles Orders,³ which sought, among other things, to promote just this result -- the timely construction of additional transmission facilities.

¹16 U.S.C. § 824d (1994).

²As we do not have before us an agreement establishing rates, we take no position, but rather reserve judgment, on all rate issues including those raised by the intervenors that are not specifically delineated as rate principles in Section 7 of the Letter Agreement; such issues are not before us at this time.

³Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States, 94 FERC ¶ 61,272, reh'g denied, 95 FERC ¶ 61,225, order on requests for reh'g and clarification, 96 FERC ¶ 61,155, further order on requests for reh'g and clarification, 97 FERC ¶ 61,024 (2001) (Removing Obstacles Orders).

Background

Path 15 encompasses two high voltage transmission lines that extend from southern California to northern California. Path 15 transmission lines are often constrained because of the need for significant north-to-south transmission to accommodate the movement of hydro power from the Pacific Northwest to Southern California and also to permit the movement of energy from generators in Southern California to Northern California.

On May 17, 2001, the National Energy Policy Report recommended that President George W. Bush direct the Secretary of Energy to authorize WAPA to explore ways to relieve the Path 15 bottleneck through transmission expansion. Through a public process, WAPA solicited proposals from non-federal entities to participate in the construction and ownership of Path 15 upgrades.⁴ WAPA ultimately selected Trans-Elect and PG&E. The effect of the Path 15 upgrades agreed to by the Path 15 Participants, principally a new 500 kV transmission line, would be to increase capability from 3900 MW to 5400 MW for north-bound power deliveries. It would also increase capability for southbound deliveries. The expected completion date of the project is Fall 2004.

On April 30, 2002, the Path 15 Participants filed a Letter Agreement with the Commission in the instant docket, which, among other things, sets forth rate principles to be followed in the recovery of costs associated with the transmission upgrades.

Letter Agreement

Pursuant to the Letter Agreement, WAPA will own the new 500 kV transmission line and associated land that is the most significant part of the transmission upgrades, while PG&E will perform upgrades to preexisting substations and 230 kV transmission facilities. The Letter Agreement also provides that Trans-Elect, PG&E and WAPA each will receive an entitlement to the transmission system rights (TSRs). Initially, Trans-Elect will receive 72 percent, PG&E will receive 18 percent and WAPA will receive 10 percent of these TSRs. The final allocation of TSRs will be based on the ratio of the contribution made by a participant to the project either in terms of funding or actual work performed. However, in no event will WAPA's share be less than 10 percent. The estimated cost of the project is \$306 million.

The Letter Agreement provides that Trans-Elect is responsible for raising approximately \$250 million of equity and debt to fund the construction of the new 500

⁴See 66 Fed. Reg. 31,909 (2001).

kV transmission line. Trans-Elect requests: (1) a 13.5 percent rate of return on equity for its portion of the project, consistent with what was granted in the Removing Obstacles Orders; (2) fixed rates at the initial rate level for the first 36 months of service; (3) a 30-year depreciable life for the project; and (4) use of a target 50/50 capital structure. Trans-Elect states that the target 50/50 capital structure is a necessary predicate for it to obtain financing for the project.

PG&E's participation in the project involves it making upgrades to preexisting substations and 230 kV transmission facilities. PG&E requests: (1) a 10-year depreciable life for PG&E's Path 15 Project facilities; (2) a reasonable industry target capital structure as requested by PG&E or ETrans (PG&E's transmission successor organization) in a subsequent rate filing (the project costs will be fully rolled into network rates and recoverable from all parties who take service under PG&E's transmission owner (TO) Tariff; PG&E, in a separate and subsequent filing, will file a comprehensive request with the specifics of cost recovery, according to the rate provision set out in Section 7.3 of the Letter Agreement); and (3) a reasonable rate of return on all of the Path 15 Project facilities it owns, plus a 200 basis point incentive consistent with the Commission's Removing Obstacles Orders.

WAPA, which is not a public utility under the FPA,⁵ will provide about \$1.33 million to the project.

Participation Agreement

Applicants state that they intend to sign a Participation Agreement no later than ten days after the Commission issues an order on the Letter Agreement. The Participation Agreement will provide more detail on the governance, ownership percentages, coordinated operations (including curtailment sharing) with the existing PG&E system, project work products and project scope. The Participation Agreement will also detail the nature of the ownership rights and responsibilities, including payment for project costs, coordination with the ISO and the mitigation of adverse impacts due to subsequent system modifications.

Notice of Filing, Protests and Interventions

⁵See 16 U.S.C. § 824 (1994).

Notice of Applicants' filing was published in the Federal Register,⁶ with protests and motions to intervene due on or before May 21, 2002. In response, the Public Utilities Commission of California (California Commission) filed a notice of intervention and protest. Timely motions to intervene were filed by Modesto Irrigation District and the Sacramento Municipal Utility District. Timely motions to intervene and comments were filed by Turlock Irrigation District (Turlock), the California Independent System Operator Corporation (CA ISO), Northern California Power Agency (NCPA), and jointly by the Transmission Agency of Northern California, M-S-R Public Power Agency, and the Cities of Santa Clara, Redding, and Palo Alto, California (Joint Movants). A timely motion to intervene and protest was filed by Southern California Edison Company (SoCal Edison). Late-filed motions to intervene were filed by the California Department of Water Resources and the Metropolitan Water District of Southern California. A late-filed motion to intervene and protest was filed by San Diego Gas & Electric Company (SDG&E).

The California Commission argues that the filing is premature because the California Commission has not yet determined whether the proposed upgrades are necessary. The California Commission also argues that there is an insufficient evidentiary record to support the ratemaking treatment that the Path 15 Participants request. The California Commission further argues that the ratemaking treatment requested for this project is overly generous to PG&E and Trans-Elect and exceeds the incentives provided for in the Removing Obstacles Orders. Finally, the California Commission argues that the proposed allocation of TSRs allocates a disproportionate share of transmission rights to WAPA.

Turlock requests that the Commission ensure that the Path 15 upgrades will not have a negative impact on the current capability of Path 15 and specifically ensure that Turlock's rights of use will be fully protected and unhindered during the implementation of the upgrade and thereafter.

SDG&E's protest is limited to a request that the Commission require the Path 15 Participants to provide greater detail about their plans. SDG&E requests that the Commission direct Trans-Elect to provide a greater explanation of how it will recover its revenue requirement from the CA ISO and how the CA ISO would fund that requirement.

The Joint Movants agree with the Path 15 Participants that the Path 15 bottleneck is a serious problem in the California energy market and agree that the public interest will be best served if the Path 15 upgrade project is completed on an expedited basis. The

⁶67 Fed. Reg. 34,443 (2002).

primary interest of the Joint Movants at this stage of the proceeding is to ensure that the approval or the acceptance of the Letter Agreement does not have an adverse impact on the Joint Movants' existing rights, entitlements and allocations.

The Joint Movants acknowledge, however, that these concerns may be premature since such matters appear to be reserved or deferred. The Joint Movants state, though, that it would be helpful if the Commission provided guidance that addresses such matters. Furthermore, they ask the Commission to clarify that the Path 15 Participants must allow other entities to become project participants.

NCPA states that it does not oppose a much needed fix Path 15's congestion, even at the high compensatory rates sought here. However, NCPA is concerned about cost allocation and does not want approval of the Letter Agreement to be determinative of these issues.

SoCal Edison states that the transmission control agreement (TCA) and CA ISO open access tariff never contemplated "partial participating TOs." SoCal Edison states that unless WAPA can show that there are legal impediments to WAPA becoming a full participating TO, WAPA should not be allowed to become a partial participating TO. SoCal Edison adds that amendments are needed to both the TCA and CA ISO Tariff to implement the partial participating TO concept.

With regard to the Letter Agreement, itself, SoCal Edison questions various individual provisions, and how they interact with existing practices and agreements in California. SoCal Edison adds that all Path 15 facilities should be placed under the CA ISO-controlled grid and be available for use by all market participants on a comparable basis.

The CA ISO supports upgrading Path 15. The CA ISO has concerns, however, because the Path 15 Participants have not provided the CA ISO with the details of their proposals, including any necessary proposed changes to the CA ISO Tariff and the TCA. The CA ISO also notes that there is a process under the CA ISO's Tariff for Trans-Elect to join the CA ISO and have its transmission revenue requirement recovered through the CA ISO's Access Charge, and the CA ISO states that this process has not yet been initiated.

The CA ISO states that Section 9.4.4 of the Letter Agreement seeks changes to the CA ISO Tariff requested by Trans-Elect for the revenue recovery mechanism for the project. Trans-Elect seeks to bar the CA ISO from commingling transmission revenues with generation related revenues. The CA ISO states that any such change to the CA ISO Tariff would impact all market participants in the California market. The CA ISO is

generally concerned about any proposal that would change the assessment of charges and disbursement of funds pursuant to the CA ISO Tariff. Since it appears that customers of PG&E, SDG&E, SCE, and Vernon, as well as all wheeling customers will pay a portion of the TRR associated with the Path 15 upgrade, it would likely prove difficult to justify a proposal for special treatment of the costs and revenues associated with the Path 15 upgrade. Also, the CA ISO's Access Charge is the subject of an ongoing settlement proceeding in Docket No. ER00-2019-000 pending before Chief Administrative Law Judge Curtis Wagner.

On June 5, 2002, PG&E, Trans-Elect, and WAPA each filed answers to CPUC's protest.

Discussion

A. Interventions

The California Commission's notice of intervention and the timely motions to intervene serve to make the entities that filed them parties to this proceeding. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2001), we will grant the untimely motions to intervene as we find that granting these interventions will not unduly delay the proceeding nor unduly prejudice the interests of any party. Pursuant to 18 C.F.R. § 385.213(a)(2) (2001), we will reject PG&E, Trans-Elect, and WAPA's answers as impermissible answers to a protest.

B. Specified Rate Principles

Trans-Elect

The California Commission states that Trans-Elect's request for approval of a target capital structure is premature. The California Commission states that there is insufficient information available to examine Trans-Elect's proposal. Specifically, the California Commission states that there is no project in place yet, no funding, no market ratings of Trans-Elect's debt or equity, and no identification of comparable entities.

While we generally agree with the California Commission's characterization of Trans-Elect's participation, we disagree with the California Commission's argument that Trans-Elect's request for a target capital structure is premature. We find that a target capital structure is necessary to assure financing for this project. Accordingly, we will grant Trans-Elect's request to use a target capital structure.

Furthermore, Trans-Elect states that while these transactions are optimally leveraged at between 20 and 30 percent equity, its actual equity/debt ratio will vary dramatically over time and its equity portion may well be between 40 and 50 percent over a period of time. Trans-Elect states that it needs a 50/50 capital structure as a predicate for obtaining financing here.

We find a 50/50 capital structure is appropriate in this context and for this particular transaction. Our approval of the use of a target 50/50 capital structure for Trans-Elect at this time in this proceeding is due to the unique circumstances surrounding the Path 15 upgrades. The Path 15 upgrades project was the result of an RFP conducted by WAPA, at the behest of the Secretary of Energy, and represents, on balance, a reasonable basis for WAPA to move ahead with this much needed project. We also note that, at this time, there is no proxy group of entities similarly situated to Trans-Elect that would allow for a comparative analysis of the proposed capital structure. It is generally recognized that serious transmission congestion plagues the California energy markets, particularly along Path 15, and that the upgrades will provide much needed transmission capacity to northern California. This rate incentive will move the project forward. However, we will permit this 50/50 target capital structure for use in Trans-Elect's rates only for the first 36 months of operation. At the end of that period, Trans-Elect will be required to file with the Commission information reflecting its actual capital structure. We also find Trans-Elect's rate principles regarding its return on equity, depreciation and rate moratorium are reasonable for this unique project.

PG&E

PG&E requests a reasonable rate of return on all Path 15 Project facilities, plus a 200 basis point incentive. We agree that under the unique circumstances of this case a 200 basis point incentive is appropriate for PG&E's substation and other upgrades necessary to accommodate the new 84-mile, 500 kV transmission line. However, we will reject PG&E's request for a reasonable industry target capital structure as requested by PG&E or Etrans in a subsequent TO tariff filing. We granted Trans-Elect's request for a target capital structure because it is a relatively new company and must obtain the majority of the financing for the Path 15 upgrade. PG&E is a utility that has an established capital structure and, as such, the use of a target capital structure is not warranted under these circumstances. Finally, we approve PG&E's requested rate treatment regarding its proposed depreciation of the Path 15 Project facilities.

C. Other Issues

Intervenors raise various other issues regarding the Path 15 upgrades. We find these issues to be premature at this stage of the proceeding. Our acceptance of the Letter

Agreement, and the rate principles therein, is intended to allow the Path 15 Participants to move forward with financing and preliminary matters and, as we discuss below, does it not constitute final Commission review of jurisdictional rates, terms and conditions associated with the Path 15 upgrade project. We will, however, comment briefly on three matters.

First, many intervenors are concerned with protecting their transmission rights on pre-existing Path 15 facilities. We note that the Firm Transmission Rights (FTRs) at issue in the Letter Agreement pertain to rights on the new 500 kV transmission line and not to pre-existing Path 15 facilities. Final allocation of FTRs will be set out in the Participation Agreement, which will be filed with the Commission at a later date. To the extent intervenors have concerns that their pre-existing transmission rights will be adversely impacted by the Path 15 upgrades, they may raise those issues when the Participation Agreement is filed.

Second, many intervenors, including the California Commission express concerns that the Path 15 Participants, through the Letter Agreement, may be attempting to circumvent CA ISO Tariff procedures required for new participating transmission owners. We need not address these issues here, as we anticipate that there will be adequate opportunity to review these matters in the CA ISO tariff filings that the Path 15 Participants will be required to make. We note, however, that WAPA has committed to turn over control of the new Path 15 facilities to the CA ISO.

Third, with respect to California Commission's concerns regarding section 9.4.4 of the Letter Agreement, we note that the transmittal letter states that section 9.4.4 of the Letter Agreement identifies certain threshold conditions for further participation of some or all the parties, including a change by the CA ISO in how it handles the flow-through of payments to transmission owners. The California Commission is also concerned that Trans-Elect seeks to bar the CA ISO from commingling transmission revenues with generation revenues. However, section 9.4.4 states: "ISO Board approval indicating support for all changes to the ISO's Tariff or an order by the Commission requiring the CA ISO to accept the changes requested by Trans-Elect for the revenue recovery mechanism for the Project" must occur. Based on this language, we find that our acceptance of the Letter Agreement does not resolve one way or the other the issues raised by the California Commission regarding section 9.4.4, because we find that the intent of section 9.4.4 is vague and unclear on its face.

D. Conclusion

Our review of the Letter Agreement indicates that it appears to be just and reasonable and that it has not been shown to be unjust, unreasonable, unduly

discriminatory or preferential, or otherwise unlawful. Therefore, we will accept the Letter Agreement for filing. While we are accepting the Letter Agreement for filing, we note, however, that it is only a preliminary step that allows the Path 15 Participants to move forward and not the last opportunity for the Commission to review matters that are subject to its jurisdiction. Accordingly, we are approving the rate making principles outlined in the Letter Agreement, as discussed and modified in this order, and our acceptance of this Letter Agreement is predicated on the Path 15 Participants' acknowledgment that, consistent with sections 9 and 13 of the Letter Agreement, they are required to make subsequent filings with the Commission which will address the intervenors concerns regarding non-rate principles.

The Commission orders:

Applicants' Letter Agreement is hereby accepted for filing, as discussed in the body of this order.

By the Commission.

(S E A L)

Linwood A. Watson, Jr.,
Deputy Secretary.