IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 04-76131

CALIFORNIA DEPARTMENT OF WATER RESOURCES,
PETITIONER,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUES

1. Whether the Federal Energy Regulatory Commission ("Commission" or "FERC"), in considering whether Pacific Gas and Electric Company ("PG&E") could include certain facilities in its transmission rate base, properly adhered to FERC's longstanding policy favoring the "roll-in" method of allocating costs of facilities that benefit an integrated network transmission system, rather than apply a PG&E-designed rate methodology that FERC has never endorsed.

2. Whether the Commission's ruling that certain facilities could be

included in PG&E's transmission rate base is supported by substantial evidence, where an administrative law judge found the record "conclusive" that all of the facilities perform a network transmission function, no party has disputed that fact, and the Commission pointed to additional supporting record evidence.

COUNTERSTATEMENT OF JURISDICTION

Petitioner has failed to meet the statutory prerequisites under FPA § 313(b), 16 U.S.C. § 825*l*(b), for several issues it now raises (*see, e.g.*, *infra* pages 27 & n.9, 42, 48) because it failed to raise them with specificity on rehearing.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutes and regulations are contained in the Addendum to this brief.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

This case involves a rate filing by PG&E seeking to recover the costs of transmission facilities operated by the California Independent System Operator ("ISO"), by including those facilities in the transmission rate base under PG&E's transmission owner ("TO") tariff. Though it is undisputed that all of the facilities perform some network transmission function, Petitioner California Department of Water Resources ("DWR") opposed the "roll-in" of such costs. DWR contended that the facilities at issue primarily benefited specific generation facilities, so the

costs should be allocated only to specific parties seeking to interconnect those facilities to the transmission grid.

After a hearing, the Administrative Law Judge ("ALJ") found that all of the facilities performed some network transmission function, but nevertheless excluded most of the facilities from PG&E's rate base because they also performed generation-related functions. As to certain facilities that performed only network transmission functions, the ALJ allowed PG&E to include the associated costs in its rate base. DWR excepted to the ALJ's decision to include this last group of facilities, based in part on a challenge to a PG&E witness's testimony on which the ALJ relied. PG&E, in contrast, excepted to the exclusion of most of the facilities from its rate base.

In its first order on this matter, the Commission reversed the ALJ's decision in part and allowed all of the facilities to be rolled into the transmission rate base, holding that the transfer of control of the facilities to the ISO was determinative as to the rate treatment. *Pacific Gas & Elec. Co.*, 104 FERC ¶ 61,226 (2003) ("Opinion No. 466"), ER 342.[1] In its second order, the Commission granted rehearing and acknowledged that its previous focus on ISO control was inconsistent with FERC precedent; it thus reversed that holding and considered

[1] "ER" refers to the Excerpts of Record filed by DWR. "Supp. ER" refers to FERC's Supplemental Excerpts of Record filed herewith. "P" refers to the internal paragraph number within a FERC order.

anew the parties' exceptions to the ALJ's decision. *Pacific Gas & Elec. Co.*, 106 FERC ¶ 61,144 (2004) ("Opinion No. 466-A"), ER 393. Applying its longstanding FERC policy favoring "roll-in" of costs that benefit an integrated transmission grid, the Commission adopted the ALJ's undisputed factual finding that all of the subject facilities performed network transmission functions and ruled that PG&E could include the associated costs in its rate base. DWR sought rehearing.

In the third and final order in this case, 108 FERC ¶ 61,297 (2004) ("Opinion 466-B"), ER 443, the Commission denied rehearing of its second order. This appeal followed.

II. STATEMENT OF FACTS

A. Statutory and Regulatory Background

Section 201 of the FPA, 16 U.S.C. § 824, affords the Commission jurisdiction over the rates, terms and conditions of service for the transmission and sale at wholesale of electric energy in interstate commerce. *See* 16 U.S.C. § 824(a)-(b). This grant of jurisdiction is comprehensive and exclusive. *See New York v. FERC*, 535 U.S. 1 (2002) (discussing statutory framework, and division between federal and state regulatory authority under the FPA); *see also, e.g.*, *Transmission Agency of N. Cal. v. Sierra Pac. Power Co.*, 295 F.3d 918, 928 (9th Cir. 2002) (discussing exclusive FERC jurisdiction over transmission and wholesale power sales). All rates for or in connection with jurisdictional sales and

transmission services are subject to FERC review to assure they are just and reasonable, and not unduly discriminatory or preferential. FPA § 205(a), (b), (e), 16 U.S.C. § 824d(a), (b), (e).

In orders issued in 1996 and 1997 (which are not at issue in this appeal), the Commission conditionally authorized the establishment and operation of the California ISO. *Pacific Gas & Elec. Co.*, 77 FERC ¶ 61,204 (1996); *Pacific Gas & Elec. Co.*, 81 FERC ¶ 61,222 (1997). *See also, e.g., In re California Power Exch. Corp.*, 245 F.3d 1110, 1114-15 (9th Cir. 2001) (explaining development and role of California ISO). The Commission also allowed PG&E and other utility companies to categorize certain assets as either "transmission" or "distribution" facilities and to transfer operational control of any transmission facilities to the ISO. *See* Opinion No. 466 at P 2 (describing 1996 order), ER 345-46. The Commission required PG&E and the other companies to submit TO tariffs designed to recover their revenue requirements as transmission owners. 77 FERC at p. 61,826.

Prior to the instant proceeding, PG&E made two TO rate filings that were resolved by a FERC-approved settlement. *See* Opinion No. 466 at P 5, ER 347.

The instant proceeding concerns PG&E's third TO rate filing ("TO-3").[2]

B. The ALJ Decision and Commission Orders

PG&E sought to include approximately $132 million worth of facilities (collectively, the "Facilities") in its transmission owner rate base. The Facilities are grouped into three categories: (1) the Diablo Loop, Morro Bay Loop, and Moss Landing Loop facilities (collectively, "Loop Facilities"), comprising the bulk of the amount, approximately $89 million; (2) facilities described by the ALJ as "dual-function" ("Dual-Function Facilities"), approximately $17 million; and (3) facilities once performing, in addition to their network transmission functions, generation connection functions for generation that is no longer in service (collectively, "Dedicated Facilities"), approximately $26 million.

1. Proceedings Before Administrative Law Judge and ALJ Decision

The record in this case was developed in a proceeding before a presiding ALJ. PG&E and other parties, including DWR, filed written testimony and exhibits during the period from March 31, 1999 to February 10, 2000, and the ALJ conducted an evidentiary hearing from March 7, 2000 to March 16, 2000. ER 325 (summarizing deadlines); ER 454-78 (showing docket entries).

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[2] The TO-3 rates were in effect for a ten-month period in 1999 and 2000, and were superseded by a later rate filing that is not at issue here. *See* Opinion No. 466-B at P 2 & n.4, ER 444; ALJ Decision at 5 & n.3 (noting TO-3 rates would be effective from May 31, 1999 through March 31, 2000), ER 325.

On October 31, 2001, the ALJ issued his initial decision, *Pacific Gas & Elec. Co.*, 97 FERC ¶ 63,014 (2001) ("ALJ Decision"), ER 321. In relevant respect, regarding the facilities that PG&E sought to classify as network transmission facilities, the ALJ found that "[t]he record is conclusive that each of the facilities performs at least *some* network transmission function. . . . No party disputes this fact." ALJ Decision at 18, ER 338 (citations omitted; emphasis in original). Therefore, with the underlying facts established, the only issue to be decided was the appropriate treatment of the associated costs. *Id.*

The ALJ recognized that long-standing Commission policy required all costs associated with transmission to be rolled into the network transmission rate base, so long as any degree of integration with the transmission grid was shown. *Id.* But he went on to discuss FERC orders ruling that certain generation interconnection facilities should not be rolled into transmission rates,[3] and to conclude that FERC policy now favored allocating costs of transmission facilities by taking into account the extent to which they performed generation-related functions. *Id.* at 18-19, ER 338-39. Considering the three groups of Facilities and the functions they serve, the ALJ ruled as follows:

> Loop Facilities: The record established that "the Diablo, Morro Bay and Moss Landing Loops each indisputably performs a critical network transmission function," but their generation interconnection

[3] *See infra* Part II.C.1 (discussing FERC orders).

function outweighed their transmission function. *Id.* at 19, ER 339. Therefore, their associated costs were excluded from transmission rates. *Id.* at 20, ER 340.

Dual-Function Facilities: The record showed $17 million worth of the facilities to be "dual-function" (*i.e.*, network transmission function was not similarly outweighed by generation-related functions), but the ALJ likewise excluded them from the rate base. *Id.*

Dedicated Facilities: The record demonstrated that "while the remaining $26 million worth of facilities at issue once performed generation connection functions in addition to their network transmission functions, the previously connected generation is no longer in service. . . . It follows that these facilities must now be dedicated exclusively to network transmission." *Id.* The ALJ Decision thus allowed 100 percent of their associated costs to be included in the rate base. *Id.*

Acknowledging that cost recovery under the TO-3 tariff also required operational control of the facilities to have been transferred to the ISO, the ALJ Decision directed PG&E to make a supplemental filing with the Commission accurately reflecting all facilities that had been transferred to the ISO's operational control. *See id.* at 20-21, ER 340-41.

Various parties, including DWR, filed briefs on exceptions to the ALJ Decision.

2. Opinion No. 466

On August 28, 2003, the Commission issued an Opinion and Order Affirming in Part and Reversing in Part Initial Decision, *Pacific Gas & Elec. Co.*, 104 FERC ¶ 61,226 (2003) ("Opinion No. 466"), ER 342.

The Commission explained that the 1996 and 1997 orders conditionally

authorizing the establishment and operation of the California ISO, *see supra* p. 5, had indicated that the TO tariff of a participating transmission owner, such as PG&E, "would solely pertain to facilities . . . [that were] turned over to the operational control of the ISO." *Id.* at P 12, ER 349. The Commission quoted the specific language in PG&E's TO-3 tariff that conditioned inclusion in the rate base on the transfer of operational control. *Id.* at P 12, ER 349-50.

The Commission then held that the ALJ Decision had erred in deciding which facilities could be included in PG&E's rates based on whether those facilities should be classified as transmission or generation. *Id.* at P 13, ER 350. Instead, the Commission ruled that the transfer of operational control to the ISO was dispositive. *Id.* Though the record indicated that control of nearly all the disputed facilities had been turned over to the ISO, the Commission ordered PG&E to make a compliance filing to ensure that only facilities that had been turned over would be included in the transmission rate base. *Id.* at P 14, ER 350.

DWR and other parties requested rehearing of the order. *See* DWR Request for Rehearing (dated Sept. 29, 2003) ("First Rehearing Request"), ER 352.

3. Opinion No. 466-A

On February 17, 2004, the Commission issued its Order Granting Rehearing, Reversing the Initial Decision in Part and Affirming the Initial Decision in Part, *Pacific Gas & Elec. Co.*, 106 FERC ¶ 61,144 (2004) ("Opinion No. 466-A"),

ER 393. The Commission noted that DWR had "raised a legitimate concern that Opinion No. 466's approach — determining the rate treatment of facilities based solely on whether control has been transferred to the ISO — is inconsistent with [Commission] precedent." *Id.* at P 10, ER 397. Specifically, in earlier orders that had accepted PG&E and other utility companies' designation of their facilities as FERC-jurisdictional transmission and state-jurisdictional local distribution, the Commission had stated that the transfer of operational control of FERC-jurisdictional facilities to the ISO would not predetermine rate and cost issues and that cost recovery issues would be resolved in the utilities' individual tariff filings. *Id.* Therefore, the Commission granted rehearing and discarded its previous analysis. *Id.*

Having acknowledged the previous legal error, Opinion No. 466-A then essentially started over, "review[ing] the [ALJ] Decision anew to determine the appropriate allocation of transmission costs . . . ." *Id.* at P 1, ER 393; *see also id.* at P 11, ER 398 (again reviewing parties' briefs on exceptions).

a. Loop Facilities

The Commission cited the ALJ's conclusion that the each of the Loop Facilities indisputably performed a critical network transmission function, and further noted that "these 500 kV and 230 kV 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." *Id.* at P 14, ER 399. Examining the record, the Commission found additional supporting evidence to confirm the network transmission function of the Loop Facilities. *See infra* Part III.A (discussing record evidence).

The Commission reversed the ALJ Decision on the ground that, having found that the Loop Facilities provided network benefits, the ALJ had incorrectly focused on the Loop Facilities' generation-related functions and excluded their costs from PG&E's transmission rate base. The Commission rejected that conclusion: "That [the Loop Facilities] may also be used to transmit power from local area generation stations does not invalidate their status as part of the integrated grid." *Id.* at P 20, ER 401. Based on its policy that the integrated grid serves and inherently benefits all transmission customers, the Commission ruled that the costs associated with the Loop Facilities could be rolled into PG&E's transmission rate base. *Id.* at P 22, ER 401-02.

b. Dual-Function Facilities

The Commission then turned to the Dual-Function Facilities, and again "agree[d] with the [ALJ's] factual finding, but not his legal conclusion." *Id.* at P 23, ER 402. Noting that the ALJ had found the record "conclusive" and the facts undisputed that all of the facilities at issue performed network transmission functions, *id.*, the Commission examined the evidence regarding the Dual-Function

Facilities and confirmed that "[t]he record demonstrates that these transformers, though they also connect generation to the integrated grid, nonetheless serve a critical network function." *Id.* at P 24 (citing record evidence), ER 402; *see infra* Part III.B.

Based on this record evidence that the Loop Facilities and Dual-Function Facilities "undeniably serve an important network function," the Commission reversed the ALJ's legal conclusions and allowed the costs associated with those categories of facilities to be rolled into PG&E's Transmission Revenue Requirement. Opinion No. 466-A at P 25, ER 402.

c. Dedicated Facilities

With respect to the Dedicated Facilities, the Commission affirmed the ALJ's finding that the facilities exclusively serve the transmission system and should be rolled into the TO-3 rate base. *Id.* at P 26, ER 402; *see also infra* Part III.C. The Commission rejected DWR's challenge to that finding as relying on rebuttal testimony of a PG&E witness, Robert Jenkins, which DWR contended was unreliable and contradictory to other PG&E evidence. *See infra* Part IV.

In addition, the Commission reiterated the requirement that PG&E make the compliance filing, because, even though control was not dispositive of the rate issue, it did "remain[] a qualifying factor for facilities to be included in the Transmission Revenue Requirement." *Id.* at P 26 n.44, ER 403; *see infra* Part

V.A.

DWR again requested rehearing. *See* DWR Request for Rehearing (dated Mar. 18, 2004) ("Second Rehearing Request"), ER 404.

4. Opinion No. 466-B

On September 22, 2004, the Commission issued an Order Denying Rehearing, *Pacific Gas & Elec. Co.*, 108 FERC ¶ 61,297 (2004) ("Opinion 466-B"), ER 443. The Commission first rejected DWR's "incorrect factual premise" that the facilities in question are generation interconnection facilities, because "there is clear record evidence that they are not." *Id.* at P 11, ER 447. The Commission also rejected DWR's legal premises, denying that FERC's recent policy pronouncements had abandoned the fundamental principles of its roll-in policy, *id.*, and emphasizing that FERC continues to stand by that policy, as do the courts, *id.* at PP 14-15, ER 448. The Commission also denied that FERC had ever endorsed a different ("subfunctional") rate methodology for PG&E, expressly refuting DWR's misreading of a prior FERC order. *Id.* at P 16, ER 448-49.

The Commission observed that "DWR's evidentiary claims largely do not come to terms with the [ALJ]'s finding that all of the facilities perform some network function," and that DWR focuses instead on "to how great an extent the facilities perform such a function, which is irrelevant to the application of the policy" that any degree of integration is sufficient to support roll-in of costs. *Id.* at

P 20, ER 450. In any event, the ALJ's findings were supported by record evidence, including (but not limited to) Mr. Jenkins's rebuttal testimony, and were substantiated by the Commission's institutional knowledge of the California grid. *Id.* at P 21, ER 450-51. The Commission proceeded to refute DWR's specific contentions regarding Mr. Jenkins's rebuttal testimony and DWR's procedural objections to that testimony. *See id.* at PP 22-24, ER 451-52.

SUMMARY OF ARGUMENT

The Commission properly allowed PG&E to roll the costs of the Facilities into its transmission rates, based on application of FERC's "roll-in" pricing policy to the undisputed factual findings of the ALJ, supported by substantial record evidence, that the Facilities perform network transmission functions.

First, the Commission properly applied its longstanding policy allowing costs of transmission facilities that are part of an integrated transmission grid to be included in the transmission rate base. FERC's policy is based on its view that all facilities in an integrated transmission system benefit the system's users. Contrary to DWR's contention that FERC has changed its policy, FERC has consistently reaffirmed the "roll-in" policy, and the courts have consistently upheld its underlying rationale. FERC never endorsed PG&E's previous "subfunctionalized" rate methodology and was not required to adhere to that approach. DWR's emphasis on FERC precedents regarding facilities that are *not* part of the integrated

transmission grid is misplaced. Likewise, DWR's arguments regarding the reasonableness of PG&E's decisionmaking in developing its rate proposal are immaterial to review of FERC's orders in this case.

Second, the Commission's findings that the Facilities are part of the integrated transmission grid are well-supported by the record. The ALJ found the record conclusive, and undisputed, that the Facilities performed at least some network transmission functions. The Commission disagreed with the legal standard the ALJ applied to determine pricing of the Facilities, but adopted his factual findings. The Commission also went further, examining the record and citing additional evidence confirming those findings. DWR's evidentiary claims do not undermine that substantial evidence of the Facilities' integration with the grid.

DWR's remaining arguments are without merit. DWR's claim that it was denied due process because it could not respond to the rebuttal testimony of a single witness does not withstand scrutiny. DWR fails to show that it was denied any opportunity to respond, or that it objected to admission of the testimony, and likewise fails to explain how it would have contested the substance of the testimony. Though DWR argues that PG&E's required compliance filing regarding the Facilities' transfer to the ISO proves the Commission made ISO control dispositive of rate treatment, DWR itself concedes that ISO control is a

second, separate prerequisite for including costs in the rate base. Finally, DWR's conclusory arguments regarding discrimination also fail.

ARGUMENT

I. STANDARD OF REVIEW

Under the Administrative Procedure Act, 5 U.S.C. § 706(2)(A), the Court reviews FERC's orders to determine whether they are arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. *See, e.g., City of Fremont v. FERC*, 336 F.3d 910, 914 (9th Cir. 2003). The Commission's policy assessments are owed "great deference." *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 702 (D.C. Cir. 2000); *see Brannan v. United Student Aid Funds, Inc.*, 94 F.3d 1260, 1263 (9th Cir. 1996) ("We defer to the specific policy decisions of an administrative agency unless they are arbitrary, capricious, or manifestly contrary to statute"). The Commission's ratemaking determinations are accorded similar deference. *See, e.g., Entergy Servs., Inc. v. FERC*, 319 F.3d 536, 541 (D.C. Cir. 2004) (explaining "highly deferential" standard for issues of rate design).

The Commission's factual findings are conclusive if supported by substantial evidence. FPA § 313(b), 16 U.S.C. § 825*l*(b). Substantial evidence "'means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. If the evidence is susceptible of more than one rational

interpretation, we must uphold [FERC's] findings.'" *Bear Lake Watch, Inc. v. FERC*, 324 F.3d 1071, 1076 (9th Cir. 2003) (quoting *Eichler v. SEC*, 757 F.2d 1066, 1069 (9th Cir. 1985)) (alteration in original); *accord California ex rel. Lockyer v. FERC*, 329 F.3d 700, 714 (9th Cir. 2003); *see also Sierra Pac. Power Co. v. FERC*, 793 F.2d 1086, 1088 (9th Cir. 1986) (Commission's "conclusions on conflicting engineering and economic issues" must be upheld "so long as its judgment is reasonable and based on the evidence").

II. FERC PROPERLY APPLIED ITS POLICY OF ALLOWING COSTS OF FACILITIES THAT PERFORM A NETWORK TRANSMISSION FUNCTION TO BE ROLLED INTO THE TRANSMISSION RATE BASE

DWR attempts to portray the Commission's analysis of network transmission function in this case, and its holding that PG&E can include the costs of the Facilities in its TO-3 rate base, as a radical departure from prior FERC policy. *See generally* Br. at 1-3. FERC's policy, however, has long favored the roll-in of transmission costs where a system operates as an integrated whole; recent FERC orders have not backed away from that traditional policy. In addition, FERC's alleged "endorsement" (Br. at 23, 41) of PG&E's subfunctionalized rate methodology is a fiction; the relative merits of that methodology have never been litigated, and FERC has never endorsed it. Moreover, DWR glosses over the undisputed fact that all of the Facilities perform at least some network transmission function and instead focuses on irrelevant issues, such as PG&E's internal reasons

for seeking roll-in treatment.[4]

A. FERC's Policy Favors "Rolled-in" Cost Allocation for Facilities That Benefit the Transmission Grid

As the Commission noted below, it "has generally and routinely authorized rolled-in pricing for transmission facilities." Opinion No. 466-B at P 14, ER 448; *see also* Opinion No. 466-A at P 12, ER 398. Indeed, "historically, the rolled-in method of transmission cost allocation has been favored [by the Commission], 'given a finding that the system operates as an integrated whole . . . [and] . . . absent a finding of special circumstances.'" *American Elec. Power Serv. Corp.*, 101 FERC ¶ 61,211 at P 13 (2002) (quoting *Otter Tail Power Co.*, 12 FERC ¶ 61,169 at p. 61,420 (1980)) (alterations in original), *cited in* Opinion No. 466-A at P 12 n.25, ER 398, *and* Opinion No. 466-B at P 14 n.25, ER 448.

This policy is based on FERC's view that all facilities in an integrated

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[4] In addition, DWR continues to challenge the Commission's initial holding that ISO control was determinative of rate treatment. Br. at 49-51; *see also id.* at 60 (criticizing Opinion No. 466 for not distinguishing precedents). But the Commission itself reversed that holding. *See* Opinion No. 466-A at P 10 ("[T]he parties on rehearing have raised a legitimate concern that Opinion No. 466's approach . . . is inconsistent with our precedent."), ER 397; *id.* at P 1 ("Having reconsidered this issue, we review the [ALJ] Decision anew . . . ."), ER 393; Opinion No. 466-B at P 5, ER 445. In this case, the rehearing requirement of FPA § 313(b), 16 U.S.C. § 825*l*(b), functioned exactly as intended — DWR and others challenged the Commission's initial holding, and the Commission recognized its legal error and reviewed the ALJ Decision anew using the correct standard. Therefore, Opinion No. 466's holding, subsequently abandoned by the Commission, need not be addressed on appeal.

transmission system benefit the system's users:

> The basis of this policy is that the integrated grid is a single interconnected system serving and benefitting all transmission customers; indeed, it is the grid's interconnected nature that makes for a reliable system consistently providing for the delivery of electric energy to all customers even when particular facilities go out of service, either due to scheduled maintenance or unexpected outages.[] Our rolled-in pricing policy recognizes the inherent benefit of the integrated grid to customers, by spreading the costs of the integrated grid among all customers.

Opinion No. 466-A at P 22 (footnote omitted; citing *Otter Tail*, 12 FERC at p. 61,420), ER 401-02. *See also American Elec. Power Serv. Corp.*, 88 FERC ¶ 61,141 at p. 61,443 n.34 (1999) ("Rolled-in transmission rates are based on the costs of the entire transmission system and reflect the fact that, when there is an integrated system, all of the facilities in the system are deemed to contribute to each use of the system.").

Recent FERC orders confirm that its pricing policy for integrated networks remains unchanged: "It 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." *Northeast Tex. Elec. Coop., Inc.*, 108 FERC ¶ 61,084 at P 47 (2004), *cited in* Opinion No. 466-B at P 14, ER 448. Based on that policy, "a showing of *any* degree of integration is sufficient." 108 FERC at P 48 & n.66, *cited in* Opinion No. 466-B at P 19 & n.37

(emphasis in original), ER 450.[5]

The courts have consistently affirmed FERC's policy favoring rolled-in costs, as well as its "underlying rationale":

> The Commission's position with regard to assignment of costs is . . . part of a consistent policy to assign the costs of system-wide benefits to all customers on an integrated transmission grid. *We have approved the underlying rationale of this policy.* When a system is integrated, any system enhancements are presumed to benefit the entire system.

Western Mass. Elec. Co. v. FERC, 165 F.3d 922, 927 (D.C. Cir. 1999) (emphasis added). *See also Entergy*, 319 F.3d at 544, 545 (recognizing "the consistent application of the Commission's long-held view . . . that the transmission grid is an integrated whole" and "the Commission's long-standing rejection of direct assignment of network costs"). Moreover, courts have rejected challenges to

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[5] Contrary to DWR's contention, the Commission has not backed away from its roll-in policy. *See* Br. at 52-53 (discussing *Standardization of Generator Interconnection Agreements and Procedures*, 104 FERC ¶ 61,103 (2003) ("Order No. 2003"), *order on reh'g*, 106 FERC ¶ 61,220 (2004) ("Order No. 2003-A"), *order on reh'g*, 109 FERC ¶ 61,287 (2004)). In its policy pronouncements in its Order No. 2003 rulemaking, the Commission specifically explained that it "did not intend to abandon any of the fundamental principles that have long guided our transmission policy." Order No. 2003-A at P 580 (citation omitted); *see* Opinion No. 466-B at P 12, ER 447.

While that rulemaking, dealing with generator interconnection procedures, does permit certain (independent) transmission providers to use a "more creative and flexible approach," including the option of direct assignment of interconnection costs under certain circumstances, *see* Order No. 2003-A at P 587, nothing in Order No. 2003 mandates an incremental pricing policy with respect to any facilities. *See* Opinion No. 466-B at P 12, ER 447.

FERC's broad view of what benefits the transmission system:

> The Commission's rationale for crediting network upgrades, based on a less cramped view of what constitutes a "benefit," reflects its policy determination that a competitive transmission system, with barriers to entry removed or reduced, is in the public interest. That Entergy would confine "benefits" to increases in capacity of the transmission system or to enhancements other than maintained stability in an expanded system . . . overlooks the Commission's long-held view of the benefits of expansion and the role of network system upgrades.

See id. at 543-44; *see also Western Mass.*, 165 F.3d at 927-28 (affirming FERC orders allowing costs of grid upgrades associated with interconnections to be rolled into transmission service provider's rate base rather than assigned to those interconnecting facilities).

The D.C. Circuit again upheld the principle of FERC's ratemaking policy in July 2004, barely two months before the Commission denied rehearing in this case. *See Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361 (D.C. Cir. 2004), *cited in* Opinion No. 466-B at P 15 n.28, ER 448. In that case, the court affirmed FERC orders approving a cost adder under the Midwest Independent System Operator ("MISO") tariff, designed to recover MISO administrative costs. 373 F.3d at 1369-71. The MISO transmission owners argued that certain kinds of loads would benefit little from those costs and should not be charged the cost adder. *Id.* at 1369-70. The court began with the uncontroversial proposition (which the MISO owners did not contest) "that upgrades designed to preserve the grid's reliability constitute system enhancements [that] are presumed to benefit the entire

system." *Id.* at 1369 (quoting *Entergy*, 319 F.3d at 543) (internal quotation marks omitted); *see also Western Mass.*, 165 F.3d at 923, 927 (cited in *Entergy*). Ultimately, the court reasoned that the cost adder recovered "the administrative costs of *having* an ISO," which benefits users "even if they are not in some sense *using* the ISO." 373 F.3d at 1371 (emphases in original).[6]

B. FERC Never Endorsed PG&E's Subfunctionalized Rate Method

DWR's core argument — that the orders below departed from FERC precedent *regarding PG&E* — rests on a false premise: that the Commission previously endorsed and adopted PG&E's subfunctionalization methodology and could not approve a different rate methodology without justifying the change. *See, e.g.*, Br. at 37-43. PG&E did develop a unique rate methodology in the 1970's that it previously used to establish its rates for transmission services; rather than aggregate all its transmission facilities into a single transmission function, PG&E subdivided its transmission facilities into five classes (backbone, generation tie, exclusive use, system interconnection, and area) and allocated costs and

[6] The court further emphasized that it has "never required a ratemaking agency to allocate costs with exacting precision." *Id.* at 1369, *quoted in* Opinion No. 466-B at P 15, ER 448. Thus, the Commission noted in this case that, "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." *Id.*

determined rates for each subfunction.[7] But while the Commission previously accepted various rate proposals that were based on PG&E's methodology, the Commission never determined whether that methodology was appropriate, much less whether it was superior to FERC's roll-in method. *See* Opinion No. 466-B at P 16, ER 448-49. The Commission did not need to decide that question, as the merits of the subfunctionalized method were never contested or litigated in a FERC proceeding.

DWR wrongly asserts that the Commission "endorsed" PG&E's old methodology. *See* Br. at 23, 41. In particular, DWR persists in advancing a misreading of a FERC order that the Commission itself has discredited. DWR premises its argument on a strategically placed ellipsis:

> *As the Commission explained* in Opinion No. 356, ". . . the subfunctionalized method tracks the costs associated with providing transmission services more accurately than the more traditional system-wide 'rolled-in' method. . . ."

Br. at 37-38 (first ellipsis in original) (emphasis added). The language that DWR omits from the beginning of the quotation is "PG&E states that." *See* Opinion No. 356, 53 FERC at p. 61,521. Responding to this same argument, the Commission pointed out that the 1990 order was merely describing, in a background section, PG&E's advocacy in favor of its own method. Opinion No. 466-B at P 16

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[7] *See, e.g., Pacific Gas & Elec. Co.*, 53 FERC ¶ 61,146 at p. 61,520 (1990) ("Opinion No. 356").

("Opinion No. 356 describes *PG&E's rate filing* as containing this claim") (emphasis in original), ER 449.

Indeed, immediately following that summary of PG&E's statements, the 1990 order noted that "No party in this proceeding contests PG&E's subfunctional methodology. *In fact, the merits of PG&E's subfunctional methodology, as compared to a system-wide 'rolled-in' methodology, have never been litigated*." Opinion No. 356 at p. 61,521 n.66 (emphasis added), *quoted in* Opinion No. 466-B at P 16, ER 449. Later in the same order, the Commission stated "that 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.*" Opinion No. 356 at p. 61,525 n.90 (emphases added), *quoted in* Opinion No. 466-B at P 16, ER 449. Therefore, the text of Opinion No. 356 itself, and the Commission's thorough refutation in Opinion No. 466-B, left no room for misinterpretation.

Nor do other FERC orders cited by DWR support its claim that FERC adopted and endorsed PG&E's prior method. For instance, contrary to DWR's claim that the Commission "endorse[d]" PG&E's subfunctional rate methodology (Br. at 41) in *Turlock Irrigation Dist. v. Pacific Gas & Elec. Co.*, 64 FERC

¶ 61,183 (1994),[8] the Commission actually *declined* to do so. Turlock petitioned for a declaratory order "stating that a subfunctionalized rate design is appropriate . . . and finding that any proposal proffered by PG&E to convert to a rolled-in rate design will be rejected." *Id.* at p. 62,542. The Commission dismissed the petition, expressly leaving the question to be litigated whenever PG&E filed a proposed change in rates for that service. *Id.* at p. 62,544. Moreover, the Commission went out of its way to note that "[t]he Commission's usual policy is to consider the transmission grid as fully integrated, and to develop a rolled-in rate reflecting a pro rata share of the average cost of all transmission facilities," and that PG&E's methodology "depart[ed] from this [FERC] precedent." 64 FERC at p. 62,542 n.1.

Similarly, a 1993 decision regarding PG&E interconnection agreements does not further DWR's claim (*see* Br. at 40). In that case, an ALJ rejected a proposal by PG&E to convert the rates under numerous existing interconnection agreements, which had been established using PG&E's subfunctionalized rate method, to rolled-in pricing that would aggregate PG&E's entire transmission system, over the opposition of the counterparties to those existing agreements. *Pacific Gas & Elec. Co.*, 63 FERC ¶ 63,018 at pp. 65,096-98 (1993). On review of

[8] DWR never raised this order to the Commission in either of its Rehearing Requests.

the ALJ's decision, the Commission subsequently noted that the ALJ had found the proposal to be "'unjust, unreasonable and, for the most part, unwanted and unneeded.'" *Pacific Gas & Elec. Co.*, 67 FERC ¶ 61,239 at p. 61,753 n.5 (1994) (citation omitted). But the Commission did not, as DWR implies (Br. at 40), endorse or even analyze that finding; because "[n]o party excepted to [the ALJ's] ruling," the Commission affirmed the ALJ's ruling rejecting PG&E's proposal without considering its merits. *Id.*

In short, DWR's only argument that the Facilities' "roll-in" to the TO-3 rate base departs from "precedent" is premised on PG&E's own past choices, not on the Commission's adoption or "endorsement" of PG&E's past rate method over established FERC policy. At most, one could argue that, had the Commission chosen to require subfunctionalized transmission rates here, against PG&E's present wishes, PG&E's own past use of such methodology might have supported the reasonableness of that holding. But there is no basis in law or fact to compel FERC to disregard its longstanding roll-in policy and to adhere to a methodology it never adopted in the first place, especially in light of the deference afforded to FERC's policy decisions.

C. DWR's Arguments Regarding Exceptions to FERC's Roll-in Policy and PG&E's Decisionmaking Are Irrelevant

1. FERC Precedents Regarding Non-Integrated Facilities Are Inapposite

The Commission reversed the ALJ's legal conclusions because it concluded he had misapplied a narrow line of cases concerning an exception to FERC's roll-in policy. Relying on *Kentucky Utilities Company*, 85 FERC ¶ 61,274 (1998), and *Northern States Power Company*, 64 FERC ¶ 61,324 (1993), the ALJ ruled that PG&E should not be allowed to roll in the entire costs associated with facilities that performed generation interconnection functions in addition to network transmission functions. ALJ Decision at 18-20, ER 338-40.

Though DWR now argues the relevance of *Kentucky Utilities* and *Northern States* at some length (Br. at 56-61), it did not make this argument on rehearing, as the Commission noted: "DWR does not attempt to distinguish our discussion of *Kentucky Utilities* and *Northern States*." Opinion No. 466-B at P 10, ER 446. Because DWR failed to challenge the Commission's reading of those cases below, it is jurisdictionally barred from adopting this new argument on appeal. FPA § 313(b), 16 U.S.C. § 825*l*(b); *California Dep't of Water Resources v. FERC*, 341 F.3d 906, 910-11 (9th Cir. 2003) (citing cases); *California Dep't of Water*

Resources v. FERC, 306 F.3d 1121, 1126 (D.C. Cir. 2002).[9]

In any event, those cases are inapposite. As the Commission explained,[10] *Kentucky Utilities* (as well as *Maine* and *AEP*) involved facilities that were not part of the integrated grid. *See* Opinion No. 466-A at P 19, ER 400. Those cases specifically concerned the costs of generation step-up transformers ("GSUs"), "which are located at generation stations and used solely to increase the voltage of electric energy produced by generators to the higher voltages necessary for bulk power transmission to load centers." *Id.*; *see also Kentucky Utils.*, 85 FERC at p. 62,109 n.33; *Maine*, 85 FERC at p. 12,565 n.23; *AEP*, 88 FERC at p. 61,447. The GSUs' *only* transmission-related role was directly tied to generation; "such 'GSUs serve[] no purpose without the generator.'" Opinion No. 466-A at P 19 (quoting *Kentucky Utils.*, 85 FERC at p. 62,109 n.33), ER 400; *see also* 85 FERC at p. 62,112 ("any service provided by a GSU is provided from its related

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[9] DWR also goes on to discuss additional cases that neither the Commission nor the ALJ addressed. Br. at 59-60 (discussing *Maine Pub. Serv. Co.*, 85 FERC ¶ 61,412 (1998), and *American Elec. Power Serv. Corp.*, 88 FERC ¶ 61,141 (1999) ("*AEP*")). DWR itself never mentioned either case, even in passing, in either Rehearing Request.

[10] The Commission's reasonable interpretation of its own orders must be upheld. *Mid-Continent Area Power Pool v. FERC*, 305 F.3d 780, 783 (8th Cir. 2002); *Texaco Inc. v. FERC*, 148 F.3d 1091, 1099 (D.C. Cir. 1998).

generator").[11] Here, by contrast, the ALJ found, and the Commission affirmed, that the Facilities are part of the integrated grid; therefore, the GSU cases are inapposite and FERC's rolled-in transmission pricing policy should apply. Opinion No. 466-A at PP 20, 24, ER 401, 402.

The Commission also distinguished *Northern States*. *See* Opinion No. 466-A at P 21, ER 401. In that case, decided before FERC mandated unbundling of transmission and wholesale generation services, a utility company sought to include certain costs of generation in its transmission rates, on the theory that its generating plants provided certain benefits (related to reactive power and frequency control) to the transmission network. *See id.*; *Northern States*, 64 FERC at p. 63,378-79. The Commission did not rule out the possibility of permitting such a voluntary departure from precedent to allow "refunctionalization" of generation costs to transmission rates if the allocation were well-supported, but found the utility's proposal was not. Opinion No. 466-A at P 21, ER 401; *see also Northern States*, 64 FERC at p. 63,379-80. Here, PG&E's costs for the Facilities were historically included in its transmission rates — there is no such

[11] In those cases, the Commission concluded that, because "'GSUs are not part of a utility's integrated transmission grid' . . . the costs associated with them should be charged directly to the relevant generating unit, and not to transmission customers . . . ." Opinion No. 466-A at P 19, ER 400 (quoting *Kentucky Utils.*, 85 FERC at p. 62,111-12); *accord Maine*, 85 FERC at p. 62,566; *AEP*, 88 FERC at p. 61,447.

"refunctionalization" of generation costs — and the Facilities were actually found to provide network benefits. Opinion No. 466-A at P 21, ER 401.

2. PG&E's Decisionmaking Is Not Relevant

At the heart of DWR's challenge to the Commission's rulings on the rate treatment of the Facilities are objections to PG&E's decisionmaking. DWR devotes much of its Brief to attacking PG&E's proposed standard for inclusion in the TO-3 rate base and its selection of facilities it would seek to include — all of which is irrelevant to the Commission's determination, based on FERC's own policy and an extensive factual record, as to the proper rate treatment of the Facilities. Whether PG&E's internal decisionmaking, leading to the filing of its rate proposal with the Commission, would meet the standards of the Administrative Procedure Act is immaterial.

For instance, DWR contends that PG&E failed to justify its change, for purposes of seeking rate treatment of particular facilities, from a "primary purpose" standard to an "exclusive use" standard. *See, e.g.,* Br. at 30-32, 35, 37, 54-55; *see also id.* at 11-16. But the ALJ expressly declined to "address the merits/deficiencies of PG&E's proposed 'exclusive use' definition" because it was not necessary to decide the issue presented and, as a policy matter, was not within the scope of the ALJ's authority. ALJ Decision at 17-18 & n.17, ER 337-38. Likewise, in the series of orders on appeal, the Commission never discussed

PG&E's "exclusive use" standard, or the "merits/deficiencies" thereof, instead applying its own well-established roll-in policy. Therefore, neither PG&E's "exclusive use" proposal nor its previous "primary purpose" test factored into FERC's decisionmaking.[12]

For the same reason, DWR's focus on whether "physical change[s]" to the Facilities justified PG&E's decision to seek to include the Facilities in its TO-3 rate base is beside the point. *See* Br. at 31; *see also id.* at 30, 35. Nothing in FERC's decisionmaking purported to be based on physical changes. Moreover, as the Commission noted, DWR's emphasis on PG&E's "reclassification" of the Facilities (*see, e.g.*, Br. at 30-32, 35) ignores the fact that the Facilities were *always* included in transmission rates. *See* Opinion No. 466-B at P 17 ("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.") (emphases in original) (footnote omitted), ER 449.

III. FERC'S FINDINGS ARE SUPPORTED BY SUBSTANTIAL EVIDENCE

Despite DWR's efforts to portray the Commission's ruling on the Facilities

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[12] Along these same lines, DWR cites the irrelevant testimony of a PG&E witness regarding the reason he used certain internal PG&E criteria to assign costs in preparing PG&E's rate filing. *See* Br. at 32, 43. Notably, that witness was not Robert Jenkins, whose testimony DWR contends (*see, e.g.*, Br. at 21, 22) is the primary evidentiary basis for the Commission's rulings. *See* ER 312, 314 (testimony of Gary Irwin).

as uninformed and unsupported, the orders on appeal demonstrate the Commission's careful consideration of the extensive factual record developed by the ALJ. Taken together, the FERC orders more than meet the deferential "substantial evidence" standard.

First, the ALJ found the record "conclusive" that each of the Facilities performs a network transmission function. ALJ Decision at 18, ER 338 (citing written testimony of PG&E and DWR witnesses and transcript excerpts).[13] He further noted that no party disputed that fact. *Id.* DWR itself asserts that the ALJ's decision "reflected thorough consideration of the record evidence which he had taken at the hearing. . . ." Br. at 17.

The Commission did not disturb the ALJ's factual findings; to the contrary, it expressly adopted and relied on them. *See, e.g.*, Opinion No. 466-A at PP 14, 23, 26, ER 399, 402, 403; Opinion No. 466-B at PP 19, 20, ER 450. The Commission only disagreed, with respect to the Loop Facilities and the Dual-Function Facilities, with the ALJ's legal analysis of the rate treatment that followed from those facts:

> Our problem with the [ALJ] Decision was that the [ALJ] — having found the record "conclusive" that each of the contested facilities in all three categories performed "at least some network transmission

[13] Notably, the ALJ cited the written testimony of Gregory Vassell, submitted by DWR. *See id.* (citing Exh. DWR-1 at 29). The cited page of Mr. Vassell's testimony appears at ER 39.

> function," and that "[n]o party disputes this fact,"[] — 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.

Id. at P 19 (footnote omitted) (alterations in original), ER 450; *see also* Opinion No. 466-A at P 23 ("The Commission agrees with the judge's factual finding [that each of the Facilities performed some network transmission function], but not his legal conclusion."), ER 402. Rather than simply correct that legal analysis, the Commission took the extra step of citing additional details from the record to corroborate and flesh out the Facilities' particular roles in the integrated network transmission system. Thus, the Commission's discussion of specific record evidence enhanced, but in no way repudiated, the ALJ's findings of fact.

As the Commission explained, the network transmission function of each of the three categories of Facilities was well-supported by undisputed record evidence.

A. The Record Showed That the Loop Facilities Serve the Integrated Transmission Network

Comprising $89 million of the gross plant at issue, the Loop Facilities account for "the lion's share" of the costs that PG&E sought to recover through its Transmission Revenue Requirement. Opinion No. 466-A at P 2, ER 394; *see also* Opinion No. 466-B at P 2 (facilities to be included in rate base were "primarily the Diablo Loop, Morrow Bay Loop and Moss Landing Loop facilities"), ER 444. *See*

also ER 250 (testimony submitted by PG&E, specifying that the Diablo Loop consists of $61 million gross plant, the Morro Bay Loop $12 million, and the Moss Landing Loop $16 million).

The ALJ found that the record established that "the Diablo, Morro Bay and Moss Landing Loops each indisputably performs a critical network transmission function." ALJ Decision at 19, ER 339. In fact, DWR's own witness, Gregory Vassell, conceded that the 500 kV lines in the Diablo Loop and the 230 kV lines in the Morro Bay Loop "undoubtedly contribute to the overall resilience of the transmission network." ER 39. The Commission adopted the ALJ's finding. *See* Opinion No. 466-A at P 14, ER 399.

Especially critical to the Loop Facilities' network transmission function is their relationship to Path 15. The Commission took notice of the fact that "these 500 kV and 230 kV 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." *Id.* Though DWR derides (Br. at 23, 33[14]) the Commission's reference to its "institutional knowledge concerning the California grid," Opinion No. 466-B at P 21, ER 451, it would be remarkable if the Commission had

[14] The Commission did not, as DWR claims (Br. at 22), cite its familiarity with the California grid "for the first time" in the third and final FERC order. The Commission plainly referred to its knowledge in Opinion No. 466-A: "the Commission *takes notice of the fact* [that lines are parallel to Path 15]." *Id.* at P 14 (emphasis added), ER 399.

disregarded that knowledge. Path 15 is essential to the operation of the transmission grid throughout California and the Pacific Northwest — and it is often stretched to (or beyond) its capacity. The D.C. Circuit recently described its function as follows:

> High voltage transmission lines, known as Path 15, extend from southern to northern California. Path 15 is the principal means of transmitting electricity between these two regions of the state and into the Pacific Northwest. . . . In the winter, energy typically flows from south [from natural gas-fired generators in Southern California] to north. Summer flows are in the opposite direction [from hydroelectric generation in Northern California and the Pacific Northwest to the south].

Public Utils. Comm'n of Cal. v. FERC, 367 F.3d 925, 927 (D.C. Cir. 2004); *see also id.* at 928 (citing FERC's finding that "Path 15 was 'a uniquely critical path'") (citation omitted). Those seasonal shifts in generation sources tax the available capacity on Path 15; in fact, "[t]he movement of power along Path 15 is often constrained because of its lack of capacity to handle the transmission of power in the summer and winter months." *Id.* at 927. In that case, FERC had found that "congestion had 'serious impacts on the ability to move power,' . . . and that congestion costs to California energy consumers amounted to $222 million in just the 16 months prior to December 2000." *Id.* at 928 (citations omitted).

Given the record evidence that the Loop Facilities serve as alternative paths to relieve constraints on Path 15, the Commission would have been remiss had it failed to acknowledge the significance of that network function. In any event, the

Commission merely indicated that its familiarity with the grid "substantiated" the ALJ's findings (Opinion No. 466-B at P 21, ER 451) — not that such knowledge was a substitute for record evidence. The record evidence did, in fact, support the Commission's understanding that the Loop Facilities offered parallel paths to Path 15. For example, Mr. Jenkins had testified that the Diablo Loop lines provide an "additional transmission path" on a separate corridor that "allow[s] for increased power transfers between northern and southern California." Supp. ER 500; Opinion No. 466-A at P 15, ER 399. Without these facilities, north-south "transfers on . . . Path 15 would need to be reduced by as much as 25 percent (500 MW)." Supp. ER 500; *see also* 3/9/00 Hrg. Tr. 476:6-477:10, Supp. ER 549-50; Opinion No. 466-A at P 15, ER 399. Mr. Jenkins further testified that the Morro Bay Loop provides an additional parallel path to the Diablo Loop and thus to Path 15. Supp. ER 500; Opinion No. 466-A at P 16, ER 400.

Aside from the Loop Facilities' relationship to Path 15, the Commission went beyond the ALJ's finding that the Loop Facilities "indisputably" perform a critical network function, ALJ Decision at 19, ER 339, and cited additional details in the record regarding the Loop Facilities' integration with the transmission grid. As noted above, there was evidence that the three 500 kV lines comprising Diablo Loop "integrate the Diablo Canyon nuclear facility with other 500 kV facilities." Opinion No. 466-A at P 15, ER 399; Supp. ER 500. There was evidence that the

Morro Bay Loop, which consists of six 230 kV lines, integrates the Las Padres area of PG&E's system with the rest of the Northern California grid and delivers excess local generation into the grid and imports power when local generation is low. Opinion No. 466-A at P 16, ER 399-400; Supp. ER 500-01; *see also* 3/9/00 Hrg. Tr. 468:14-469:1, Supp. ER 543-44. There also was evidence that the 500 kV Moss Landing Loop integrates the Central Coast area of PG&E's system with the rest of the Northern California grid, serves the bulk power needs of the area load, and is one of only two 500 kV sources for 2000 megawatts of load served from the Metcalf substation. Opinion No. 466-A at P 17, ER 400; Supp. ER 501.[15]

Based on this record evidence supporting the ALJ's finding that the Loop Facilities performed network transmission functions, the Commission reversed the ALJ's legal conclusions, in accordance with FERC policy that "a showing of *any* degree of integration is sufficient," and allowed the costs associated with the Loop Facilities to be included in the rate base. Opinion No. 466-B at P 19 (emphasis in original, internal quotation marks and citation omitted), ER 450.

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[15] *See generally* ER 222-23 (testimony of a different PG&E witness, in an earlier proceeding, that 500 kV and 230 kV are the two highest voltages of lines used in PG&E's transmission system; that the 500 kV lines are integrated with the 230 kV facilities, and "were designed to provide the ability to import and export large blocks of power from and to the Northwest and Southwest"; and that, "[a]lthough some of these 500 kV facilities also provide connections for PG&E's Diablo Canyon Power Plant . . . and Moss Landing Power Plant . . . , they are part of the integrated transmission network . . . .").

B. The Record Showed That the Dual-Function Facilities Serve the Integrated Transmission Network

The ALJ found that the record showed $17 million worth of the remaining Facilities to be "dual-function," meaning that they performed both network transmission and generation-related functions. ALJ Decision at 20, ER 340. The Commission again adopted the ALJ's factual finding. *See* Opinion No. 466-A at P 23, ER 402.

Noting that the ALJ had found the record "conclusive" and the facts undisputed that all of the facilities at issue performed network transmission functions, *id.*, the Commission examined the detailed evidence regarding the Dual-Function Facilities to confirm that those Facilities "serve a critical network function." *Id.* at P 24, ER 402. Responding to testimony submitted by FERC's Trial Staff that winding transformers are not part of the network grid, Mr. Jenkins testified that these transformers "serve as 'interchange' banks," allowing power flows between two transmission voltages. Supp. ER 502-03; *see also* 3/9/00 Hrg. Tr. 493:8-21 (testifying that "there's no load directly connected to the transformer. It's just a transformer within the network . . ." and that both voltage levels are part of the transmission network), Supp. ER 551; Opinion No. 466-A at P 24 (concluding "fact that transformers allow power flows between two transmission voltages . . . distinguish[es] these transformers" from other transformers serving no transmission function), ER 402. As such, he testified that "[t]hese are not

transformers that are solely serving generation station load or distribution load . . . ." Supp. ER 503. Based on this record evidence that the Dual-Function Facilities "undeniably serve an important network function," the Commission reversed the ALJ's legal conclusions and allowed the costs associated with those Facilities to be rolled into PG&E's rate base. Opinion No. 466-A at P 25, ER 402.

C. The Record Showed That the Dedicated Facilities Serve the Integrated Transmission Network

The ALJ found that the record demonstrated that "while the remaining $26 million worth of facilities at issue once performed generation connection functions in addition to their network transmission functions, the previously connected generation is no longer in service. . . . It follows that these facilities must now be dedicated exclusively to network transmission." ALJ Decision at 20, ER 340.[16] The Commission adopted the ALJ's finding that the facilities exclusively served the transmission system and should be rolled into the TO-3 rate base. Opinion No. 466-A at P 26, ER 402. The Commission noted that DWR challenged that finding because it relied on Mr. Jenkins's rebuttal testimony, but "d[id] not refute the substance of Mr. Jenkins'[s] testimony." *Id.*, ER 402-03.

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[16] In addition to Mr. Jenkins's rebuttal testimony (Supp. ER 496-519, cited by ALJ as Exh. PGE-13), the ALJ cited other evidence in the record: Exh. PGE-10 (Prepared Rebuttal Testimony of Gary Irwin) at 12, ER 276; 3/9/00 Hrg. Tr. 383 (testimony of Irwin); and 3/15/00 Hrg. Tr. 661-62 (testimony of DWR witness Vassell). *See* ALJ Decision at 20, ER 340.

D. DWR's Arguments Do Not Detract From the Substantial Evidence Showing the Facilities' Integration With the Transmission Grid

As the Commission noted, "DWR's evidentiary claims largely do not come to terms with the judge's finding that all of the facilities perform some network function." Opinion No. 466-B at P 20, ER 450. Rather, DWR focused on the extent to which the Facilities performed network functions, relative to other functions, which the Commission found irrelevant to the application of the roll-in policy. *Id.* In this sense, DWR repeats the ALJ's legal error.

Furthermore, as the Commission observed, DWR's focus on the reliability or admissibility of Mr. Jenkins's testimony "ignores that the [ALJ]'s specific findings . . . that the three Loop facilities and the so-called 'dual-function' facilities performed network functions is also supported by other evidence." *Id.* at P 21, ER 450-51 (citing Opinion No. 466-A at P 14 & n.28, P 23 & n.40, in turn citing ALJ Decision at 18, 20, ER 338, 340). Those two groups of Facilities account for $106 million, or approximately 80 percent, of the disputed costs. "Only with respect to the third group of facilities [the Dedicated Facilities] did the [ALJ] and the Commission primarily rely on Mr. Jenkins." Opinion No. 466-B at P 21 n.39,

ER 451. *But see supra* note 16 (listing other evidence cited by ALJ).[17] Moreover, DWR never disputed the *substance* of Mr. Jenkins's testimony about the Facilities. Opinion No. 466-A at P 26, ER 403; Opinion No. 466-B at P 22 ("DWR continues to nibble around the edges without directly attacking the heart of Mr. Jenkins'[s] testimony."), ER 451.

Nor does Mr. Jenkins's reliance on PG&E maps and diagrams detract from the evidentiary value of his testimony. *See* Br. at 31-32. As the Commission noted, "DWR has not demonstrated that the diagrams do not accurately represent the facilities in question." Opinion No. 466-B at P 22, ER 451. Instead, DWR's focus on errors in the maps "appear to refer to the confusion about what facilities had been turned over to ISO control" — an issue that, as discussed *infra* in Part V.A, is immaterial to this appeal — "not whether they correctly represented the facilities." *Id.* Moreover, given Mr. Jenkins's experience with PG&E's system and responsibility for its transmission system planning, his testimony was not based solely on the content of maps or diagrams to which he referred but was

[17] Of course, even if the Commission had, as DWR contends, depended on the testimony "of a single company witness who was advocating for the applicant" (Br. at 35), this Court has recently "decline[d] to hold as a matter of law that facts developed from the testimony of one interested person cannot constitute substantial evidence." *California ex rel. Lockyer*, 329 F.3d at 714 n.16 (holding FERC's decision, relying on affidavit of official of interested party, was based on substantial evidence). But as shown herein, the Commission's ruling was in fact supported by substantial evidence from multiple sources in the record.

"obviously based on his knowledge and experience pertaining to the relevant portions of the PG&E transmission system." *Id.*[18]

DWR also points to various evidence it argues the Commission failed to discuss. Br. at 31. But here again it focuses on irrelevant issues — "reclassification[]" of the Facilities and comparison of internal PG&E methodology determinations. *See id.* Moreover, these evidentiary arguments are jurisdictionally barred because DWR failed to raise them on rehearing. FPA § 313(b), 16 U.S.C. § 825*l*(b). In any event, DWR "misconceives the nature of the substantial evidence standard"[19] — it is not enough for DWR to point to bits of purportedly conflicting evidence in a voluminous record developed through extensive litigation. Even if DWR could strongly support its own position, the Commission's adequately-supported ruling must nonetheless be affirmed. *See Ash Grove Cement*, 577 F.2d at 1379 ("Even if we accepted [Petitioner's] exhibits as reliable and agreed that a strong showing of [Petitioner's position] had been made, we must affirm the Commission if the record contains substantial evidence to

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[18] In any event, maps constitute appropriate evidentiary support for FERC decisionmaking. *See, e.g., B&J Oil & Gas v. FERC*, 353 F.3d 71, 77 (D.C. Cir. 2004) (rejecting argument that FERC orders were unsupported where FERC had based findings on maps relating to natural gas storage facility: "This data-rich evidentiary record easily satisfies our 'more than a scintilla, less than a preponderance' standard. Moreover, FERC's decision rests on just the type of highly technical evidence that this court is least equipped to second-guess.").

[19] *Ash Grove Cement Co. v. FTC*, 577 F.2d 1368, 1379 (9th Cir. 1978).

support the Commission's findings.").

IV. DWR'S DUE PROCESS ARGUMENT IS MERITLESS

DWR argues that it was denied due process because it could not respond to Mr. Jenkins's rebuttal testimony. Br. at 33-35. Setting aside the fact, as discussed above, that the Commission's ruling was not based solely on Mr. Jenkins's rebuttal testimony, DWR's due process argument is without merit.

DWR never describes what kind of evidence it might have sought to introduce in response to the rebuttal testimony, or what such evidence might have shown to counter that testimony. *See Entergy*, 319 F.3d at 545 (affirming Commission's decision not to hold formal evidentiary hearing, where "[Petitioner] fails to point to any evidence that could have been submitted or developed only through additional evidentiary procedures").

More to the point, DWR fails to specify what due process it claims to have been denied. Nor does it point to any prejudice it claims to have suffered. Indeed, DWR has cited nothing in the record to show that it ever sought any opportunity to respond to Mr. Jenkins's testimony, other than by cross-examination, or that the Commission ever denied DWR such opportunity. DWR merely points to its own arguments and conclusory statements in its Second Rehearing Request regarding PG&E's discovery responses. *See* Br. at 33 (citing ER 432-33).

First, DWR contends that it was denied the opportunity "to respond to all

evidence presented at the hearing" (Br. at 33). But DWR had ample notice of the testimony PG&E would present. As is standard practice in such administrative proceedings, all witness testimony was submitted in written form weeks or months before the hearing. *See* 18 C.F.R. §§ 385.506, .507 (Commission rules of practice and procedure requiring all direct and rebuttal testimony to be submitted in written form prior to hearing). In particular, Mr. Jenkins's rebuttal testimony was filed at FERC on February 10, 2000, more than a month before he testified at the hearing on March 9. *See* ER 325 (ALJ Decision); ER 475 (docket entry showing date of filing); 3/9/00 Hrg. Tr. 439:19-25, Supp. ER 522 (beginning of Mr. Jenkins's hearing testimony). DWR has not alleged that it was unaware of Mr. Jenkins's testimony prior to the hearing, or that DWR sought, and the ALJ denied it, an opportunity to present responsive evidence.

Second, Mr. Jenkins's testimony was proper rebuttal testimony. He professed to respond to testimony of witnesses for FERC trial staff and for DWR regarding the functions of the specific facilities at issue and how they "perform a 'network' transmission function to integrate electric resources and/or provide for reliability [of] service to electric consumers . . . ." Supp. ER 499. Therefore, the Commission found that his testimony "provided information to counter contrary claims by the opposing parties, which is exactly the function of rebuttal evidence." Opinion No. 466-A at P 26, ER 402-03. *See also United States v. Webb*, 115 F.3d

711, 719 (9th Cir. 1997) (noting that "[t]he proper scope and function of rebuttal is . . . refutation, which involves evidence which denies, explains, qualifies, disproves, repels, or otherwise sheds light on evidence offered by the defense . . . .") (citation omitted).

Third, "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." Opinion No. 466-B at P 24, ER 452. DWR's cross-examination of Mr. Jenkins, spanning approximately 22 pages of the hearing transcript, is reproduced in its entirety at Supp. ER 526-48. Notably, at no point during that cross-examination did DWR's counsel challenge the scope or propriety of Mr. Jenkins's rebuttal testimony, nor did she inquire about any alleged inconsistency with PG&E's discovery responses.

Finally, the Commission correctly concluded, when DWR first raised the due process argument in its Second Rehearing Request at 25-26, that DWR had waited too late in the review process to raise a new procedural challenge:

> [T]he 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'[s] testimony. Indeed, DWR did not even claim that Mr. Jenkins'[s] testimony was improperly admitted in its brief on exceptions to the [ALJ] Decision.

Opinion No. 466-B at P 23, ER 452. *See also* 3/9/00 Hrg. Tr. 444:21-445:17 (receiving Mr. Jenkins's written rebuttal testimony into evidence without

objection), Supp. ER 524-25.[20] As the Commission noted, DWR had instead argued, on exceptions to the ALJ Decision, that the ALJ erroneously disregarded alleged inconsistencies between Mr. Jenkins's testimony and PG&E's discovery responses (regarding physical changes to the Facilities) — which is "a substantively different argument" (Opinion No. 466-B at P 23 n.45, ER 452). It also is immaterial. As discussed above, *see supra* Part II.C.2, DWR's focus on whether "factual changes . . . support reclassification" of certain facilities (Br. at 35) is misplaced.

The D.C. Circuit's recent decision in *Public Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005) ("*PSCKY*"), is inapposite. It did not, as DWR contends (Br. at 33-34), involve "a similar failure to give parties the right to respond to evidence." In *PSCKY*, the Commission had not placed the parties on notice that it would consider adopting an incentive-based premium for ISO transmission owners; quite the opposite, it had declined to consider the issue and limited the subject matter of the hearing at the outset to other issues. *Id.* at 1012. "As a result, the record compiled at the hearing contained *no evidence* on the need for — or appropriate size of — such a premium." *Id.* (emphasis added); *see also*

[20] In light of the centrality of Mr. Jenkins's rebuttal testimony to DWR's argument, that testimony, excerpts from the hearing transcript reflecting its unopposed admission into evidence, and DWR counsel's cross-examination of Mr. Jenkins are submitted herewith in FERC's Supplemental Excerpts of Record.

id. at 1013 (FERC "failed to place petitioners on notice that it would consider an incentive-based premium, and ultimately applied the [premium] . . . without considering *any* record evidence") (emphasis in original). Thus, *PSCKY* has no bearing on this case, where the appropriate rate treatment of the Facilities was clearly the subject of the hearing, and DWR had full opportunity to present evidence on that issue, and in fact did so. *See, e.g.*, ER 37-40 (testimony submitted by DWR rebutting PG&E's proposed rate treatment of specific Facilities); *see generally* ER 11-246 (testimony and exhibits submitted by DWR regarding rate treatment).

V. DWR'S REMAINING ARGUMENTS ARE MERITLESS

A. DWR Misunderstands the Purpose of the Compliance Filing

DWR makes much of the fact that, after reversing its earlier holding that ISO control was determinative of pricing treatment, the Commission still required PG&E to make a compliance filing regarding the transfer status of the facilities. *See, e.g.*, Br. at 27, 51. DWR contends that the Commission "continued to adhere" to the principle that ISO control was dispositive. *Id.* at 51. *But see* Opinion No. 466-A at PP 1, 10, ER 393, 397; *see supra* pages 9-10, 18 n.4. DWR further contends that the need for the compliance filing demonstrated that "FERC did not know exactly which facilities it was ruling on." *Id.* at 27; *see also id.* at 26-30 (also citing uncertainty in PG&E's subsequent compliance filing regarding two

facilities, and the ISO's alleged uncertainty as to which facilities had been turned over). DWR failed, however, to raise these arguments on rehearing; therefore, they are jurisdictionally barred. FPA § 313(b), 16 U.S.C. § 825*l*(b).

In any event, the determination of PG&E's Transmission Revenue Requirement did not end with the Commission's ruling on transmission pricing. Even after the Commission corrected itself on the appropriate legal standard for roll-in of transmission costs, PG&E *still* was required to show that operational control of the subject facilities had in fact been transferred, as a separate, second prong of the inquiry:

> In spite of our new resolution of this case, PG&E must still file the compliance filing required by Opinion No. 466. The Commission continues to be concerned about the accurate assessment of which facilities were turned over to the control of the ISO, which *remains a qualifying factor* for facilities to be included in the Transmission Revenue Requirement.

Opinion No. 466-A at P 26 n.44 (emphasis added), ER 403. *See also* TO Tariff § 3.86 (defining Transmission Revenue Requirement), *quoted in* Opinion No. 466 at P 12, ER 350.

Indeed, DWR itself acknowledges that "ISO operational control is *one necessary element* for including costs in systemwide roll-in transmission rates . . . ." Br. at 51 (emphasis added). *See also* First Request for Rehearing at 11 (describing ISO control as one element of "a *two-part* test") (emphasis in original), ER 366; Second Rehearing Request at 32 (ISO control is "one of two

prerequisites"), ER 439.[21] The series of FERC orders on review in this appeal went to one qualifying factor; the compliance filing went to the other.

B. DWR's Discrimination Argument Likewise Fails

DWR's only attempt to raise a discrimination argument below consisted of conclusory assertions in its First Rehearing Request at 23, ER 378, in which, as here, DWR failed to explain why the general categories of facilities to which it referred were similar to the Facilities (specifically, whether they were likewise integrated into the transmission grid) and thus required the same rate treatment. Its Second Rehearing Request made only a generic allusion to discrimination and purported to adopt arguments from the First Rehearing request by reference (*id.* at 31, ER 438).[22]

Moreover, DWR based its claim of discrimination on "PG&E's redefinition to exclusive use proposed here" (First Rehearing Request at 23); as discussed *supra* in Section III.C.2, PG&E's proposal of an "exclusivity" standard and its

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[21] DWR obviously understood this two-part inquiry when it argued to the ALJ that the Dedicated Facilities, despite their exclusive network transmission function, should be excluded from the TO-3 rate base because of a technical flaw in the transfer of operational control to the ISO. *See* ALJ Decision at 16, ER 336 (describing DWR's argument).

[22] In particular, DWR now premises its discrimination argument on a separate proceeding regarding a dispute between PG&E and a generator, Los Medanos Energy Center LLC. Br. at 62-63. Because DWR failed to mention that proceeding on rehearing, the Commission had no opportunity to address it in the orders on review here.

purported reclassification of facilities were not relevant to FERC's decisionmaking and thus are not relevant to this appeal. In any event, if DWR believes that PG&E's rates are discriminatory, the appropriate avenue for the Commission to consider that claim is a complaint filed under FPA § 206, 16 U.S.C. § 824e.

CONCLUSION

For the reasons stated, the petition should be denied, and the challenged FERC Orders should be affirmed in all respects.

Respectfully submitted,

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STATEMENT OF RELATED CASES

Respondent has no related cases to add to those listed by Petitioner DWR.

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C)(i) and 9th Cir. R. 32-1, I certify that the Brief of Respondent Federal Energy Regulatory Commission is proportionately spaced, has a typeface of 14 points, and contains 11,872 words, not including the tables of contents and authorities, the certificates of counsel, and the addendum.

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April 15, 2005