UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

The Nevada Hydro Company, Inc. Docket Nos. ER06-278-000
ER06-278-001
ER06-278-002
ER06-278-003
ER06-278-004

ORDER ON RATE REQUEST

(Issued November 17, 2006)

1. In this order, the Commission defers ruling on the merits of certain rate principles requested by The Nevada Hydro Company, Inc. (Nevada Hydro) for a proposed combined generation/transmission project, pending submission of additional information specified herein that the Commission deems necessary to complete its evaluation of Nevada Hydro's proposal. Upon completion of the Commission's analysis, a subsequent order on the merits of Nevada Hydro's proposal will be issued in this proceeding.

Background

2. On December 1, 2005, as amended on December 22, 2005, Nevada Hydro submitted a filing pursuant to section 205 of the Federal Power Act (section 205),[1] to request approval of certain rate principles that it states will enable it to attract financing for two distinct projects: (1) the Talega-Escondido/Valley-Serrano 500 kV Interconnect project (TE/VS Interconnect), which consists of an approximately 30-mile, high voltage

[1] 16 U.S.C. 824d (2000). Nevada Hydro characterizes its filing as a partial section 205 filing and commits to submitting a full section 205 filing no later than 90 days prior to the projected in-service date of the Project.

transmission line that runs through public lands managed by the United States Forest Service and connects San Diego Gas & Electric Company's (SDG&E) transmission system with Southern California Edison's (SCE) system, and (2) the Lake Elsinore Advance Pump Storage project (LEAPS), which is intended to be a pumped hydro storage facility with an installed generating capacity of 500 MW and a pumping capacity of 600 MW. Nevada Hydro states that, for the purpose of this filing, it has combined these projects (together, TE/VS Interconnect/LEAPS Project or combined Project) and, in accordance with the provisions of sections 1223[2] and 1241[3] of the Energy Policy Act of 2005 (EPAct 2005), Nevada Hydro seeks Commission approval to treat its proposed pumped hydro storage facility as a transmission asset to be included in the California Independent Service Operator Corporation (CAISO) Transmission Access Charge (TAC), along with the wires portion of its proposal. Accordingly, Nevada Hydro requests the following rate principles for the TE/VS Interconnect/LEAPS Project: (1) an initial post-tax rate of return on equity (ROE) of 14.5 percent for the LEAPS project and 13.5 percent for the TE/VS Interconnect project;[4] (2) an assumed 50/50 capital structure

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[2] Pub. L. No. 109-58, § 1223, 119 Stat. 594, 953 (2005). Section 1223 states, "[i]n carrying out the Federal Power Act (16 U.S.C. 791a et seq.) and the Public Utility Regulatory Policies Act of 1978 (16 U.S.C. 2601 et seq.), the Commission shall encourage, as appropriate, the deployment of advanced transmission technologies." Section 1223 defines an advanced transmission technology as "a technology that increases the capacity, efficiency, or reliability of an existing or new transmission facility," including pumped hydro.

[3] Pub. L. No. 109-58, § 1241, 119 Stat. 594, 961-62 (2005) (to be codified at section 219 of the Federal Power Act (FPA), 16 U.S.C. § 824s). Section 1241 of EPAct amends Part II of the FPA by adding a new section 219 (Transmission Infrastructure Investment) (section 219). In section 219, in recognition of the need for rate incentives to promote capital investment in the enlargement, improvement, maintenance, and operation of facilities for the transmission of electric energy in interstate commerce, Congress granted the Commission explicit authority to establish, by rule, such incentive-based rate treatments for the purpose of ensuring reliability or reducing the cost of delivered power by reducing congestion. The Commission issued a final rule. *See Promoting Transmission Investment through Pricing Reform*, Order No. 679, 71 Fed. Reg. 43,294 (July 31, 2006), FERC Stats. & Regs. ¶ 31,222 (2006) (Order No. 679).

[4] In its original filing on November 29, 2005, Nevada Hydro requested a 14.5 percent ROE on the TE/VS Interconnect project. It later amended its proposal by stating that if the Commission preferred not to approve the requested 14.5 percent ROE for the combined TE/VS Interconnect/LEAPS Project, it would accept a 13.5 percent ROE for the TE/VS Interconnect project. Nevada Hydro Answer at 16.

for at least the first three years of service; (3) a three-year rate moratorium; and (4) full recovery of prudently incurred construction work in progress (CWIP).[5] Further, Nevada Hydro does not seek any special depreciation of the combined Project's capital costs as a rate incentive, but requests a final determination on the period of depreciation so that financing can be structured accordingly.

3. Nevada Hydro represents the LEAPS facility as "an environmentally friendly facility that will help the [CAISO] manage grid operations, shift off-peak energy closer to the demand center during peak periods, and enhance the reliability of the Southern California transmission grid while helping the State of California achieve its renewable resource use goals."[6] According to Nevada Hydro, the facility's pump-turbine units will operate under an average net head of approximately 1600 feet, making the LEAPS facility one of the most efficient pumped storage facilities in the world, with the highest lift in the continental United States. Moreover, peak energy will be available over a 16-hour period and will be dispatchable in approximately 15 seconds, serving a variety of ancillary service needs for the CAISO market.

4. Nevada Hydro states that it intends to turn the combined Project over to the operational control of the CAISO and, thus, expects compensation of its proposal through transmission system rights generated in accordance with the CAISO Open Access Transmission Tariff (Tariff) protocols and other governing agreements. The proposed in-service date of the transmission line is 2007, and the generation facility is expected to commence operations in 2009. Nevada Hydro estimates the projected cost of both projects is approximately $750 million. Nevada Hydro will be the sole owner of both projects; however, the Elsinore Valley District Municipal Water District, as co-applicant on the hydro-license application of the LEAPS project, will serve as lead agency in coordinating the environmental review of the LEAPS project.[7] Nevada Hydro also

[5] Nevada Hydro requests this incentive in its September 11, 2006 supplemental filing.

[6] Transmittal Letter at 6.

[7] The LEAPS project hydropower license application was filed with the Commission in August 2004 (Project No. 11858), and a final environmental impact statement is expected to be completed in December 2006, according to the Commission's Office of Energy Projects. The Elsinore Valley Municipal Water District is the co-applicant on the license application. For its participation in the project, the District will retain a variety of water quality and water rights related responsibilities throughout the operational life of the LEAPS project.

requests waiver of section 35.3 and 35.12 of the Commission's regulations to allow its rate request to become effective on the proposed in-service date of the individual projects and to defer the filing of cost of service information.

5. As justification for its requested rate principles, Nevada Hydro relies on EPAct 2005 and argues that section 1223 advances the definition of transmission facilities under the Commission's ratemaking authority by mandating that the Commission encourage the deployment of energy storage devices (including pumped hydro) as advanced transmission technology. Moreover, Nevada Hydro contends that section 1241 grants the Commission expanded authority to establish incentive-based rates to benefit consumers. Nevada Hydro further contends that advanced pump storage is not generation but is instead an advanced technology that best serves grid management functions. For this reason, Nevada Hydro believes that the Commission should treat the proposed LEAPS project no differently than it would traditional network transmission assets.[8] Additionally, Nevada Hydro avers an array of benefits that will emerge from CAISO-operation of the combined Project.

Notice of Filing and Responsive Pleadings

6. Notice of Nevada Hydro's filing, as later amended, was published in the *Federal Register*, 70 Fed Reg. 74,796 (2005) and 71 Fed. Reg. 1424 (2006), with interventions and protests due on or before December 22, 2005 and January 12, 2006, respectively. Timely motions to intervene and/or protests were filed by the SCE, Pacific Gas and Electric Company (PG&E), and SDG&E, as later corrected. Late motions to intervene and/or comments or protests were filed by the CAISO, the California Department of Water Resources State Water Project (DWR), the California Public Utilities Commission (CPUC), the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, California (Cities), and Elsinore Valley Municipal Water District (Elsinore Valley). Nevada Hydro filed an answer on January 27, 2006.

7. In response to Nevada Hydro's initial filing, SDG&E argued that Nevada Hydro's proposal was premature, as the project appeared to be at the very early stage of regulatory development, both in terms of analysis and in terms of commercial development. SDG&E stated that the timing of Nevada Hydro's proposal may have been an attempt to

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[8] In support of its application, Nevada Hydro also cites to EPAct 2005 section 1242 (Funding Transmission Upgrades), section 1701 et. seq. (Incentives for Innovative Technologies), section 925 (Transmission and Distribution Programs), and section 1211 (Electric Reliability Standards).

circumvent state planning and siting processes. SDG&E argued that Nevada Hydro's assertions regarding the economic and reliability benefits of its proposal relied on the analysis of other, very different projects.[9] SDG&E argued further that Nevada Hydro's system impact study application was only recently submitted to the CAISO and had not yet been acted upon. Considering that this study will entreat multiple parties (*i.e*., SDG&E, SCE, CAISO, Nevada Hydro), SDG&E contends that Nevada Hydro's cost estimate and asserted benefits for its proposal are speculative at best. Third, SDG&E argues that Nevada Hydro's proposal would have the Commission treat the TE/VS Interconnect as a reliability and/or economic network transmission upgrade, but that, on its face, the proposed interconnection appears to be a gen-tie not eligible for network treatment. Finally, SDG&E contends that Nevada Hydro's request for a 14.5 percent ROE is unjust and unreasonable, given that Nevada Hydro has not demonstrated that the transmission portion of its project can be built at a lower cost than a third party, including SDG&E's Sunrise Powerlink project.[10]

8. SCE also argued that Nevada Hydro's initial filing was premature and requested that the Commission defer action until the proposal made its way through the CAISO regional planning process. Moreover, SCE argued that, even if the Commission were to consider granting the requested rate principles prior to Nevada Hydro receiving CAISO-approval for its proposal, "there is no question that the instant filing raises factual issues that necessitate a hearing on the issues," as Nevada Hydro has not provided enough information for any party to make an accurate assessment.[11] Lastly, SCE asserts that the numerous claims made by Nevada Hydro lauding the benefits of its proposal are unsubstantiated and that no evidence has been provided demonstrating that it is

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[9] SDG&E states that a Transmission Comparison Study was conducted to determine the best transmission alternative through the Southwest Transmission Expansion Plan (STEP), a group stakeholder process, and the need for this study resulted from SDG&E's Long Term Resource Plan, as approved by the CPUC in June 2004, which includes a strategy of mixed resources (*i.e*., demand reduction, renewable resources, new generation, new transmission) to ensure reliable and affordable power in the region for the next twenty years. The study evaluated, according to SDG&E, a Serrano/Valley-Northern alternative, which is equivalent to Nevada Hydro's TE/VS Interconnect proposal, and determined that it had weak technical performance and provided the lowest benefit to California ratepayers.

[10] In July 2006, the CAISO Board of Governors approved jointly SDG&E's Sunrise Powerlink Project and the Imperial Irrigation District's Green Path Project.

[11] SCE Protest at 3.

reasonable for the non-wires portion of Nevada Hydro's combined Project to be considered a jurisdictional transmission asset or even an advanced transmission technology in accordance with EPAct 2005.

9. The CAISO states that it has several concerns about the combined Project that should be resolved before the Commission grants the proposed rate treatment requested by Nevada Hydro. The CAISO states that it has not yet made the requisite determinations under the CAISO Tariff to approve the TE/VS Interconnect project and, therefore, the Commission should not grant incentive rate treatment absent successful completion of the CAISO Tariff process.[12] In addition, the CAISO notes that there are two other potentially competing transmission projects in the same region as Nevada Hydro's proposal and it is uncertain whether all three projects will be approved and ultimately built. With respect to Nevada Hydro's proposal to turn operational control of the LEAPS facility to the CAISO, the CAISO states that it is unsure as to how this generation resource would function in the CAISO's market-based environment (*e.g.*, how the CAISO could dispatch the LEAPS facility based on economic merit order and whether the LEAPS project would participate in the market or be the subject of a Participating Generator Agreement). For this reason, the CAISO argued that Nevada Hydro has not adequately justified its request for cost-based rate treatment for the LEAPS facility.

10. DWR and the CPUC raised similar arguments. In addition, the CPUC also protested Nevada Hydro's proposed 14.5 percent ROE as too high for the risk Nevada Hydro will incur. The CPUC argued that there is a high degree of certainty of return to investors if the project is approved and built. Thus, the only serious financial risk that project proponents bear, according to the CPUC, is at the permitting and initial project development stage. For this reason, the CPUC contends that Nevada Hydro's proposal does not require an above-average ROE. The CPUC contends further that this case differs from previous cases permitting a 13.5 percent ROE because no emergency situation exists here and there is no additional risk that a company that proposes something entirely new faces. Additionally, the CPUC argued that Nevada Hydro should be able to use a 50/50 capital structure only if that ratio reflects its actual capital structure. With respect to Nevada Hydro's requested three-year rate moratorium, the

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[12] Section 24.1 of the CAISO Tariff states that "[a] Participating TO or any other Market Participant may propose a transmission system addition or upgrade. The [CA]ISO will determine that a transmission addition or upgrade is needed where it will promote economic efficiency or maintain System Reliability as set forth below [in the Tariff]."

CPUC states that Nevada Hydro should be required to submit a new revenue requirement at least once every three years, and that none of the terms of the initially-approved rate principles should carry over in these subsequent filings.

11. In its answer, Nevada Hydro responds that the lack of formal action by the CAISO is not sufficient reason for the Commission to reject or delay action on its filing, as the requested Commission action will neither preempt nor predetermine the outcome of the CAISO's or other state planning proceedings. Nonetheless, Nevada Hydro states that the CAISO has historically supported the purpose and need for the combined Project.

12. Next, Nevada Hydro argues that its application is not premature but instead is ripe for Commission action. It argues that Commission approval of its proposed rate principles now would be consistent with Congressional intent to promote transmission infrastructure investment. Nevada Hydro also alleges that the claims of the CAISO and SDG&E as to the unavailability of a completed system impact study are misleading.

13. Finally, in addressing intervenors' arguments that the LEAPS project should not be afforded cost-based rate treatment, Nevada Hydro asserts that Congress, through EPAct 2005, has already labeled pumped hydro as an advanced transmission technology that may be eligible for incentive rate treatment. Further, it states that the Commission recognized that pumped hydro may be eligible for incentives in *Promoting Transmission Investment Through Pricing Reform*.[13] Thus, Nevada Hydro argues that its requested cost-based treatment for the LEAPS facility is reasonable.[14] Lastly, Nevada Hydro contends that there are no material issues of fact warranting a hearing and that the combined Project is not a gen-tie but a network asset fully eligible for network treatment.

The Commission's Data Request

14. On February 17, 2006, the Commission issued a data request to obtain additional information necessary to process Nevada Hydro's filing. The Commission requested: (1) an update on Nevada Hydro's assertion that the CAISO Board of Governors is expected to consider whether to approve its proposal on reliability and/or economic grounds in the near future; (2) additional support for the projected ratepayer cost savings; (3) an explanation of the significant risks necessitating a higher rate premium than that

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[13] Notice of Proposed Rulemaking, 70 Fed. Reg. 71,409 (November 29, 2005), FERC Stats. & Regs. ¶ 32,593 (2005).

[14] Nevada Hydro proffers that other issues can be examined in a future rate proceeding and need not be determined at this time.

the Commission has approved for comparable projects; (4) any workpapers or studies to explain the impact to the CAISO grid if both Nevada Hydro's proposal and SDG&E's competing proposal were to be built; and (5) whether any discussions have taken place to date regarding how the CAISO will dispatch energy from Nevada Hydro's proposed cost-based generation facility in a market-based environment in economic merit order, and how these transactions will be settled or, in the absence of such discussions, how Nevada Hydro envisions this process to work.

15. On March 20, 2006, as supplemented on March 29, 2006 and April 7, 2006, Nevada Hydro filed its response to the Commission's data request.[15] First, Nevada Hydro clarified that, as of March 20, 2006, there was no formal application before the CAISO or its Board, but that the CAISO is required to support any project that promotes either system reliability or economic efficiency in accordance with the CAISO Tariff. Nevada Hydro stated that the CAISO's own preliminary analysis demonstrated reliability benefits resulting from the combined Project and, therefore, it urged the Commission to grant the requested rate principles without condition. Second, Nevada Hydro stated that reliability benefits should suffice and that economic savings analyses are not a pre-requisite for Commission approval of incentive rate treatment.[16] Third, Nevada Hydro stated that, unlike traditional transmission projects, there are additional construction and development risks associated with the combined Project due to the addition of the pump storage facility (*e.g*., complicated construction and licensing requirements). Finally, Nevada Hydro responds that all of the transmission, pumping, storage, and generation functions of the combined Project can be effectively integrated with CAISO grid operations in late 2007.

16. Notice of Nevada Hydro's responses to the Commission request for more information was published in the *Federal Register*, 71 Fed Reg. 19,493 (2006) and 71 Fed. Reg. 21,008 (2006), with interventions and protests due on or before April 21, 2006

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[15] The bulk of this response is an interconnection study performed by an independent third party in March 2005.

[16] Nevada Hydro later supplemented its response with testimony from an expert witness, Matthew P. Harris, stating that the combined Project is expected to provide benefits including: (1) reduced RMR contract costs in the San Diego service area of about $114 million/year; and (2) reduced energy costs and an expected $64 million/year in net energy savings for California electricity customers. Nevada Hydro states that this total of $178 million in annual benefits is well in excess of the $148 million levelized costs associated with the combined Project's investment.

and April 28, 2006, respectively. SDG&E and SCE filed comments. Nevada Hydro filed an answer.

17. Commenting on Nevada Hydro's supplemental filings, SDG&E and SCE reiterate previous arguments and question whether the CAISO's independence will be compromised by Nevada Hydro's proposal. These intervenors also take issue with the support provided by Nevada Hydro's in its supplemental filing, which, according to the intervenors, relies on out-of-date data and lacks an accurate analysis of ratepayer benefits.

18. Nevada Hydro responds that it has provided sufficient evidence demonstrating that the combined Project will increase import capability in the region, reduce RMR contract costs, and provide value in the ancillary market, as well as significant environmental benefits. Nevada Hydro states that it is not attempting to socialize the fixed cost of generation or recoup energy costs, but rather to recoup ancillary services costs, which are already treated as transmission under the CAISO Tariff. Nevada Hydro clarifies that it does not intend to retain the Transmission System Rights for the combined Project, thereby reaping financial gains above revenues realized through rates; instead, it will leave energy revenues and profits for the benefit of the ratepayers, through the CAISO. In response to SDG&E and SCE's concerns that transferring operational control of the LEAPS project to the CAISO may jeopardize the CAISO's independence, Nevada Hydro states that the CAISO often influences market outcomes, including in the CAISO's decisions to issue RMR dispatch notices for energy and ancillary service capacity, which have an impact on real-time imbalance energy prices.

<u>Nevada Hydro's Supplemental Filing in Response to Order No. 679</u>

19. On September 11, 2006, Nevada Hydro submitted a supplemental response to provide options for the Commission to consider regarding how the CAISO could exert functional control of the LEAPS facility without becoming a *de facto* market participant, and to request an additional rate incentive (*i.e.*, 100 percent CWIP in rate base) in light of Order No. 679.[17] Nevada Hydro provides testimony describing how the LEAPS facility could be incorporated into the CAISO system without causing market interference under three separate approaches: (1) the CAISO assumes operational control and bids and schedules into the market but creates a firewall between the actual operators of the

[17] Nevada Hydro states that full recovery of prudently incurred CWIP would reduce costs to ratepayers by an estimated $100 million.

LEAPS facility and transmission personnel to ensure that the LEAPS operators will have no access to non-public information; (2) the CAISO periodically auctions its right to operate the LEAPS unit to market participants; and (3) the CAISO contracts with a third party. Under the last approach, the CAISO will be prohibited from sharing non-public information with this third party.

20. Notice of the supplemental filing was published in the *Federal Register*, 71 Fed. Reg. 55,460 (2006), with interventions and protests due on or before October 2, 2006. The CAISO filed its comments, a motion for a technical conference, and a request for expedited action. PG&E and SDG&E filed comments. The California Electricity Oversight Board filed a motion to intervene out of time. CPUC filed a motion to file comments out of time.

21. The CAISO responds to Nevada Hydro's latest supplemental filing and comments on several issues of concern regarding the LEAPS proposal that must be resolved before the CAISO Board may act on the combined Project: (1) whether it is appropriate to include the costs of the LEAPS facility in CAISO TAC rates or whether the LEAPS facility should be treated like other similar resources in California; (2) whether it is appropriate for the CAISO to bid and schedule the LEAPS facility into CAISO markets and under what terms; and (3) whether the treatment of the proposed LEAPS facility will establish a precedent for the treatment of other pumped hydro units in California.[18] The CAISO states that it currently does not have operational control of any cost-based pumped hydro and that important questions are raised as to how the CAISO would treat the LEAPS project for operational and cost recovery purposes. While the CAISO takes no position on the specific incentives requested by Nevada Hydro for the LEAPS facility, the CAISO requests that the Commission defer action on ruling on the proposed rate incentives for the LEAPS facility pending the outcome of a technical conference to address the factual and policy issues surrounding this proposal.

22. The CAISO states that each of the three approaches provided by Nevada Hydro regarding how the LEAPS project could be incorporated into the CAISO system require further analysis and development. Specifically, a concern for the CAISO is Nevada Hydro's intention that the CAISO adopt a strategy to maximize the profits of the LEAPS unit. The CAISO argues that "even if such profits offset TAC payments, they could increase overall Market Clearing Prices." Moreover, the CAISO finds that Nevada Hydro's proposal may jeopardize its non-profit, tax-exempt status under section 501(c)(3) of the Internal Revenue Code of 1986. The CAISO believes that these issues

[18] The CAISO mentions that, currently, pumped hydro storages devices in its footprint are dispatched by Load Serving Entities on behalf of their customers.

should be addressed expeditiously in a process that includes input from stakeholders to achieve a mutually acceptable resolution. Thus, the CAISO requests that the Commission schedule, on an expedited basis, a technical conference to allow the CAISO to work with Nevada Hydro and other interested parties on developing a resolution to the issues concerning incentive rates for the LEAPS facility. The CAISO does not believe it is necessary for the Commission to delay ruling on the wires portion of the project, but notes that the proposed interconnection must still be approved under the transmission planning procedures of the CAISO Tariff.

23. SDG&E and PG&E state that EPAct 2005 does not require the Commission to provide the same ratemaking treatment to pumped hydro as traditional transmission assets. Instead, they contend that both EPAct 2005 and Order No. 679 call for a project-specific analysis and a careful application of incentive rates to some or all parts of projects warranting incentive ratemaking. PG&E argues that the Commission should require Nevada Hydro to show that reliability of California's bulk electric system will not be adequate without the resource offered by the proposed pumped hydro project and that the only way the proposed pumped hydro project will be built is to obligate the CAISO to take and pay for operational control of the project. As to the approaches proffered by Nevada Hydro, SDG&E and PG&E argue that Nevada Hydro overlooks whether CAISO-control of the pumped hydro project is consistent with its charter and mandate to administer independently the transmission grid. PG&E argues that a hearing is necessary to test the facts asserted in Nevada Hydro's testimony.

24. CPUC argues that the Commission should reject Nevada Hydro's request to fully recover prudently incurred CWIP because Order No. 679 does not provide an absolute right for transmission owners to obtain unjust and unreasonable rates. SDG&E argues that Nevada Hydro should explain how it derived the figure of reduced costs resulting from the recovery of CWIP, as well as the sources from which the funds would be saved, and the beneficiaries of those savings. CPUC, along with SDG&E, state that Nevada Hydro has not fully responded to CPUC's concerns raised in its February 17, 2006 protest regarding the nature and magnitude of Nevada Hydro's requested incentives.

Discussion

A. Procedural Matters

25. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will allow the late interventions of the CAISO, DWR, CPUC, California Electricity Oversight Board, the Cities, and Elsinore Valley because they have each demonstrated an interest in this proceeding that

cannot be adequately represented by any other party. Given this fact and the lack of undue prejudice or delay, we will grant the late-filed motions to intervene. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Nevada Hydro's answers because they have provided information that assisted us in our decision-making process.

B. Commission's Determination

26. Nevada Hydro's proposal presents a number of important issues, some of which are issues of first impression. Nevada Hydro seeks a determination from the Commission that: (1) the LEAPS facility is an advanced technology per EPAct 2005; (2) the incentives it seeks, including whether to treat the pumped storage as transmission for rate recovery purposes, are just and reasonable; and (3) the CAISO should either manage or facilitate the management of the LEAPS facility. The Commission is committed to providing appropriate incentives for critical transmission infrastructure that, as stated in Order No. 679, either improve the reliability of the grid or reduce congestion costs.[19] We note that while the state of California has added or is in the process of building additional infrastructure, there remains a need for infrastructure. Nevada Hydro has proposed a project that may help meet the needs of the CAISO in managing the grid and serving load.

27. With regard to whether the LEAPS facility meets the requirements of section 1223 of EPAct, we find that it does. Section 1223 of EPAct 2005 declares pumped hydro an "advanced transmission technology" that this Commission should encourage, as appropriate. Nevada Hydro's LEAPS facility meets the requirements of this section. However, at present, we do not have sufficient information to determine whether inclusion of the LEAPS facility in the CAISO's TAC is appropriate and whether the rate incentives requested by Nevada Hydro are justified and would result in just and reasonable rates for California ratepayers. During the course of this proceeding, several analogous studies, memorandums, transcribed communications and testimony have been submitted; however, none have been definitive or complete.

[19] In Order No. 679, the Commission requires an applicant seeking incentive rates to show that its incentive rates are justified by demonstrating that: (1) the facilities for which it seeks incentives either improve the reliability of the grid or reduce congestion costs, consistent with the requirements of section 219; and (2) that there is a nexus between the incentive sought and the investment being made. Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 76.

28. Nevada Hydro has put CAISO in an unusual position here, basically asking the CAISO to decide how the pumped storage project should be managed, as well as who should manage the pumped storage project. Without information from the CAISO as to how it expects to use this facility for meeting load and managing the grid, and whether and to what extent this facility reduces congestion or enhances reliability, it is premature for the Commission to, in the first instance, determine whether incentives are appropriate and whether the costs of the LEAPS facility should be included in the TAC and thus recovered from all customers on the CAISO system that pay the TAC.

29. The CAISO has expressed a number of concerns shared with this Commission regarding the implementation of Nevada Hydro's proposal – namely, how the implementation will work. In its latest comments, the CAISO states that each of the three approaches provided by Nevada Hydro (i.e., the CAISO assumes operational control of the facility but imposes a firewall to prohibit the improper sharing of non-public information, the CAISO periodically auctions its right to operate the LEAPS unit to market participants, and the CAISO contracts with a third party) regarding how the LEAPS project could be incorporated into the CAISO system require further analysis and development. Additionally, the CAISO is unsure as to whether Nevada Hydro's intention that the CAISO adopt a strategy to maximize the profits of the LEAPS unit is appropriate because the CAISO is uncertain as to whether Nevada Hydro's proposal will jeopardize its non-profit, tax-exempt status. Therefore, the CAISO requests a technical conference among the parties to address these issues.

30. We understand the predicament of the CAISO; however, we see no need at this time for the Commission to convene a technical conference. The CAISO has the expertise to determine how best to integrate the LEAPs project into the grid and has processes in place that allow it to meet with all affected stakeholders to determine what role the CAISO should have with regard to this project. Thus, we believe that the CAISO can provide the best forum for exploring the issues and solutions and explaining to Nevada Hydro the options available to it. As mentioned above, Nevada Hydro has implicated the CAISO in its plans, and without more information from the CAISO, we are unable to rule. The CAISO is directed to report to the Commission no later than 60 days from the date of this order, the outcome of its discussions with stakeholders regarding the LEAPs project. The CAISO should address, among other things it deems necessary, the following: operation/management options and recommendations, cost recovery options given the CAISO's determination of the extent to which the combined Project reduces congestion costs or enhances reliability; whether the CAISO can effectively operate this combined Project in the context of being an independent system operator; whether it is appropriate to include a cost-based, fixed revenue requirement in its TAC where the benefits associated with that revenue requirement will be determined

by the daily operation of the market; whether the CAISO recommends inclusion of the LEAPS costs in its TAC and, if so, why?

31. Further, the CAISO should provide information on all correspondence or discussions the CAISO has had with the Internal Revenue Service (IRS) regarding whether a change in tax status would occur if the CAISO assumes operational control over the LEAPS facility, including whether the CAISO has sought a Letter Ruling from the IRS regarding a possible change in tax status, or whether it plans to seek such a Letter Ruling.

32. With regard to the proposed incentive rates for the TE/VS Interconnect project, we find that Nevada Hydro has not provided sufficient evidence to support its requested ROE. The Commission issued Order No. 679 in compliance with EPAct 2005, and in that final rule, the Commission found that incentives must result in a rate that is within the zone of reasonableness. Nevada Hydro has not provided us with any evidence or analysis (e.g., DCF study) that would show the requested returns are within the range of reasonable returns. Accordingly, we direct Nevada Hydro to address this matter within 30 days of the date of this order. Further, the requested hypothetical capital structure, the three year rate moratorium, and the proposal for 100 percent recovery of CWIP will be subject to a future determination that the combined Project has met the requirements of Order No. 679. Nevada Hydro's combined Project will have to meet all elements of Order No. 679 before the Commission grants any of these incentives.

<u>The Commission orders</u>:

(A) The CAISO is hereby directed to file a response to this order within sixty (60) days of the date of this order, addressing the concerns raised herein.

(B) Nevada Hydro is hereby directed to file a response to this order within thirty (30) days of the date of this order, addressing the concerns raised herein.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.