

associated with the ISO Tariff. The TID appears to equate the lack of choice with a lack of flexibility to choose when they enter or leave the ISO environment.

Western believes that choosing the PTO Alternative would give it the short-term flexibility needed to adapt to NERC and WECC policy changes. The long-term flexibility of joining whatever RTO Western chooses is minimally constrained by the current 2-year TCA termination notice. Western, therefore, concludes that the PTO option meets the flexibility criteria.

Evaluation of the Certainty Criteria Under the PTO Alternative

Under the PTO Alternative, Western would be subject to all of the ISO charges associated with being the SC for Reclamation to schedule Base Resource and Custom Product to its customers. The SC for each customer would be subject to all of the ISO charges associated with scheduling and delivering power to the customer's delivery point and the associated ancillary services. Many of the ISO charges, such as imbalance energy and reserves, fluctuate on a daily basis with spot market price variations. Although a portion of this risk may be minimized through forward purchases, this alternative does not provide Western with the ability to load follow. Unanticipated energy imbalance charges may still arise as a result of normal project operations. Transmission and delivery-related charges as well as overhead charges of the ISO may change less frequently, but based on historical trends, these costs are expected to change more frequently than Western's.

The ISO is in the midst of implementing new operating guidance for its Market Redesign (MD02). The proposed new initiative would implement the concept of locational marginal pricing to deal with transmission congestion. If MD02 is implemented in its current format, during periods of congestion, the ISO would redispatch all generation based on economic factors. Under this alternative, during periods of congestion, affected CVP Preference Power customers and Project Use loads could end up paying a different price than the actual cost-of-service rates associated with Federal hydropower resources. These rates may not be consistent with Reclamation law and policy, and Western may need to consider mitigation strategies.

Several of Western's customers are concerned with the predictability and stability of any alternative selected by Western. The TID summarized its view of certainty by stating that under the

PTO option, the cost of power from generation to load will be set by a market that cannot be forecast with any certainty. The TID also commented that the Western rate process is open and generally results in a fair allocation of costs based on cost causation principles. The TID contrasts the Western process with the ISO stakeholder process as follows:

This can be contrasted to the CAISO method of allocating costs, which does not accept meaningful direction from stakeholders representing consumers. Rather, the CAISO seems willing only to socialize costs in order to make it seem that the costs of CAISO services are less prohibitive.

The TID also states that transmission allocation based on firm physical transmission rights adds certainty to long-term and short-term planning. TANC commented:

Firm physical transmission rights are a prerequisite to a stable forward energy market. With known physical rights there is no need for unpredictable congestion management schemes, multiple markets, and there is no fictitious congestion. Without firm physical transmission rights it is commercially imprudent to contract in the forward markets. The CAISO provides transmission for a maximum period of one day, and those who are willing to pay the most get to use the transmission grid.

The City of Palo Alto stated:

The City values long-term transmission contracts for establishing firm transmission rights and obligations of load serving entities. Western has always utilized this approach to deliver Western energy to its customers. This provides cost and operational certainty that the CAISO Tariff, and market cost based approach to service, does not provide.

The TPUD commented:

The Cal ISO prepares rate amendments on an average of one every three to four weeks. By contrast, Western ratemaking occurs on an average of once every three to four years. The Cal ISO has some 250 different rates. Even with a Federal control area it is doubtful that Western will have a tenth as many.

The Arvin-Edison Water Storage District stated:

Despite the best of intentions and a talented staff, the California Independent System Operator (CAISO) is mired in unwieldy governance that results in perpetual tariff revisions and market redesigns. Each revision results in added costs and complexity that bog the CAISO with some of the highest overhead expenses, and hence the highest grid management costs of any current ISO or RTO in the nation.

Reclamation stated:

Costs of CVP operation have not changed significantly except due to escalation or increased maintenance as the facilities have aged. This situation would change significantly should the CVP become a part

of the CAISO. As the largest CVP load, Reclamation does not want the CVP beneficiaries to be exposed to CAISO operational costs beyond what the historical CVP cost of operations have been.

The ISO commented:

The ISO's transmission rates are based on Commission approved cost-of-service basis and on an open and non-discriminatory basis to all market participants * * * the only volatility Western would experience is through buying and selling in the ISO's Ancillary Services and Real-Time Imbalance Energy markets. However, this volatility is present regardless of whether or not Western becomes a control area, and the degree of volatility is based on Western's need to procure additional resources. If Western has sufficient resources, the volatility of these markets would not impact Western and its customers.

Under the PTO Alternative, although Western may retain its ability to purchase power in the forward markets to reduce energy imbalance charges during real-time operations, since Western would not be able to load follow, it would not have the ability to respond to significant changes during real-time operations. Consequently, to the extent that Western is short resources, Western would be subject to any volatility in the ISO's ancillary services and real-time energy imbalance markets.

Western must set its rates at the lowest possible level consistent with sound business practices, but must cover all of its costs, including amounts to repay the project investment over the prescribed repayment period. In the past, Western's costs have been stable with rate adjustments made on an average of once every 3 years. Western's rates are set in an open public process designed to assure that customer concerns are accommodated through an appropriate rate design and cost allocation methodology.

The rate certainty associated with each of the operational alternatives is important in the post-2004 time period. Rate changes could occur more frequently if Western chose an operational alternative where it is subject to more frequent changes in cost. Under the PTO option, Western would be subject to changes in ISO costs that are not within Western's ability to control. For example, between 1999–2002, the ISO revenue requirement for grid management charges increased from \$158.7 million to an estimated \$239.2 million, an increase of more than 50 percent. Western's customers have expressed an intense interest in assuring that the post-2004 operational alternative selected is responsive to cost containment principles so that to the