



Memorandum

To: Grid Reliability/Operations Committee
From: Kellan Fluckiger, Chief Operations Officer
Armando J. Perez, Director of Grid Planning
Jeanne Solé, Regulatory Counsel
cc: ISO Board of Governors; ISO Officers
Date: January 16, 2001
Re: *Status on Valley-Rainbow RFP*

This memo provides a status report on the Valley-Rainbow RFP and does not require Board action.

EXECUTIVE SUMMARY

The ISO has discussed undertaking an RFP for alternatives to the Valley-Rainbow project with the California Public Utilities Commission (CPUC) and San Diego Gas and Electric Company (SDG&E) in accordance with the Governing Board's October 26, 2000 motion. As a result of these discussions, the ISO proposes to undertake an RFP for alternatives, in cooperation and consultation with the CPUC: the results of that RFP can be made part of the record before the CPUC. Once SDG&E files for an application for Certificate of Public Convenience and Necessity (CPCN) for the Valley-Rainbow project, the CPUC could use the information received during the RFP process for their CEQA review of the project. The ISO would assess responses in accordance with evaluation criteria that will be discussed with stakeholders between now and the February board meeting and will be presented to the Governing Board for approval at the February Governing Board meeting. This memorandum contains, for informational purposes, some initial thoughts on the part of ISO staff regarding such evaluation criteria.

ISO assessments (regarding each respondent's satisfaction of the above mentioned evaluation criteria) would be forwarded to the CPUC CEQA staff and would be set forth in ISO testimony in CPUC CPCN proceeding. The CPUC CEQA staff would assess the alternatives identified by the RFP process from a CEQA standpoint. The ISO testimony and CEQA information would be used by the CPUC in making a decision on the CPCN.

The ISO proposes that while the ISO would coordinate the RFP process, SDG&E should be the party that would contract with any successful alternative.

BACKGROUND

During its October 2000 meeting, the Governing Board passed the following motion:

Moved, that the Board of Governors,

1. Rescind its motions of May 25 and August 1.
2. Finds that Approve a 500 kV Project, such as the Valley-Rainbow project, is needed (without selecting a preferred near-term alternative and without regard to routing) to address the identified reliability concerns of the San Diego and southern Orange county portion of the ISO grid beginning in 2004 and direct SDG&E to proceed with design and licensing activities for the proposed project and to include the ISO's analysis of the alternatives in its application to the CPUC.
3. Direct the ISO to solicit non-wires alternative proposals to compete with the 500 kV transmission line in conjunction with and for consideration in the CPUC process, before a Certificate of Public Convenience and Need (CPCN) is issued by the CPUC, but after SDG&E has chosen its preferred route, demonstrated the feasibility of right-of-way acquisition, provided an analysis of environmental impacts, and provided an estimate of its costs (to include a full disclosure of all costs including environmental mitigation and distribution system upgrade costs) as part of its design and licensing activities required through the CPCN process. The ISO will support SDG&E in its case to FERC to recover reasonably incurred costs if its project is not chosen as the preferred alternative.
4. Request ISO staff to continue to refine the parameters and process of a competitive solicitation for recommendation to the Board in January, to consult with the CPUC regarding what might assist the CPUC in its consideration of alternative proposals, to include its (staff's) recommendation regarding the CPUC's needs, and determine when and whether the ISO Board should recommend a preferred alternative to the CPUC.

This memorandum provides an update on ISO plans in relation to an RFP for alternatives to the Valley-Rainbow project.

UPDATE

In January, the ISO met with CPUC staff to discuss an approach to the RFP that would provide the CPUC with the information it needs to consider alternatives to the Valley-Rainbow project in the CPCN process for Valley-Rainbow and the associated CEQA process. In addition, the ISO discussed ideas for undertaking a competitive solicitation with SDG&E. These conversations have resulted in the following plan for undertaking an RFP for alternatives to the Valley-Rainbow project.

Process:

The RFP process would be undertaken by the ISO in coordination with the CPUC and SDG&E. The purpose of the RFP process would be to solicit alternatives that could be considered by the CPUC in the CPCN proceeding related to Valley-Rainbow and the associated CEQA review. Ultimately, in the CPCN process, the CPUC would have before it information on the Valley-Rainbow project (including alternative routes for the project) and alternatives to the project identified through the RFP process, along with information on the pros and cons of each alternative, including costs, environmental impacts, reliability impacts, market impacts, and any other information that parties intervening in the CPCN proceeding choose to bring to the CPUC's attention in the CEQA process and in evidentiary hearings.

An important issue that has emerged in both the ISO's own deliberations and in preliminary discussions with CPUC staff and SDG&E is who should enter into the contract for an alternative to the Valley-Rainbow project, the ISO or SDG&E? For reasons explained in more detail below, the ISO believes there are advantages to having SDG&E rather than the ISO be the contracting party. Regardless of the resolution of this issue, the ISO could nonetheless undertake the RFP process.

Projected timeline

January 24-25, update on Valley-Rainbow RFP to the Governing Board

February 15, the ISO issues the Valley-Rainbow RFP

February 21-22, review by the Governing Board of ISO evaluation criteria

March 30, letters of intent due

April 25, responses to the RFP are due to the ISO, the CPUC and SDG&E

May 16, ISO staff finalizes its assessment of responses in accordance with ISO evaluation criteria

May 23-24, Governing Board reviews ISO staff assessments

May 25, ISO forwards to the CPUC its assessment of RFP responses

Criteria:

The RFP would solicit information from respondents that would allow the ISO to compare each project with the Valley-Rainbow Project in accordance with the ISO evaluation criteria. Such information and ISO analysis of the information would be formally submitted to the CPUC, in order for the CPUC to evaluate the project as an alternative to the Valley-Rainbow project as part of its CEQA review of the Valley Rainbow project and in the CPCN proceeding.

The ISO evaluation criteria would be as determined by the Governing Board at the February Board meeting. ISO staff will discuss such criteria with stakeholders prior to the February Governing Board meeting and present a proposal at the meeting. For information purposes only, the ISO provides some initial thoughts on possible evaluation criteria which are discussed in further detail in Attachment A.

- Ability of the project to satisfy the ISO Grid Planning Criteria
- Ranking of the alternatives from the standpoint of overall value to the transmission system considering:
 - Relative Reliability Benefits
 - Cost effectiveness (as compared to the transmission alternative)
 - Value for Purposes of Accessing Regional Energy Markets, Reducing Congestion Costs and Assuring Adequate System Capability (for example, whether the project enhances the ability to access additional power supplies or directly adds power supplies)
 - Market Power Impact (i.e. both with respect to the ability to mitigate existing market power and the ability to exercise market power)

General CPUC criteria would relate to CEQA standards. At a minimum, consistent with CEQA, a project proponent would have to submit information on:

- Project description
- Setting

- Impacts
- Mitigation

Finally, project proponents would be required to submit financial and technical information, and proposed terms and conditions of service. Project proponents would be required to hold such terms and conditions firm and open for acceptance from the time that a response to the RFP is submitted until the conclusion of the CPUC CPCN process. If SDG&E is to be the contracting party, terms and conditions could include services other than those required to make the project a feasible alternative to Valley-Rainbow.

Assessment of RFP responses:

The ISO would review and evaluate RFP responses in accordance with its evaluation criteria and would submit to the CPUC staff undertaking the CEQA review the following information: 1) All responses to the RFP, 2) the ISO's evaluation of the responses in accordance with its evaluation criteria, and 3) a ranking of the responses, based on their satisfaction of the ISO evaluation criteria.

The CPUC staff would then consider the RFP responses, and the ISO's assessment of responses in undertaking its CEQA review of the Valley-Rainbow project. CPUC CEQA staff indicated that they would assess those projects that appear to be feasible alternatives to the Valley-Rainbow project only at a level of detail such that they could provide recommendations regarding the Valley-Rainbow project. It may be necessary for project proponents to agree to reimburse the CPUC for the cost of this assessment. The CPUC is reviewing whether and how such reimbursement could occur. To the extent an alternative selected by the CPUC requires its own CEQA assessment (for example a large generating unit), the extent of additional CEQA review required would have to be determined by the relevant lead agency (in the case of a large generator, the CEC).

Finally, as described in the paragraph below, the CPUC would have before it, at the time it makes a decision on the Valley-Rainbow CPCN, the following information:

1. alternatives identified through the RFP process,
2. analysis and documents from the CEQA process,
3. ISO testimony, and
4. testimony of any other interested party.

Based on this information the CPUC would make the decision it deems appropriate regarding the CPCN application.

CPUC CPCN proceeding:

In addition to providing information to the CPUC staff undertaking the CEQA review of the project, the ISO would participate actively in the evidentiary hearings of the CPCN proceeding. That is, the ISO would in addition to providing information in the CEQA process, provide testimony in the CPCN evidentiary hearings on the Valley Rainbow project and the various alternatives identified through the CEQA process, and on how the project and alternatives fare under ISO evaluation criteria. The CPUC would ultimately determine whether to grant a CPCN based on its assessment of which alternative best meets CPCN and CEQA criteria. The CPUC could assess information on proposed contract terms in making this determination.

Timing:

In order for CPUC staff to be able to assess the results of the RFP without unduly delaying the CPCN proceeding, it is important that the responses to the RFP and the ISO's assessment of those responses be available to the CPUC staff within 120 days from the date on which SDG&E makes its CPCN application. SDG&E is expected to file its CPCN application by the end of January. Accordingly, RFP responses and the ISO's assessment of these responses should be completed as soon as possible but no later than mid-May. This is an aggressive schedule that requires prompt action to put the RFP into place.

Responsibilities:

An outstanding question remains as to who is the appropriate party to contract with an alternative in the event that a non-wires alternative, superior to the Valley-Rainbow line, emerges as a result of the RFP process. In last year's Tri-Valley pilot program, the ISO proposed to enter into such a contract. However, Transmission Owners had concerns regarding the cost recovery method proposed by the ISO. Further, there were concerns that any payment by the ISO to a non-wires alternative would subsidize its market activity and thereby skew market signals.

Since the Tri-Valley RFP was issued, the ISO has reconsidered its position that it is the ISO that should enter into a non-wires contract. It is possible instead that a utility (which would build a transmission facility) should be the entity that contracts for, or if relevant regulatory entities support such an approach, builds non-wires alternatives. From the ISO's standpoint this approach has several advantages. First, this approach keeps the ISO from becoming increasingly involved in generation. The RFB for summer 2001 generation highlighted the discomfort of many policy makers and Market Participants with the concept of increasing ISO involvement in stimulating the development of generation. By having utilities responsible for developing non-wires alternatives, the ISO avoids becoming increasingly involved in development of generation.

Second, the utility contracting approach provides for a direct relationship between the utility (which would in any event ultimately pay for the cost of non-wires alternatives) and the non-wires alternative developer. The cost recovery approach developed for Tri-Valley was awkward, with interdependent payment responsibilities all conditioned on the utility's ability to recover the costs of the project. By having a utility contract directly with a project developer, more direct payment arrangements can be put into place.

Third, in circumstances where utilities have been given increasing latitude to enter into long term contracts, utilities entering into contracts with non-wires alternatives can consider and contract for additional services from such alternatives, rather than being limited to considering transmission system benefits. The ISO would not need to be involved in determining what type of contract is appropriate. The ISO would only have to be assured that the non-wires alternatives equally comply with the ISO Grid Planning Criteria.

One possible drawback of the utility contracting approach is that some may question the impartiality of a utility in choosing between building transmission or contracting for non-wires alternatives. This drawback can be minimized, however, by having the ISO undertake the RFP

process, and to the extent the ISO and the CPUC (through the CEQA and CPCN process) play a key role in evaluating and selecting between the transmission projects and the RFP respondents. Thus, the final recommendation regarding the optimal project would come from the ISO and the CPUC and not from the utility.

The determination of whether the ISO or the utility should contract with non-wires alternatives is a significant policy issue that may not need to be determined at this time. Given the short lead time related to a Valley-Rainbow RFP, the ISO could expeditiously develop an RFP without specifying whether the ISO or the utility will be the contracting party. The issue of who should be the contracting party can then be addressed as part of the Long Term Grid Planning process and may be considered by the CPUC in the context of the CPCN application.

ATTACHMENT A - Discussion of ISO Evaluation Criteria:

The ISO presented the Governing Board with a discussion of proposed criteria for a Valley – Rainbow solicitation during the August 2000 Governing Board meeting. Because at that time, the Governing Board determined that there should be not be a competitive solicitation, the Governing Board did not address criteria. Since August, our approach to a competitive solicitation for Valley-Rainbow has evolved, particularly in light of the Governing Board directive that the RFP should be a mechanism to solicit information to be considered by the CPUC. As discussed above, to accomplish the Governing Board’s objective, we believe it is appropriate for the ISO to solicit potential alternatives to the project, evaluate those responses based on ISO evaluation criteria, and then provide such information to the CPUC for consideration in its CPCN proceeding. Under this approach, the ISO would no longer determine a “winner”.

Below is an initial discussion of the criterion the ISO would use to assess RFP responses. The ISO will attempt to refine these criterion with stakeholders, and submit them to the Governing Board for consideration at its February meeting. These criteria incorporate some of the thinking that has emerged in the context of Long Term Grid Planning.

Proposed ISO evaluation criteria

- Ability of the project to satisfy the ISO Grid Planning Criteria
- Ranking of the alternatives from the standpoint of overall value to the transmission system considering:
 - Relative Reliability Benefits
 - Cost effectiveness (as compared to the transmission alternative)
 - Value for Purposes of Accessing Regional Energy Markets, Reducing Congestion Costs and Assuring Adequate System Capability (for example, whether the project enhances the ability to access additional power supplies or directly adds power supplies)
 - Market Power Impact (i.e. both with respect to the ability to mitigate existing market power and the ability to exercise market power)

Ability of the project to satisfy ISO Grid Planning Criteria.

In order for a project to be a viable alternative to replace the Valley-Rainbow project, it must allow the ISO to maintain equal or better reliability than the proposed project. Accordingly, in the first instance, the ISO will determine whether a project allows the ISO to satisfy ISO Grid Planning Criteria taking into account whether this can be accomplished in light of 1) the technical characteristics of the proposed project, 2) the terms and conditions proposed by the project developer, and 3) existing mechanisms available by the ISO to secure reliability services such as RMR contracts, and related mechanisms.

Whether the project allows the ISO to maintain equal or better reliability than the proposed project will be a threshold issue. The ISO would argue in the CEQA process, and if necessary the CPCN process, that any project that does not allow the ISO to meet the ISO Grid Planning Criteria is not a proper project alternative.

Ranking of the alternatives from the standpoint of value to the transmission system:

The ISO would rank RFP responses from the standpoint of value to the transmission system taking into account the following criteria (at a minimum). The ISO would provide to the CPUC its ranking and the underlying rationale.

Relative Reliability Benefits

As noted above, the ISO would disqualify any projects that do not allow the ISO to maintain reliability. For projects that allow the ISO to meet ISO Grid Planning Criteria, the ISO would assess the relative reliability pros and cons of different alternatives in developing response rankings. For example if a project allows the ISO to meet ISO Grid Planning Criteria but it is less robust to maintain reliability than another project, the ISO would use this information in undertaking its ranking and would pass this information on to the CPUC.

Cost effectiveness (as compared to the transmission alternative)

The ISO would compare the cost of the project from a transmission system standpoint against the cost of the Valley-Rainbow project. In undertaking this comparison, the ISO would consider: 1) whether the project requires costs that would be rolled into transmission rates and if so the extent of those costs; and 2) whether the project will likely require the ISO to contract with the project as an RMR, LARS or other form of reliability contract, and if so the projected costs under such contracts; and 3) whether the project will likely allow the ISO to avoid RMR, LARS or other form of reliability contract costs, and if so the projected savings from such contracts.

The ISO could describe costs in terms of “replacing” or “displacing” the Valley-Rainbow project and in terms of “deferring” the Valley-Rainbow project. As part of the analysis, the ISO would assess whether the project likely defers or replaces the Valley-Rainbow project (providing the rationale for its determinations) and, in the case of deferral, would estimate the likely deferral time frame.

Value for Purposes of Accessing Regional Energy Markets, Reducing Congestion Costs and Assuring Adequate System Capability

In ranking projects, the ISO would consider the extent to which a proposed project would improve the ability of Market Participants to access regional energy markets and/or the extent to which a proposed project would reduce congestion costs. In addition, the ISO would assess whether a proposed project is likely to improve or reduce the overall supply adequacy/resource picture. For example, whereas a particular transmission project might enable the ISO and Market Participants to access additional supplies located in another region (e.g. Devers-Palo Verde 2), a non-wires alternative might reduce import capability into an area.

Effect on Market Power

In ranking projects, the ISO would assess the effect of a project on market power, including positive or negative impacts, and mechanisms required to mitigate market power problems that are created by the project.