Competitive Transmission Improvements

Issue Paper and Straw Proposal

September 10, 2013
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Competitive Transmission Improvements
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1 Executive summary

With this paper the ISO is launching a new stakeholder process in which it is proposing several improvements to further support competition in the ISO transmission planning process. One proposed change is to create a mechanism by which approved project sponsors who are not a participating transmission owner can recover their FERC authorized transmission revenue requirements associated with projects under construction and prior to the time that the facilities are turned over to ISO operational control. Another proposed change will clarify that approved project sponsors who are not a participating transmission owner, but who have existing transmission assets, are only required to turn over to ISO operational control the project they were selected to build. Taken together, these two proposed changes are intended to help provide nondiscriminatory opportunities for incumbents and non-incumbents alike.

An additional change proposed in this paper is to impose a project sponsor application deposit as a means to mitigate costs incurred by the ISO to perform and administer the competitive solicitation process and manage any potential agreements with approved project sponsors.

The ISO will hold a stakeholder web conference on this paper on September 20 and accept written stakeholder comments received by October 3. Following a second round of stakeholder engagement, the ISO plans to present the resulting proposal to the ISO Board in December.

2 Introduction

The ISO supports the FERC’s stated goals of promoting competition in the transmission planning process.

Just a few years ago the ISO reformed its transmission planning process to explicitly consider public policy requirements as a potential driver for transmission facilities and afford both incumbent and non-incumbent transmission developers nondiscriminatory opportunities to compete to build transmission facilities that the ISO finds are needed for public policy or economic efficiency reasons.

More recently in its Order No. 1000 compliance filing, the ISO expanded on these changes and proposed tariff revisions to further promote competition in the transmission planning process. The ISO proposed to eliminate from the ISO tariff the remaining provisions that grant a federal “right of
first refusal” for incumbent participating transmission owners to build and own certain transmission facilities whose costs will be allocated regionally. These changes reflect a significant “scaling-back” of participating transmission owners’ existing right of first refusal to build all transmission facilities needed for reliability or to maintain the simultaneous of long-term congestion revenue rights (“CRRs”). On April 18, 2013, the FERC approved these changes.

In this paper the ISO is proposing three changes to further promote competition in the transmission planning process. First, the ISO proposes to create a mechanism by which non-PTO approved project sponsors that have no existing rate recovery mechanism can recover their FERC authorized transmission revenue requirements (e.g., construction work-in-progress in rate-base and abandoned plant) associated with transmission projects under construction and prior to the time that the facilities are turned over to the operational control of the ISO. Second, the ISO proposes to clarify that non-PTO approved project sponsors with existing transmission assets are only required to turn over to ISO operational control the project they were selected to build. Third, to mitigate costs incurred by the ISO to perform and administer the competitive solicitation process, the ISO proposes to impose a project sponsor application deposit.

3 Recovery of FERC authorized transmission revenue requirements prior to becoming a PTO

3.1 FERC transmission rate incentives

Section 1241 of the Energy Policy Act of 2005 (“EPAct 2005”) added new section 219 to the Federal Power Act (“FPA”) directing the FERC to establish incentive-based rate treatments that promote capital investment in reliable and economically efficient transmission and generation of electricity by promoting capital investment. In 2006, FERC issued Order Nos. 679 and 679-A to establish incentives to support the development of transmission infrastructure.† These incentives include enhanced rate of return on equity (“ROE”), recovery of 100 percent of prudently-incurred costs associated with abandoned transmission projects due to factors beyond the control of the utility, use of hypothetical capital structures, incentives to join a transmission organization, and inclusion of 100 percent construction work-in-progress (“CWIP”) in rate base, accelerated depreciation used for rate recovery, and expensing pre-commercial operations costs associated with new transmission investment, among others.

Most of these rate incentives are not included in the transmission revenue requirement of the transmission owner until the new transmission facilities are turned over to the operation control of the ISO upon completion. However, two of these—inclusion of CWIP in rate base and recovery of

† For purposes of convenience in this paper, the ISO will generally use the term Order No. 679.
abandoned plant—are unique in that they may be recovered prior to completion of the new transmission project or after abandonment of the project. It is these two rate incentives that are the subject of section 3 of this issue paper and straw proposal.

To be eligible for these incentives, the subject project must have been vetted and approved by the ISO in its transmission planning process.²

Typically an applicant will file a petition for declaratory order requesting FERC approval of certain incentive rate treatments for its proposed project under FPA section 219 and Order No. 679. FERC reviews such requests for incentives on a case-by-case basis. The ISO anticipates that approved project sponsors similarly may seek incentive rate authority once selected in the ISO’s competitive solicitation process.

3.1.1 CWIP

In Order No. 679, FERC established a policy that allows utilities to include, where appropriate, 100 percent of prudently-incurred transmission-related CWIP in rate base. FERC stated that this rate treatment will further the goals of FPA section 219 by providing up-front regulatory certainty, rate stability, reduced interest expense, and improved cash flow, by reducing the pressures on an applicant’s finances caused by investing in transmission projects. Order 679 allows inclusion of 100 percent CWIP in rate base and expensing pre-commercial operations costs associated with new transmission investment because of the long lead times required to plan and construct new transmission can negatively affect cash flow and the ability of the sponsor to attract capital at reasonable prices. Traditional rate recovery mechanisms would not allow a utility to recover the costs of construction until the project is placed into service. Without CWIP in rate base, all of an applicant’s borrowing costs would be accrued over several years and then capitalized after the new project goes into service, along with a return of the investment cost through depreciation expense. Such a process would increase an applicants’ customers’ bills more significantly than if the FERC were to allow inclusion of CWIP in rate base. Permitting a utility to recover CWIP in rate base allows investors to receive a return on their investment before the project is placed into service thereby increasing the attractiveness of these investments. Further, recovery of CWIP in rate base may facilitate financing and improve coverage ratios used by rating agencies to determine credit quality and debt ratings.

² Order No. 679 states that each applicant must demonstrate that the facilities for which it seeks incentives satisfy the requirements of section 219 by either ensuring reliability or reducing the cost of delivered power by reducing congestion. The Order establishes a rebuttable presumption that a project is eligible for incentives under section 219 if it: (1) results from a fair and open regional planning process that considers and evaluates projects for reliability and/or congestion and is found to be acceptable to the FERC; or (2) has received construction approval from an appropriate state commission or state siting authority. FERC will consider incentive requests for projects that are still undergoing consideration in a regional planning process, but may make any requested incentive rate treatment contingent on the project being approved under the regional planning process.
Typically FERC may accept an applicant’s proposal to recover 100 percent of CWIP in rate base conditioned upon the applicant fulfilling FERC’s requirements for CWIP inclusion for the project in a subsequent section 205 filing.

3.1.2 Abandoned plant

Under Order No. 679, the FERC allows applicants to seek recovery of 100 percent of prudently-incurred costs associated with a transmission project that is cancelled or abandoned for reasons outside the applicant’s control. The purpose of this incentive is to reduce the risk associated with potential upgrades or other improvements to the transmission system. The ability to recover of the costs of abandoned plant is an important consideration when applicants evaluate investment opportunities with significant risk associated with factors beyond their control, such as generation developers’ decisions to develop or terminate the development of the potential generation resources that drove the need for the line in the first place (e.g., it may be uncertain whether renewable generation resources connecting to a transmission project will ultimately be developed) or difficulty obtaining state or local siting approvals (e.g., some projects may require multiple approvals involving multiple regulatory jurisdictions which can increase the possibility that a project may be subject to forced abandonment). In Order No. 679 the FERC found that the abandonment incentive is an effective means of encouraging transmission development by reducing the risk of non-recovery of costs.

Typically, if the request is approved, FERC would conditionally grant an applicant’s request for recovery of 100 percent of prudently-incurred transmission-related costs associated with abandonment of a project, provided that the abandonment is a result of factors beyond the control of the applicant, which must be demonstrated in a subsequent FPA section 205 filing for recovery of abandoned plant.

3.2 Relationship between the ISO transmission access charge and a PTO’s transmission revenue requirement

All market participants withdrawing energy (i.e. loads and exports) from the ISO controlled grid pay transmission access charges.

In accordance with Section 26 and Schedule 3 of Appendix F of the ISO Tariff, the ISO transmission access charge is designed to recover each Participating Transmission Owner’s (“PTO”) transmission revenue requirement. Only PTOs may recover their transmission revenue requirement (for purposes of this discussion, specifically CWIP and abandoned plant) through the ISO transmission access charge. Under the ISO tariff, a participating transmission owner is defined as “a party to the Transmission Control Agreement whose application under section 2.2 of the Transmission Control Agreement has been accepted and who has placed its transmission assets and Entitlements under the CAISO’s Operational Control in accordance with the Transmission Control Agreement.”
Each PTO’s transmission revenue requirement is the total annual FERC authorized revenue requirement associated with transmission facilities turned over to the operational control of the ISO by the PTO, including projects under construction that are to be turned over to the operational control of the ISO upon completion (this latter point is relevant in the case of CWIP and abandoned plant).

Simply put, the ISO tariff contains provisions to collect the necessary funds and provide revenue to a PTO for use of transmission assets. The ISO tariff contains no such provisions for non-PTOs. The ISO pays transmission access charge revenues to PTOs on a monthly basis.

3.3 Cost recovery for non-PTO approved project sponsors

In phase 3 of the annual transmission planning process, the ISO evaluates proposals to construct, own, operate, and maintain regional transmission facilities identified in the comprehensive transmission plan and subject to competitive solicitation. The project sponsor selected may be a PTO or a non-PTO. Presumably the selected project sponsor would request FERC approval of incentive rate treatments for its proposed project under FPA section 219 and Order No. 679, including recovery of 100 percent of CWIP in rate base and recovery of 100 percent of prudently-incurred costs associated with project abandonment. If the approved project sponsor is a PTO, then the revenues associated with CWIP and abandoned plant could be recovered through the transmission access charge as part of the PTO’s existing revenue requirement; however, a non-PTO approved project sponsor would have no such mechanism to recover the revenue requirement associated with CWIP and abandoned plant. As previously stated, the ISO tariff does not contain any provision to collect the necessary funds and provide revenue to a non-PTO for use of transmission assets.

Project sponsors that the ISO (or authorized governmental body) selects to build and own a needed transmission solution identified in the comprehensive transmission plan, whether a PTO or non-PTO, are similarly situated because they both face similar risks and financing pressures caused by investing in transmission projects. Recognizing these similarities and in order to provide a more level playing field and support a competitive transmission process, the ISO proposes to create a new mechanism by which non-PTO project sponsors that are selected to build and own an identified transmission solution in the ISO’s competitive solicitation process can, through the ISO transmission access charge, recover these components of their FERC authorized transmission revenue requirements prior to the completion of the project. This recovery would be limited to CWIP and abandoned plant.

In the case of CWIP, once the project is completed and turned over to the operational control of the ISO, and the project sponsor becomes a party to the TCA, the remaining portions of its FERC authorized transmission revenue requirement would be recoverable through the ISO transmission access charge. An approved project sponsor of a project that is ultimately abandoned, for which
FERC has authorized recovery of prudently incurred expenditures prior to the time that the project was discontinued, would continue to recover these costs for the remainder of the authorized amortization period.

To implement this new mechanism, the ISO is exploring the following options:

1. Add a new Section 4.17 to the ISO Tariff describing the relationship between the ISO and non-PTO approved project sponsors.

2. Amend Section 26 and Schedule 3 of Appendix F and Section 11 of the ISO Tariff to include recovery of a non-PTO approved project sponsor’s FERC authorized transmission revenue requirements associated with transmission projects under construction that are to be turned over to the operational control of the ISO upon completion or with abandoned facilities for reasons beyond the approved project sponsor’s control.

3. Develop a pro-forma agreement for use between the ISO and each approved project sponsor to accomplish a number of purposes including:
   a. Acknowledge acceptance of the selection of the project sponsor.
   b. Establish the obligations, roles and responsibilities of the project sponsor including reporting requirements so that the ISO can proactively monitor the status of approved facilities and to take the necessary actions if projects are not on schedule. This agreement may overlap with the Transmission Control Agreement (“TCA”) once the project sponsor enters into the TCA with respect to the facility that the project sponsor was selected to construct and own as a result of the competitive solicitation process, and the transmission facilities have achieved commercial operation.

4. A potential alternative to item 3 may be to incorporate into the bid submission requirements the bidder’s agreement to comply with the relevant tariff sections and associated obligations, roles and responsibilities.

The ISO invites stakeholders to comment on these potential changes and to identify other alternative (or additive) tariff options/revisions that would (i) enable non-PTOs to recover CWIP and abandoned plant costs in rates before they become PTOs and (ii) ensure that transmission solutions are successfully completed in a timely manner.

Following receipt of this feedback, the ISO intends to further develop its proposal and present that in a draft final proposal paper. The ISO will work with stakeholders to develop proposed tariff revisions to Section 4, Section 26, Schedule 3 of Appendix F, and Section 11 of the ISO Tariff, as well as a new pro-forma agreement with each project sponsor to the extent that that is what the
ISO ultimately proposes, during the subsequent tariff language development process. The ISO intends to begin this latter effort prior to the December ISO Board meeting.  

4 Non-PTO approved projects sponsors with existing transmission assets

Under ISO tariff section 4.3.1, a new PTO is required to turn over operational control of all facilities and entitlements that (1) satisfy FERC’s functional criteria for determining what transmission facilities should be placed under the ISO’s operational control, (2) satisfy the criteria adopted by the ISO governing board identifying facilities for which the ISO should assume operational control, and (3) are the subject of mutual agreement between the ISO and the PTOs.

Some stakeholders have indicated that these tariff provisions lack clarity with respect to the disposition of the existing transmission assets of a non-PTO approved project sponsor. Thus, under the scenario in which a non-PTO with existing transmission assets is selected as the approved project sponsor for a particular transmission solution, the issue has arisen whether that approved project sponsor will not only be required to turn over to the ISO’s operational control the particular transmission solution but will also be required to turn over all of its existing transmission assets to ISO operational control.

The ISO seeks to maximize participation in the competitive solicitation process, and recognizes that many different transmission developers with existing facilities located throughout the US may seek to compete in the competitive solicitation process. Thus, the ISO believes that an approved project sponsor that is not an existing PTO should be required to turn over to the ISO’s operational control only the facilities that it was awarded the right to build, not all of its transmission facilities. The ISO is evaluating what would be required to implement this change—a new agreement, changes to the transmission control agreement, and/or targeted tariff provisions (e.g., perhaps this could be addressed in a new section 4.17 to the ISO tariff as discussed in section 3.3 above).

The ISO invites stakeholders to comment on its proposal to address the issue of non-PTO approved project sponsors with existing transmission assets and discuss what specific changes they believe are necessary to effectuate the proposal.

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3 In the case of the accelerated competitive solicitation process (Imperial Valley area) resulting from the 2012-2013 transmission planning process, the ISO is currently developing such an agreement which could serve as a starting point for a new pro-forma agreement with project sponsors.
5 Project sponsor application deposit

Over the last several years the ISO has made a number of significant tariff revisions in order to promote competition in the transmission planning process. As a direct result, the ISO now administers a competitive solicitation process providing an opportunity for project sponsors to submit proposals to finance, own, and construct facilities subject to competitive solicitation identified in the comprehensive transmission plan. Under this process the ISO carries out several significant tasks including (1) determining whether a project sponsor meets certain qualification criteria, (2) determining whether a project sponsor’s proposal meets certain proposal qualification criteria, and (3) selecting an approved project sponsor. In addition, once the project sponsor is selected, the ISO may also devote a significant amount of time ensuring that the project is on-track for completion including (1) negotiating a contract with the project sponsor to provide obligations, roles and responsibilities of the parties; (2) monthly project status review; (3) change management, if applicable; (4) coordination of commissioning activities; and (5) coordination with existing PTOs.

The ISO views these tasks as a significant undertaking that requires an extensive commitment of resources and the need to bring in outside contractors to support internal ISO staff, at significant additional cost. Also, the ISO tariff requires that ISO to retain a consultant to assist it in the selection of an approved project sponsor. This workload is likely to increase with each successive annual transmission planning process cycle because more transmission solutions will be subject to competitive solicitation under the ISO’s Order No. 1000 transmission planning framework than under the process in effect for the 2012-2013 process.

Thus far the ISO has been funding this significant incremental workload and cost without a corresponding increase in its operations budget (i.e., through the Board approved grid management charge). This raises the question whether it is appropriate for ISO ratepayers to fund the costs of individual applicants competing to build and own specific transmission solutions. For example, the ISO notes that resources seeking to interconnect to the ISO grid via the generator interconnection process pay fees to support processing their applications and conducting the necessary studies, and shortly will pay fees to process modifications for their projects. The ISO also notes that FERC authorized the Midcontinent Independent System Operator (“MISO”) to charge transmission developers participating in the competitive solicitation process a deposit.4 Similarly, FERC authorized the Southwest Power Pool (“SPP”) to charge an application fee for purposes of the qualification determination and a deposit for applicants submitting project proposals.5

To mitigate the aforementioned impacts, the ISO believes that all project sponsors should bear the costs of the competitive solicitation process. To accomplish this, the ISO proposes that project sponsors be required to provide an application deposit in the amount of $100,000 to be applied as

a pool of funds to pay for prudent costs incurred by the ISO to perform and administer the competitive solicitation process. If the amount required to pay actual costs is determined to be greater than $100,000 per application, then each project sponsor would be obligated to provide the additional amount. Conversely, if the amount required to pay actual costs was determined to be less than $100,000, then each project sponsor would be refunded the unused balance of its deposit, with interest.6

The ISO is also considering whether approved project sponsors should bear the actual costs incurred by the ISO to ensure that the project is on-track for completion (e.g., negotiating an agreement with the approved project sponsor, monthly project status review, change management, if applicable; coordination of commissioning activities, and coordination with existing PTOs).

Stakeholders are invited to provide comment on the ISO’s proposal on a project sponsor application deposit. Stakeholder are also asked to comment on whether approved project sponsors should bear the actual costs incurred by the ISO to manage any potential agreements with approved project sponsors.

6 Stakeholder process and next steps

Following the release of this issue paper and straw proposal, the ISO will hold a stakeholder web conference on September 20 to discuss the issue paper and straw proposal and obtain initial stakeholder feedback. The ISO is requesting written stakeholder comments by October 3.

Table 1 provides a summary of this stakeholder process and next steps.

**Table 1 – Stakeholder process schedule**

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<tr>
<th>Date</th>
<th>Milestone</th>
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<tbody>
<tr>
<td>September 10</td>
<td>Post issue paper and straw proposal</td>
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<tr>
<td>September 20</td>
<td>Stakeholder web conference</td>
</tr>
<tr>
<td>October 3</td>
<td>Stakeholder comments due</td>
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<tr>
<td>October 17</td>
<td>Post draft final proposal</td>
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<tr>
<td>November 12</td>
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6 Interest is based on the interest that the ISO receives on the deposit, not based on the federal rate in 18 CFR 35.19(a).
<table>
<thead>
<tr>
<th>Date</th>
<th>Milestone</th>
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<tbody>
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<td>ISO Board meeting</td>
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<tr>
<td>Early 2014</td>
<td>FERC filing</td>
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