Memorandum

To: ISO Board of Governors

From: Keith Casey, Vice President, Market and Infrastructure Development

Date: May 21, 2014

Re: Decision on generator interconnection and deliverability allocation procedures reassessment proposal

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This memorandum requires Board action.

EXECUTIVE SUMMARY

The ISO performs an annual reassessment of projects in its generation interconnection queue pursuant to the Generator Interconnection and Deliverability Allocation Procedures (GIDAP) tariff provisions approved by the Federal Energy Regulatory Commission in 2012. The reassessment is performed following the phase I interconnection studies to reflect status changes of earlier-queued projects, such as project withdrawals, and establishes the study assumptions to be used for the phase II interconnection studies.

The first reassessment occurred in 2013 as part of the initial implementation of the GIDAP. The reassessment results indicated that, due to project withdrawals, a number of previously identified transmission network upgrades were no longer needed to support the interconnection of customers remaining in the queue. The removal of these upgrades led to a reduction in the overall cost responsibility for certain customers.

As a result of these effects, generation developers requested that the reassessment results serve as a basis for adjusting interconnection customers' cost caps and interconnection financial security posting requirements. However, because the GIDAP reassessment was never intended to serve as a basis for making such adjustments, Management conducted a new stakeholder process to examine the policy implications of making such adjustments and to consider whether such adjustments could be made. Through this process, Management has proposed solutions to these issues that are broadly supported by stakeholders.

To address these issues, Management proposes two tariff amendments. First, Management recommends that an interconnection customer be eligible for a cost cap adjustment if a reassessment results in a significant difference between the customer's existing cost cap and its revised estimated responsibility for network upgrade costs.

Second, Management recommends that a change in network upgrade cost responsibility resulting from a reassessment will qualify a customer for a change in the amount of interconnection financial security the customer is required to post.

Management recommends the following motion:

> ***Moved, that the ISO Board of Governors approves the proposal to make adjustments to an interconnection customer's maximum cost responsibility for network upgrades and interconnection financial security posting requirement, as described in the memorandum dated May 21, 2014; and***
>
> ***Moved, that the ISO Board of Governors authorizes Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the proposed tariff change.***

DISCUSSION AND ANALYSIS

The ISO performs an annual reassessment pursuant to the Generator Interconnection and Deliverability Allocation Procedures (GIDAP). The reassessment is performed following the phase I interconnection studies to reflect status changes of earlier-queued projects, such as project withdrawals, and establishes the study assumptions to be used for the phase II interconnection studies.[1]

The ISO issued the results of the first annual reassessment in September 2013. The results indicated that, due to project withdrawals, a number of previously identified network upgrades were no longer needed to support the interconnection of customers remaining in the queue.

After the reassessment reports were issued in September, some interconnection customers with reassessment results indicating lower network upgrade costs requested revisions to their maximum cost responsibilities (*i.e.*, cost caps) and their posted interconnection financial security amounts. Some customers contended that the reassessment results should be treated as an amendment to the phase I and phase II interconnection studies, and as such a customer's cost cap should be adjusted to reflect any reduction in the estimated costs of network upgrades reflected by the reassessment. In addition, customers advocated for using the reassessment results as a basis for making revisions to the interconnection financial security amounts they had previously posted.

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[1] The interconnection study process consists of two phases. The phase I study starts July 1 of each year, takes 170 calendar days to complete, and preliminarily identifies all network upgrades needed to address impact on the ISO grid, required interconnection facilities, and establishes maximum cost responsibility for network upgrades. The phase II study begins May 1 of each year, takes 205 calendar days to complete, and forms the basis for executing the generator interconnection agreement. The reassessment occurs in between these two phases.

In response to these concerns, during the November 7, 2013 Board of Governors meeting, Management conveyed that the ISO's tariff does not provide for such adjustments, and that because the reassessment never contemplated an adjustment to cost caps or to interconnection financial security, making such adjustments could have broad policy implications. Thus, any consideration of adjusting cost caps and interconnection financial security in subsequent reassessment cycles would need to be examined in a comprehensive manner through a new stakeholder process. In December 2013, Management initiated a stakeholder process dedicated to these issues. That stakeholder process resulted in this proposal.

<u>Adjustments to cost caps</u>

The tariff provisions that implement the ISO's generator interconnection process, including the GIDAP, state that an interconnection customer's maximum cost responsibility for network upgrades is based on the lower of the phase I or phase II interconnection study cost estimates. This maximum responsibility is often referred to as a customer's "cost cap."

The imposition of binding cost caps for network upgrades based on the lesser of the phase I and phase II study results was an important change in cost allocation policy made through the Generator Interconnection Process Reform initiative in 2008. The ISO has consistently explained that the purpose of including, as part of the cluster study process, a cap on interconnection customers' responsibility for network upgrades is to ensure that generation developers know, relatively early in the interconnection process, their maximum responsibility to finance needed transmission upgrades. This is in contrast to the prior serial study process where an interconnection customer's total cost exposure could change dramatically depending on decisions made by other interconnection customers (*e.g.*, a decision to withdraw from the interconnection queue). One of the main reasons for providing interconnection customers with certainty as to their maximum cost exposure early in the process is to encourage customers to make decisions regarding the viability of their projects as early as possible. Providing customers with their maximum cost exposure early in the process is also important in light of the increased financial security commitments that the Generator Interconnection Process Reform required from interconnection customers.

Reducing the cost responsibility of customers for network upgrades creates some risk that a participating transmission owner (PTO) will have to, up-front, fund some portion of the upgrades. This risk exists because the applicable PTO is responsible for funding any capital costs for network upgrades that exceed the maximum cost responsibility assigned to the interconnection customers. If cost caps were to be ratcheted downwards whenever queue withdrawals eliminated the need for some network upgrades, then the relevant PTO would be at greater risk to up-front fund any cost increases that might result from subsequent queue withdrawals. Such a risk would arise if a network upgrade was still needed despite subsequent queue withdrawals. In such a case, the lower cost caps for the remaining customers would preclude assigning them a share of the network cost responsibilities of the withdrawn projects and would consequently require the PTO to up front fund these costs.

This same policy rationale informs the design of the GIDAP – *i.e.*, even though the GIDAP reassessment acknowledges and accounts for interconnection request withdrawals, it does not provide for an adjustment to a customer's assigned maximum cost responsibility. Thus, a reassessment does not shift the balance of funding risks between the interconnection customers and the PTOs. Adjusting interconnection customers' cost caps based on the results of the annual reassessments would undermine the fundamental structure and balances established in the ISO's reforms to its generation interconnection procedures.

Management continues to believe that the current approach based on the lesser of phase I and phase II study results provides a reasonable balance between providing interconnection customers with cost certainty as early as possible in the process on the one hand and PTO financing exposure on the other. However, Management also recognizes that there may be situations where the difference between an interconnection customer's existing cost cap and a revised cost allocation resulting from the reassessment may be significant. In recognition of this, Management worked with stakeholders and developed this proposal to allow cost cap adjustments in these limited circumstances while also mitigating cost exposure to the PTOs by moderating the amount of any cost cap reduction allowed.

Management proposes that an interconnection customer be eligible for a reduced cost cap if the reassessment results indicate the difference between the customer's existing cost cap and its revised estimated responsibility for network upgrade costs is at least 20% and at least $1 million. For a customer that meets this eligibility threshold, the provisional revised cost cap amount would be equivalent to what the customer's cost responsibility would be if all other customers requiring the same upgrade withdrew from the interconnection queue (*i.e.*, a 100% cost allocation to each project for all remaining network upgrades). Moderating the amount of cost cap reduction in this way addresses concerns about a potential transfer of financing risks from interconnection customers to the PTOs. The revised cost cap amount would be provisional because the customer's actual new cost cap would be the lesser of the customer's existing cost cap and the provisional revised cost cap amount. However, should there be, at any time, a subsequent significant change in system configuration that results in an increased cost responsibility above the customer's new cost cap (*e.g.*, such as occurred with the loss of the San Onofre Nuclear Generating station), the customer's cost cap will be adjusted upwards to this increased cost level. If the increased cost level is greater than the customer's original cost cap, then the original cost cap would apply.

<u>Adjustments to posting requirements</u>

After the reassessment reports were issued in September 2013, some interconnection customers with reassessment results indicating lower network upgrade costs also requested immediate revisions to their posted interconnection financial security amounts.

The GIDAP provides that the maximum value for the interconnection financial security posting required of each interconnection customer is established by the lesser of the costs for network upgrades assigned to the customer in the final phase I interconnection study report or the final phase II interconnection study report, not the reassessment report. The GIDAP does not provide a mechanism for making adjustments to interconnection financial security postings between the specified posting milestones. Thus, to use the reassessment results as the basis for modifying interconnection customers' financial security postings requires a tariff change. Under the current rules, to the extent that a customer's network upgrade costs are reduced as a result of a reassessment, such reduction would be reflected in the customer's next scheduled interconnection financial security posting the following year.

To address this situation, Management worked with stakeholders and developed a proposed solution that allows posting requirements to be adjusted based on reassessment results. Management recommends that a change in estimated network upgrade cost responsibility resulting from a reassessment qualify an interconnection customer for a change in the amount of interconnection financial security the customer is required to post. A change in estimated network upgrade cost responsibility resulting from a reassessment can result in an increase (*i.e.*, an upward adjustment) or a decrease (*i.e.*, a downward adjustment) in a customer's interconnection financial security amount, as applicable. The adjustments will be automatic. However, an interconnection customer can opt out of a downward adjustment by submitting notification to the ISO within 10 days of the issuance date of the reassessment report that the customer wants to keep the posting as is.

If a customer's total estimated share of network upgrade costs declines as a result of the most recent reassessment, then that new cost estimate will be used to calculate the amount of financial security that is at risk of forfeiture if the customer withdraws. This rule will apply even if the interconnection customer elects not to adjust the project's posting.

POSITIONS OF THE PARTIES

Most stakeholders either fully support, or support with qualification, Management's proposal that an interconnection customer be eligible for a cost cap adjustment if the reassessment results in a significant difference between the customer's existing cost cap and its revised estimated upgrade costs. The qualifications expressed and Management's responses are summarized in the attached stakeholder matrix.

Additionally, as shown in the stakeholder matrix, most stakeholders fully support Management's proposal that a change in network upgrade cost responsibility resulting from a reassessment will qualify a customer for a change in the amount of interconnection financial security the customer is required to post.

CONCLUSION

Management recommends that the Board approve the proposal described in this memorandum. Management's proposal is broadly supported by stakeholders and was refined over the course of the initiative to address their comments and concerns. Management believes that this proposal will further enhance the generator interconnection process to better accommodate the needs of interconnection customers.