

Memorandum

To: ISO Board of Governors
From: Phil Pettingill, Manager of Infrastructure Policy and Contracts
Anjali Sheffrin, Director of Market and Product Development
Date: March 18, 2008
Re: *Decision on Startrans IO, L.L.C. Participating Transmission Owner Application*

This memorandum requires Board action.

EXECUTIVE SUMMARY

In January 2008, Startrans IO, L.L.C. ("Startrans") submitted an application to the California ISO to become a Participating Transmission Owner ("PTO"). Startrans is acquiring the City of Vernon's rights in the "Mead Projects" – two transmission lines that extend from Southern Nevada to Southern California (the Mead-Adelanto Project in which Vernon owns 81 MW of transmission capacity) and from Southern Nevada to Southern Arizona (the Mead-Phoenix Project in which Vernon owns 75 MW of transmission capacity). Management believes that adding Startrans as a PTO will promote open transmission access and, importantly, will preserve the Vernon rights in the Mead Projects as part of the ISO Controlled Grid.

Management requests that the Board approve the CAISO's acceptance of the Startrans application and requests that, upon execution of the Transmission Control Agreement ("TCA"), Startrans become a PTO, subject to FERC accepting Startrans' Transmission Owner Tariff ("TO Tariff") and Transmission Revenue Requirement (TRR).¹

MOTION

Moved, that the ISO Board of Governors approve the CAISO's acceptance of the application of Startrans IO, L.L.C. for Participating Transmission Owner status, conditioned on (1) Startrans executing the Transmission Control Agreement and (2) the Federal Energy Regulatory Commission accepting a Transmission Owner Tariff and Transmission Revenue Requirement for Startrans.

¹ Management will also be working with Startrans and the other parties to the TCA to amend the TCA to add Startrans as a party. Management is not seeking Board approval of these non-substantive changes, however, per the Board's direction at its meeting of September 15, 2004.

BACKGROUND ABOUT THE APPLICATION

Following procedures in the ISO Tariff and the TCA, Startrans submitted an application on January 10, 2008 that proposed turning over Operational Control of Startrans' rights in the Mead Projects to the CAISO. (*Attachment A*).

In order for an applicant to become a PTO, the TCA requires that the CAISO "accept" the application. The criteria for the CAISO's acceptance of the application are specified in the TCA, as detailed below.

Although the CAISO is not required to act on an application for PTO status within a specified time, Management is seeking Board approval of the CAISO's acceptance of the Startrans application now because CAISO acceptance of the application and Startrans' execution of the TCA are conditions for finalizing Startrans' purchase of the transmission rights in the Mead Projects from Vernon. The Startrans purchase agreement contemplates a March 31, 2008 closing that can be extended only once for thirty days.

DISCUSSION OF TCA CRITERIA

The TCA states that the CAISO shall permit a party to become a PTO if it determines that:

- The transmission lines and associated facilities to be placed under the CAISO's Operational Control can be incorporated into the ISO Controlled Grid without any material adverse impact on its reliability;
- Incorporating such transmission rights will not put the CAISO in breach of Applicable Reliability Criteria and its obligations as a member of the Western Electricity Coordinating Council ("WECC");
- The applicant is capable of performing its obligations under the TCA; and
- All applicable regulatory approvals of the applicant's TO Tariff have been obtained.

The first and second elements are satisfied because Startrans is acquiring existing ISO Controlled Grid transmission rights and intends to maintain them as such. The third element is also satisfied because the Vernon rights that Startrans is purchasing are minority entitlements. The TCA's primary obligations, including compliance with the Transmission Maintenance Standards, processing generator interconnection requests, and other actions associated with the physical facilities themselves generally apply to majority owners of the transmission facilities. The Mead Projects will be owned and maintained by the majority owner, and the CAISO has no reason to doubt that Startrans will fulfill the other obligations under the TCA.

The fourth element is addressed through the conditional nature of the Board's approval. Startrans has already filed its TO Tariff and associated TRR with FERC. The proposed motion states that FERC acceptance of these filings is an express condition of accepting Startrans as a PTO. Accepting Startrans' application subject to this condition subsequent seems to be necessary due to timing constraints and the current lending market. Lenders commit only for limited time periods, and they are apparently more comfortable financing an acquisition pending regulatory approval from FERC than awaiting approval from the CAISO – as evidenced by the terms of Startrans' purchase agreement. A similar approach was followed with regard to the PTO applications of Trans Bay Cable and Trans-Elect NTD Path 15 (now Atlantic Path 15) to satisfy the concerns of their lenders.

POSITIONS OF THE PARTIES

As required by the TCA, the CAISO timely posted Startrans' application for PTO status on the CAISO website for sixty days to give interested parties an opportunity to review the application and submit comments to the CAISO. Additionally, comments on issues related to Startrans' application have also been submitted in the FERC proceedings on the Startrans acquisition of the Vernon transmission rights and on the Startrans TO Tariff and TRR. The concerns raised and Management's assessments are as follows.

The primary concern has been Vernon's liability to other PTOs resulting from Vernon's over-recovery of its TRR since 2001, and whether the transfer to Startrans would impede future efforts to collect from Vernon. The CAISO estimates this liability, which is the subject of continuing litigation, amounts to \$12 million before interest. To address this concern, Startrans has agreed to assume any liability that Vernon may have, which Startrans will then recover from Vernon. Management is satisfied with the form of the agreement, which was recently revised in response to comments by existing PTOs. On a related note, certain of the existing PTOs have also asked Startrans for assurance that, in the event it is unable to recover the assumed liability from Vernon, it will not attempt to recoup the otherwise stranded cost through its own TRR. While neither the CAISO nor Startrans expects that FERC would permit Startrans to recover the same amounts that FERC ruled Vernon could not recover, on March 14 Startrans submitted a filing in the FERC proceeding on its TO Tariff and TRR committing not to seek recovery of these amounts in its TRR. If this does not satisfy the concerns of the existing PTOs, Management believes that the proper forum for the PTOs to address this hypothetical concern is in a future rate case, not the application process.

Second, the CAISO and certain of the existing PTOs want to ensure that Vernon reduces its TRR to reflect the transfer of the Mead Projects so that there will not be double recovery of the TRR by both Startrans and Vernon. Vernon has indicated that it will make the necessary filing in the next few days. The CAISO has informed Vernon that, if it fails to do so, the CAISO will not provide its written consent which is necessary for the transaction to close.

Third, Southern California Edison Company ("SCE") asserts that Management is acting without authority under the ISO Tariff by (1) negotiating and filing the TCA amendments on an expedited basis and (2) adding Startrans as a PTO at all based on the assertion that the ISO Tariff as currently structured has no specific procedures for TRR recovery by an entity such as Startrans that does not serve load and owns only "Existing Facilities." At this time, Management believes the legal issues raised by SCE lack substance and are more appropriately addressed at FERC. The CAISO will be seeking appropriate waivers for the expedited treatment, which Management believes is appropriate under these circumstances where the facilities are already a part of the ISO Controlled Grid, and thus do not implicate integration issues. FERC will also consider SCE's rate issues during Startrans' TRR proceeding. Accordingly, these issues should not delay Board approval of the CAISO's acceptance of Startrans' application.

Fourth, certain existing PTOs have objected to various aspects of the TRR filed by Startrans with FERC. Management considers this a matter for proper resolution by FERC in the proceeding on Startrans' TO Tariff and TRR, and not a matter that is relevant to the acceptance of Startrans' PTO application. This uncertainty at FERC is causing some PTOs to withhold support until this and other FERC matters are resolved. Management accommodated this type of uncertainty in the past by making the Board approval of acceptance of PTO applications conditional on FERC making the TRRs and TO Tariffs of applicants effective. This is what occurred with the Board's approval of the Trans Bay Cable project. Management recommends similar treatment for Startrans.

MANAGEMENT RECOMMENDATION

Management recommends that the Board approve the CAISO's acceptance of Startrans' application for PTO status conditioned on (i) Startrans' execution of the TCA and (ii) acceptance of Startrans's TO Tariff and TRR by FERC.

Based on the criteria set forth in the TCA, Management has concluded that the application submitted by Startrans satisfies all of the requirements for acceptance and that preserving Vernon's rights in the Mead Projects as part of the ISO Controlled Grid is consistent with the CAISO's mission to operate the grid reliably and efficiently and to provide fair and open transmission access. Importantly, Management believes that Board approval of the CAISO's acceptance of Startrans' application at this time will enable Startrans to finalize its purchase of Vernon's rights in the Mead Projects from Vernon, giving Startrans the grounds to execute the TCA and become a PTO.