

Memorandum

To: ISO Board of Governors

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

Date: September 7, 2012

Re: **Decision on FERC Order 1000 Compliance Filing**

This memorandum requires Board action.

EXECUTIVE SUMMARY

Management requests Board approval to file tariff revisions, described herein, which were developed through a stakeholder process to comply with the Federal Energy Regulatory Commission's Order No. 1000 on transmission planning and cost allocation. Order 1000¹ imposes requirements on the ISO in three primary areas: (1) regional (i.e., ISO system-wide) planning and cost allocation; (2) opportunities for non-incumbent transmission developers to build and own ratepayer-funded transmission; and, (3) interregional planning and cost allocation. The ISO is required to file the necessary tariff amendments to comply with the first two areas by October 11, 2012, and as such this memorandum addresses only these two areas. Compliance with the third area must be filed by April 11, 2013 and will be the subject of a subsequent Management proposal in the first quarter of 2013.

In June 2010, the ISO filed significant tariff amendments with FERC substantially changing its transmission planning process and aligning the process with many of the considerations that were ultimately adopted in Order 1000. FERC approved those amendments on December 16, 2010 and the amendments went into effect on December 20, 2010 as part of the 2010-2011 planning cycle. As a result, the ISO's existing transmission planning tariff provisions largely comply with the requirements of the first two areas of Order 1000 noted above. Therefore, Management has relied on the existing ISO transmission planning process and tariff language to the greatest extent possible and is now proposing tariff amendments only where necessary to meet the specific requirements of the order with which the ISO's existing planning process does not already fully align.

Looking beyond the requirement to comply with Order 1000, Management believes that the new tariff provisions will benefit ISO market participants and other stakeholders by

¹FERC issued Order No. 1000 on July 21, 2011 and subsequently issued Order No. 1000-A that clarified certain aspects of Order No. 1000. For brevity, this memorandum refers to the two orders collectively as "Order 1000."

increasing the openness, clarity, and transparency of the ISO's transmission planning process, including the competitive solicitation process for needed transmission upgrades and additions. The key elements of Management's proposal will:

- Modify existing tariff language on "right of first refusal"²;
- Add clarity and transparency to the ISO's competitive solicitation process;
- Distinguish between "regional" and "local" transmission additions and upgrades for purposes of cost allocation and opportunities for non-incumbent transmission developers to build and own;
- Allow the costs of local transmission facilities to be allocated to the participating transmission owner that builds them and recovered from its customers that use such facilities;
- Allow the costs of regional transmission facilities to be recovered through an ISO regional (i.e., system-wide) access charge;
- Provide an express opportunity for stakeholders to propose the public policy requirements and directives that should be considered in the transmission planning process;
- Enable the ISO to proactively take the necessary actions needed to complete a project if it does not remain on schedule; and
- Conduct a competitive solicitation for economically-driven and public policy-driven transmission projects that are abandoned by a previously approved project sponsor.

With respect to the remainder of Order 1000's compliance obligations in the first two areas, Management believes that the terms of its existing tariff are consistent with or superior to the requirements of Order 1000.

For the reasons summarized above and described in greater detail in the body of this memorandum, Management recommends that the Board approve the following motion:

Moved, that the ISO Board of Governors approves the proposal for the Federal Energy Regulatory Commission Order No. 1000 Compliance Filing as described by Management in the memorandum dated September 7, 2012; and

² Strictly speaking, the ISO tariff does not contain any rights of first refusal, because under the tariff a participating transmission owner cannot refuse to build a transmission facility that has been approved in the ISO's transmission plan and is assigned to that participating transmission owner in accordance with the tariff. What participating transmission owners do have under the tariff with regard to certain categories of approved transmission facilities is an exclusive right to build and own. However, Management recognizes that Order 1000 uses the term "right of first refusal" broadly to include exclusive rights to build and own, and therefore adopts this usage in this memorandum. Nevertheless, it is important to understand that where the ISO's compliance filing does not remove or modify an existing "right of first refusal" (in the terminology of Order 1000), this should not be read to mean or imply that a participating transmission owner has a right to refuse to build a transmission facility for which it is responsible under the tariff.

Moved, that the ISO Board of Governors authorizes Management to file the necessary tariff amendments with the Federal Energy Regulatory Commission to implement this proposal.

DISCUSSION AND ANALYSIS

On February 16, 2007, FERC issued Order 890, which was designed, among other things, to increase transparency in the rules applicable to planning and use of the transmission system. In Order 890, FERC required that transmission providers implement a coordinated, open and transparent transmission planning process that satisfies nine planning principles enunciated in the order. Following a series of compliance filings submitted by the ISO, FERC ultimately found that the ISO's transmission planning process complied with each of the nine planning principles and other planning requirements adopted in Order 890.

At about the same time that FERC was considering the issues identified in its notice of proposed rulemaking released on June 17, 2010, and later addressed by Order 1000, the ISO had submitted to FERC for approval its revised transmission planning process proposal. The revised transmission planning process proposal would enable the ISO to undertake a unified and holistic planning effort that would result in a single comprehensive transmission plan that would satisfy all of the transmission planning requirements of Order 890, effectively and efficiently identify infrastructure needs driven by environmental policy goals, and provide opportunities for potential project sponsors to submit proposals in response to identified needs. FERC approved the ISO proposal, subject to certain modifications and clarifications. FERC noted, among other things, that the enhanced process was innovative, improved transparency and openness, expanded stakeholder, regional and sub-regional collaboration, fully complied with Order 890's transmission planning requirements, increased competitive opportunities (including opportunities for independent transmission developers to build projects), and provided additional opportunities for consideration of demand resources, generation and other non-transmission resources as alternatives to transmission solutions.

As a result of its revised transmission planning process proposal effort, the ISO successfully implemented many of the same transmission planning reforms that public utility transmission providers are required to implement in order to comply with Order 1000. As a result, the ISO is able to base its Order 1000 reforms, in large part, on the transmission planning reforms that the ISO implemented in connection with revised transmission planning process proposal.

With respect to the Order 1000 compliance filing, Order 1000's transmission planning reforms require:

- (1) that each public utility transmission provider participate in a regional transmission planning process that produces a regional transmission plan;³

³ Order No. 1000's interregional planning requirements will be the subject of a separate compliance filing that the ISO must submit to FERC by April 11, 2013.

- (2) that local and regional transmission planning processes must provide an opportunity to identify and evaluate transmission needs driven by public policy requirements established by state or federal laws or regulations;
- (3) the elimination of any rights of first refusal for transmission facilities selected in a regional transmission plan for purposes of regional cost allocation and tariff provisions that ensure non-discriminatory treatment of all entities seeking to build transmission facilities included in any regional transmission plan; and
- (4) a regional cost allocation method for the cost of new transmission facilities selected in a regional transmission plan for purposes of regional cost allocation.⁴

In Order 1000, FERC referred to the competitive solicitation process that it had approved in the ISO's revised transmission planning process proposal, and stated that "*this Final Rule permits a region to use or retain an existing mechanism that relies on a competitive solicitation to identify preferred solutions to regional transmission needs, and such an existing process may require little or no modification to comply with the framework adopted in this Final Rule.*" In Order 1000-A, FERC provided some clarification to the requirements of Order 1000 and required that each planning region must have a clear enrollment process that defines how entities, including non-public utility transmission providers, make the choice to become part of the region.

Management believes that the ISO's existing transmission planning tariff provisions largely comply with the requirements of Order 1000. In particular, the ISO's planning process for transmission additions and upgrades inside the ISO's footprint already contains many of the provisions required by Order 1000, including most notably:

- A framework for developing and approving policy-driven transmission projects which address the needs of federal and state policy requirements;
- A competitive solicitation process that provides an opportunity for non-incumbent transmission developers to propose to build and own transmission elements which the ISO finds to be needed in its transmission planning process; and
- A cost allocation methodology for allocating the costs of projects that provides regional benefits across the ISO footprint.

Through a comprehensive stakeholder process, Management reviewed the requirements of Order 1000 and identified modifications to the ISO tariff that it believes are necessary to comply with the order. Management did not consider tariff modifications suggested by stakeholders that were unrelated to and beyond the scope of Order 1000 compliance.

Accordingly, Management proposes the following modifications to the ISO tariff to comply with Order 1000, as well as provide increased clarity and transparency with respect to the planning process and competitive solicitation process for needed transmission upgrades and additions:

⁴ Order No. 1000 also requires specification of an interregional cost allocation method(s) for the cost of new transmission facilities that are located in two neighboring transmission planning regions and are jointly evaluated by the two regions in the interregional transmission planning coordination process.

- Elimination of a right of first refusal for incumbent transmission providers to build and own regional transmission facilities, which are generally transmission facilities of 200-kV and above (except for upgrades to existing transmission facilities);
- A right of first refusal for incumbent transmission providers to build and own local transmission facilities which are facilities under 200-kV and located entirely in the retail service territory or footprint of the transmission owner;
- Elimination of a right of first refusal for incumbent transmission owners to build facilities on their own rights-of-way;
- Tariff language reflecting that the ISO will select those solutions to meet reliability needs and enhance the simultaneous feasibility of long-term congestion revenue rights that are the most prudent and cost-effective;
- Tariff language that will add clarity to and increase the transparency of the ISO's competitive solicitation process;
- Conforming tariff changes to provide that (1) costs of local transmission facilities will be allocated to the participating transmission owner that builds them and recovered by that participating transmission owner from customers that use local transmission facilities, and (2) costs of regional transmission facilities will be recovered through an ISO regional access charge;
- An express opportunity for stakeholders to propose public policy requirements and directives that should be considered in the transmission planning process and the ISO's commitment to provide a public explanation as to why it selected specific public policies for consideration in the planning process and rejected others;
- Tariff provisions enabling the ISO to proactively monitor the status of approved facilities and take the necessary actions if projects are not on schedule; and
- A requirement to conduct a competitive solicitation for economically-driven and public policy-driven transmission projects that are abandoned by a previously approved project sponsor before directly assigning construction responsibilities to the participating transmission owner in whose service territory the facility would be located.

POSITIONS OF THE PARTIES

Management conducted a comprehensive stakeholder process that began in December 2011. There were three rounds of ISO proposals followed by stakeholder meetings, web conferences and written comments.

Overall, stakeholders are supportive of both the objectives of this initiative and the proposal developed to meet these objectives. Management kept the focus of the initiative on the tariff amendments necessary to meet the compliance requirements for regional planning and cost allocation and the treatment of non-incumbent transmission developers, and the proposal described in this memorandum reflects that focus. Despite this broad support, some stakeholders have expressed concerns in specific areas.

First, if an approved project sponsor is unable to complete an economic or policy transmission facility, the Southern California Edison Company opposes a backstop obligation to build on the participating transmission owners for such facilities (that is, beyond the backstop obligation that currently exists for reliability driven transmission facilities). In response to this concern, Management has proposed tariff modifications to clarify that for all non-reliability driven transmission facilities, if an approved project sponsor is unable to complete the facility, the ISO will open a new competitive solicitation before directing the participating transmission owner to build it.

Second, several stakeholders raised issues with regard to the ISO's competitive solicitation process. For example, LS Power and Western Independent Transmission Group believe the ISO's reliance on its current competitive solicitation process is not compliant with Order 1000. Management disagrees. As stated earlier, the current ISO competitive solicitation process is FERC approved and FERC referred to it in Order 1000 where it stated: *"this Final Rule permits a region to use or retain an existing mechanism that relies on a competitive solicitation to identify preferred solutions to regional transmission needs, and such an existing process may require little or no modification to comply with the framework adopted in this Final Rule."* Nevertheless, Management is proposing tariff modifications that will add clarity to and increase the transparency of the ISO's competitive solicitation process.

Third, the Sierra Club disagrees with Management's belief that the existing policy-driven transmission category in the ISO's tariff meets or exceeds the requirements of Order 1000 and expresses concerns about stakeholder participation in the ISO's consideration of public policy requirements. The Sierra Club states that the ISO "unduly limits" the scope of public policy requirements to the 33 percent renewable portfolio standard statutory mandate and argues that the ISO's existing tariff erroneously focuses solely on compliance with renewable portfolio standard objectives, even though there are other policy objectives that impact the state's approach to clean energy. The Sierra Club also suggests that the ISO's planning process does not permit stakeholders to participate in the identification of the public policies that should be assessed in the planning process. Management disagrees. The Sierra Club does not correctly characterize the ISO's current transmission planning process. While recent planning cycles have identified the 33 percent renewable portfolio standard mandate as a public policy directive that must be considered, the transmission planning tariff provisions do not limit the evaluation of policy directives and requirements to the renewable portfolio standard goals. Also, contrary to the Sierra Club's claims, the ISO transmission planning process provides numerous opportunities for stakeholders to participate in the identification of public policy objectives that the ISO should consider. Nevertheless, Management is sensitive to this concern and is proposing tariff modifications that will provide an express opportunity for stakeholders to propose the public policy requirements and directives that should be considered in the transmission planning process.

Fourth, the California Consumers Alliance, Sierra Club, and Natural Resources Defense Council have requested that the ISO provide an intervener funding mechanism to facilitate greater non-market-participant participation in the ISO transmission planning

process. Order 1000 does not require intervenor funding. Management does not see a current need for such a mechanism. Management offers that ISO staff are available to explain its study results to interested stakeholders and answer questions about planning assumptions and other details. If non-market participants believe it would be helpful, the ISO can provide additional, less technical descriptions of its studies and the extent to which alternatives were considered. The ISO stakeholder process is open, transparent and compliant with the requirements of FERC Orders 890 and 1000. It may also be the case that transmission approved for cost recovery through the ISO process will be submitted to the California Public Utilities Commission for permitting, and the Commission process will involve an examination of the ISO's studies and findings. The Commission provides intervenor funding and interested parties can avail themselves of intervenor compensation in the Commission's process.

A stakeholder comments matrix is attached to this memorandum which provides additional details on the positions expressed by participants, as well as Management's responses to the concerns raised.

CONCLUSION

It is important for the Board to act on this proposal expeditiously. To do so would enable tariff changes to be filed with FERC on a schedule which meets the October 11, 2012 deadline for compliance. Management recommends that the Board approve this proposal.