



Memorandum

To: ISO Board of Governors

From: Ryan Seghesio, Chief Financial Officer and Treasurer

Date: June 24, 2015

Re: **Decision on Peak Reliability Coordinator funding**

This memorandum requires Board action.

EXECUTIVE SUMMARY

With the recent bifurcation of the Western Electricity Coordinating Council (“WECC”), Peak Reliability (“Peak”) was formed as a separate, independent company to perform the reliability coordinator function in the Western Interconnection. This function had previously been performed by WECC, and the costs of these services were included in a single invoice for WECC charges, which also included charges for WECC’s functions as a regional entity. The ISO’s existing tariff provisions regarding “NERC/WECC charges” allow the ISO to pass through these charges for WECC services to scheduling coordinators for load serving entities.

To fund its reliability coordinator services, Peak has developed a funding agreement that it will enter into with each balancing authority and certain transmission operators in the west. This agreement allocates Peak’s costs for the reliability coordinator function according to the same percentage of total load formula that was used when these charges were included within the WECC invoices. The ISO thus needs to establish tariff provisions, similar to those that currently exist for NERC/WECC charges, to allow it to pass through the cost of reliability coordinator services billed directly by Peak. To preserve continuity, the ISO has closely modeled the proposed reliability coordinator settlement and payment processes on those that already exist for NERC/WECC charges, with certain differences pertinent to the ISO’s payment obligation to Peak.

Management proposes the following motion:

Moved, that the ISO Board of Governors approves the proposal to amend the tariff to establish settlement and payment processes for reliability coordinator charges from Peak Reliability, as described in the memorandum dated June 24, 2015; 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

Background

After the September 8, 2011 southwest outage event, WECC determined that it should bifurcate into two separate entities. One entity is to focus on performing the “regional entity” role of enforcing NERC reliability standards, and a separate entity is to focus on performing the operational “reliability coordinator” function that involves coordinating transmission reliability across the Western Interconnection in real time. On June 20, 2013, FERC issued a declaratory order approving the WECC bifurcation and the plan to establish a separate independent entity to perform the reliability coordinator function for the Western Interconnection.

WECC’s operations are funded primarily through a budget that is approved each year by NERC and FERC, pursuant to provisions set forth in section 215 of the Federal Power Act for the funding of regional entities to whom NERC has delegated certain of its powers. Pursuant to section 215, FERC approves an annual budget for WECC and authorizes WECC to collect charges from load serving entities within the WECC region based on their respective shares of total load. For load serving entities within the ISO’s balancing authority area, WECC assesses the ISO an amount based on the total load within the ISO’s balancing authority area. The ISO then passes those charges on to load serving entities within its balancing authority area pursuant to existing tariff provisions governing the collection of “NERC/WECC” charges.

Various parties argued to FERC that the section 215 funding should not continue to be used as a basis for funding Peak’s operations after bifurcation because those provisions were intended to cover the regional entity function and not a reliability coordinator function performed by a separate entity. In its June 20, 2013 order approving bifurcation, FERC conditionally approved the continuation of section 215 funding on a temporary basis, and allowed WECC to continue to roll Peak’s charges into the WECC invoice. FERC, however, also directed Peak to develop and present to its members a plan for alternative funding within two years after bifurcation.

On June 10, 2015, the Peak membership approved an alternative funding arrangement that takes the form of a uniform funding agreement that Peak will execute with each balancing authority and certain transmission operators in the Western Interconnection. This agreement allocates Peak’s cost for the reliability coordinator function according to the same percentage of total load formula used for the WECC charges authorized under section 215.

The new funding agreement is scheduled to become effective in August, after funding parties representing at least 90 percent of total load in the United States portion of the Western Interconnection have executed it. Peak will then issue its first annual invoice under

the agreement in November 2015, which will cover Peak's funding for 2016. Because Peak's separate invoice will now include the reliability coordinator function charges, the WECC annual invoice for 2016 will no longer include those charges.

The ISO is proposing the tariff amendment described in this memorandum to ensure that it has an approved tariff process in place to continue to allocate, invoice, and collect from scheduling coordinators reliability coordinator charges, which will now be charged by Peak in the form of a separate invoice pursuant to the funding agreement.

Summary of the proposed amendment

The ISO's proposed settlement and payment process for Peak's reliability coordinator charges is closely modeled on the process currently used for NERC/WECC charges.

The first step in that process involves establishing the method for allocating the total Peak invoice for reliability coordinator charges to market participants and informing them of their charges. After receiving the annual invoice from Peak, the ISO will issue a market notice to advise market participants of the invoice and the charge rate the ISO will use for the assessment year. The ISO will calculate the charge rate using the total dollar amount of the reliability coordinator charges invoiced to the ISO divided by the most recent total NERC/WECC metered demand figures for all scheduling coordinators within the ISO's balancing authority area. The ISO will allocate the reliability coordinator charges to each scheduling coordinator for load serving entities in the ISO balancing authority area using the most recent NERC/WECC metered demand calculation for that scheduling coordinator, which is based on the net amount of energy for serving load that is allocable to that scheduling coordinator.

This is the same methodology that the ISO currently uses to allocate NERC/WECC charges. Thus, the ISO will ensure that load serving entities' current respective allocations of NERC/WECC charges and reliability coordinator charges do not change as a result of direct billing by Peak. Rather than receiving one invoice, scheduling coordinators will receive two invoices (one for NERC/WECC charges and another for Peak reliability coordinator charges), but their payment obligation will effectively remain the same.

The proposed invoice confirmation, validation and dispute processes for the reliability coordinator charge are also closely modeled on those used for a NERC/WECC invoice. A scheduling coordinator will have seven days to validate or dispute the accuracy of the invoice it receives for reliability coordinator charges. As with NERC/WECC charges, such disputes are limited to challenges based on a typographical or ministerial error by the ISO. This allows parties to challenge the charge based on an error in calculating the charge, but does not allow parties to raise a dispute based on the total cost of Peak's reliability coordinator services. Similar to WECC, Peak has an open annual budget process that allows interested parties to raise issues or concerns regarding Peak's proposed annual expenditures for reliability coordinator services. Any issues relating to the overall magnitude of Peak's charges are properly addressed in that forum.

Although the allocation, billing and dispute processes will remain the same, the ISO proposes certain changes to the collection process to address a circumstance where a scheduling coordinator fails to make timely payment or defaults. Under the current arrangement with WECC, the ISO is obligated to pay WECC only the amounts that it successfully collects from scheduling coordinators. If a scheduling coordinator for a load serving entity fails to pay the full amount or otherwise defaults, it is WECC's responsibility to collect any shortfall from the defaulting entity. By contrast, the new Peak funding agreement holds each balancing authority financially responsible to pay the full amount of the Peak charges assessed to it based on the calculation of the balancing authority's allocated percentage of total load, regardless of the balancing authority's ability to collect those charges from scheduling coordinators.

In light of this difference, it is necessary for the ISO to have provisions that address how the ISO will proceed in the event of a payment default. Accordingly, the ISO proposes provisions that allow the ISO to generally follow its existing tariff procedures for collecting payment from a defaulting scheduling coordinator. These provisions allow the ISO to exercise its rights to recover non-payment from the financial security provided by the defaulting scheduling coordinator, assess interest charges for late payments, and exercise any available rights of recoupment or set-off. In addition, to the extent that these efforts do not result in full payment, the ISO would be permitted, at its discretion, to issue a supplemental invoice to make up for a potential shortfall resulting from a default. If the ISO determines that such a supplemental invoice is necessary, the charges would be allocated based on the share of NERC/WECC meter demand of each non-defaulting scheduling coordinator.

POSITION OF THE PARTIES

On May 8, 2015, the ISO circulated to stakeholders a straw proposal that described this proposed tariff amendment and included a complete set of the proposed revisions to existing tariff language. The ISO held two stakeholder calls to discuss the proposal and solicited written comments. Although approximately 20 parties joined the stakeholder calls, only two parties submitted comments.

One of the commenting parties expressed general support for the proposal, but asked for clarification of certain aspects of the invoicing process and the process for calculating a scheduling coordinator's collateral requirements based on a scheduling coordinator's obligation to pay reliability coordinator charges. In response to these comments, the ISO made changes to its proposal regarding collateral requirements to make clear that the ISO's calculation of collateral and other credit requirements will include an adjustment for a scheduling coordinator's allocable share of reliability coordinator charges. The specifics of this adjustment were set forth in a draft final proposal that the ISO issued on May 28, 2015.

The other commenting party asked the ISO to consider revising the methodology for allocating Peak charges to include scheduling coordinators for resources in addition to scheduling coordinators for load. The ISO declined to make this change. As noted, the existing NERC/WECC charges – which include the amount for reliability coordinator

services – are allocated by WECC only to load serving entities. This cost allocation methodology was approved by FERC as just and reasonable. The ISO's proposal preserves this fundamental approach and ensures that the change from a consolidated bill into separate bills from Peak and WECC does not result in a substantive change in the amounts that market participants are obligated to pay. The ISO's approach, moreover, is consistent with fundamental cost causation principles because the charge that the ISO receives from Peak is based solely upon the amount of load within the ISO balancing authority area and does not vary based on the nature or amount of resources participating in the ISO market.

CONCLUSION

Management requests Board approval of the ISO's proposal to revise its settlement and payment processes to accommodate a separate invoice from Peak Reliability for reliability coordinator charges. The proposed amendments are necessary to ensure that the ISO has authority to collect these charges once the Peak funding agreement becomes operative and the ISO receives its first Peak bill in November 2015.