

between incumbent utility PTOs and independents, and one project to a public power entity that was not an existing PTO. The CAISO has applied the lessons it has learned to improve its competitive solicitations. The evaluation process is not simple; it requires a comprehensive, holistic comparative analysis that considers all of the selection criteria. The CAISO selects approved project sponsors based on the totality of the facts, considering what factors are relevant to the particular project, identifying relevant differences between project sponsors and the degree and importance of those differences, and assessing the various risks and benefits of each proposal. Based on the CAISO's experience running competitive solicitations, the CAISO recommends against adopting simplistic processes, rules, assumptions, and pre-determined formulas. Nor should the Commission take actions that would have the effect of embedding a level of arbitrariness into the selection process or focus selection decisions on a single criterion that could lead to inappropriate results. The CAISO urges the Commission to forbear from directing changes to existing processes that are working effectively, spurring competition and cost containment, and promoting the goals of Order No. 1000. Rather, the Commission should allow planning regions to work with their stakeholders to assess "lessons learned" and identify appropriate process enhancements.

Question #1: What are the benefits and limitations of cost containment provisions, including cost caps and fixed revenue requirements, for competitive transmission development processes transmission developers, and customers.

Robust and binding cost containment measures -- to the extent they are enforced -- can benefit ratepayers by constraining costs and transferring cost

risk. The value of cost caps with significant headroom or “outs”, e.g., the ability to nullify the cap or adjust the cap upwards if certain events occur, is questionable.

Question No. 2: How do transmission planning regions evaluate transmission proposals with cost containment provisions? How do they compare these proposals to each other and to other proposals without cost containment provisions? To what extent do and should transmission planning regions favor binding cost containment provisions when evaluating and selecting transmission projects?

The CAISO follows a “top down” transmission planning approach in which it works with stakeholders to identify the more efficient or cost-effective solution to meet an identified regional transmission need. The CAISO then conducts a competitive solicitation -- open to all interested entities -- to select an approved project sponsor to construct, own, operate, and maintain the needed solution.

The CAISO selects an approved project sponsor by conducting an exhaustive comparative analysis that evaluates 11 selection criteria and six qualification criteria. The comparative analysis selects a qualified project sponsor that:

[i]s best able to design, finance, license, construct, maintain, and operate the particular transmission facility in a cost-effective, efficient, prudent, reliable, and capable manner over the lifetime of the facility, while maximizing overall benefits and minimizing the risk of untimely project completion, project abandonment, and future reliability, operational, and other relevant problems, consistent with Good Utility Practice, applicable reliability criteria, and CAISO Documents.¹

One of the selection criteria is a project sponsor’s cost containment capabilities and binding cost containment measures. Because the circumstances

¹ CAISO tariff section 24.5.4.

surrounding each transmission solution are different, pursuant to tariff section 24.5.1, the CAISO posts what it believes are the key selection criteria for the particular transmission solution prior to the start of the competitive solicitation. The CAISO determines the key selection criteria based on 11 considerations specified in the tariff. The tariff requires that cost containment always be one of the key selection criteria.

Project sponsor selection is a complex process. It requires the CAISO to undertake an analysis of all the selection criteria to determine which sponsor best meets the selection standard. The CAISO must consider the scope and nature the proposed transmission solution, the degrees and importance of differences between project sponsors with respect to each of the criteria, the advantages and disadvantages of each proposal, and the potential risks each proposal poses. I cannot stress these points enough.

The CAISO has evaluated proposals that included binding cost containment commitments and others that have not. The scope and robustness of cost containment proposals (e.g., cap levels, cost items being capped, proposed “outs”) can vary significantly. Accordingly, the CAISO conducts a comprehensive cost analysis and run numerous studies and scenarios to calculate illustrative revenue requirements for each project sponsor that reflect proposed cost containment measures, incorporate appropriate common assumptions to harmonize the calculations, and indicate key drivers of differences between project sponsors. The CAISO also examines a multitude of sensitivities to compare cost containment measures effectively and assess the

impacts of any cost escalation. The CAISO's evaluation of cost focuses in large part on the number of individual cost elements a project sponsor proposes to cap (e.g., construction cost, return on equity, debt cost, equity percentage, inflation), the rate incentives a sponsor will seek, cap levels, the number, type, and scope of proposed "outs" and the risk associated with them, inherent characteristics of a project sponsor's proposal that may produce specific cost advantages or disadvantages (e.g., facility differences, use of existing rights-of-way, use of existing tower positions, route/site conditions, undergrounding vs. overhead), and the potential risk and impact of cost escalation. Proposals that cap more cost elements and have robust cap levels, more limited outs, and inherent cost advantages are better positioned in the selection process compared to less robust proposals. Under tariff section 24.5.5, the CAISO issues a decisional report that sets forth, in a detailed manner, the results of the comparative analysis, the reasons for the CAISO's decision, the role of the selection factors in determining the approved project sponsor, and how the CAISO's decision is consistent with the requisite selection standard.

There is a strong trend toward project sponsors proposing some form of binding cost containment measures. In the last two competitive solicitations, eight of nine project sponsors proposed construction cost caps. The CAISO expects that, going forward, it will see few, if any, proposals without cost containment measures; although, there will likely be uncapped individual cost elements. The CAISO's experience conducting competitive solicitations shows that it would not be appropriate to automatically favor proposals with some cost

capped elements over those without cost caps, or to look at project cost in a vacuum. First, as discussed in response to Question #4, that approach would ignore other important selection criteria and potentially result in problematic and inappropriate project sponsor selections. Second, because cost containment proposals can vary significantly -- with varying cap levels, the number of items being capped, and the number and scope of the “outs” being proposed -- hardwiring simplistic rules or requirements likely would result in adverse results for ratepayers in some circumstances. Third, a cost contained proposal can have characteristics that cause it to be inherently more costly or present other cost escalation risks compared to an uncapped proposal, potentially offsetting the benefits of the proposed cost containment measures. Under these circumstances, it is better to allow the planning regions to evaluate each proposal based on its specific merits.

Question #3: Could transmission planning region’s processes for evaluating cost containment provisions be improved and, if so, how?

After each competitive solicitation cycle, the CAISO undertakes an internal assessment to discuss the “lessons learned” and identify potential process improvements. Also, the CAISO recently concluded a “lessons learned” stakeholder process that resulted, *inter alia*, in the following process enhancements: (1) a commitment in the decisional reports to (a) provide clearer explanations of differences between project sponsors with respect to meeting applicable criteria and their relevance to the decision, and (b) disclose the specific details and dollar levels of all binding cost containment commitments

agreed to by the approved project sponsor, thus providing increased transparency; and (2) amending the project sponsor application to enhance the CAISO's evaluation of cost.

The CAISO will continue evaluating ways to improve its competitive solicitation process and urges the Commission to allow this to occur through stakeholder discussions. The CAISO believes its process is working and producing the benefits the Commission envisioned in Order No. 1000. As evidenced by recent competitive solicitations, competition is increasing, and proposals are reflecting stronger and more creative cost containment measures. Based on this experience, the CAISO urges the Commission to forbear from directing any major changes to the competitive solicitation process.

The Commission should continue its policy of (1) allowing planning regions to apply their selection criteria flexibly in making decisions and (2) requiring regions to explain their comparative analyses in detail, describe the relevance of distinctions between project sponsors, and fully justify their decisions. Consistent with its prior determination in implementing Order No. 1000, the Commission should not require the use of pre-established weights and pre-determined formulas. That will introduce and embed a level of arbitrariness into the process, increase the opportunities for error, and potentially dictate inappropriate project sponsor selections. Among other things, pre-established metrics fail to recognize that the importance of individual selection factors can vary significantly depending on the particular circumstances of each project. Sponsor selection is project specific, fact specific, and fact intensive. It requires

a comprehensive assessment, especially when reliability, environmental impacts, and billions of dollars are at stake.

The Commission should not adopt rules specifying least project cost as the driver of selection decisions. Numerous factors in addition to cost are important, *e.g.*, reliability, ability to complete the project on time, financing capabilities, operational and other advantages (or disadvantages) proposals may have, level of risks posed, project feasibility, state law preferences for using existing rights-of-way, ability to site the facilities, the quality of the materials and technologies used, and abandonment risk. Basing decisions primarily on least project cost could cause a system planner to devalue or neglect other considerations, leading to problematic and inappropriate project sponsor selections. Moreover, cost is not a clear-cut, homogenous concept because proposals can cap different cost elements, contain a variety of “outs,” and pose different cost escalation risks associated uncapped or conditionally capped elements. The least-cost proposal may not be the best proposal even from solely from a cost perspective. Take for example a proposal with a construction cost cap that is \$1 lower than the cap in another proposal, but which contains far more extensive outs and conditions. Also, reasons causing lower project cost (*e.g.*, lower grade materials) can potentially increase other costs (*e.g.*, losses or O&M) or create problems (*e.g.*, increased outages). These examples show why hardwired rules are inappropriate, and planning regions must be able to assess and compare all proposals on their individual merits.

Question #4: Should a transmission planning region define in advance a common set of standards that apply to cost containment provisions that may be proposed in a competitive transmission development process? For example, should a transmission planning region define in advance one or more categories of costs that are exempt from binding cost containment?

The CAISO's competitive solicitation process does not place any constraints on the cost containment commitments project sponsors may propose. Based on our experience running competitive solicitations, the Commission should not adopt a common set of standards for cost containment provisions or limit the categories of costs project sponsor can propose to contain. Project sponsors should be permitted to propose any cost containment measures they believe are appropriate given the nature of the project and the risk they are willing to bear. The Commission should not chill creativity or limit potential benefits.

Question #5: If a transmission project was selected on the basis of its cost containment provisions but ends up costing more, should the cost overruns (all or some) be recoverable from customers? Assuming yes, should there be standards for how specified costs are to be shared between the transmission developer and customers? Should there be a cap on the total amount of changes in costs that can be recovered from customers? Should changes in cost be subject to review by the transmission planning regions, and if so, for what purpose?

Project sponsors are not required to propose binding cost containment measures. It is voluntary on their part, and they determine how much risk they are willing to bear. The CAISO incorporates an approved project sponsor's binding cost commitments into the approved project sponsor agreement. The Commission, to the extent of its authority, should enforce binding cost containment commitments. Failure to do so could undermine the competitive

solicitation process, render cost containment commitments illusory, and nullify a key reason underlying the CAISO's decision.

Question #6: How do proposed cost containment provisions affect the results of competitive transmission development process with respect to the number and composition of proposals, the selection of the winning proposals, and the composition of winning proposals? Discuss this in the context of both competitive solicitation and sponsorship models?

Cost containment creativity and the inclusion of cost containment commitments in proposals is increasing; although, cost cap levels, the cost categories being capped, and the type and number of "outs" can vary widely. No project sponsor has proposed a cap on all of its costs for the life of the project. In the CAISO's last competitive solicitation, every project sponsor proposed some form of construction cost cap. Cost is an important consideration in the CAISO's competitive solicitation process and approved project sponsors have had some cost-related advantages, but cost is not the only important consideration.

Question #7: What processes should be used for verifying that a transmission developer is abiding by a binding cost containment provision? Should verification/confirmation be part of the transmission planning process: should verification be a condition in formula rates?

The CAISO tracks adherence to binding cost containment measures through reporting requirements in the approved project sponsor agreement. The Commission should verify adherence to cost containment commitments through its ratemaking authority.