

ISSUE BRIEF

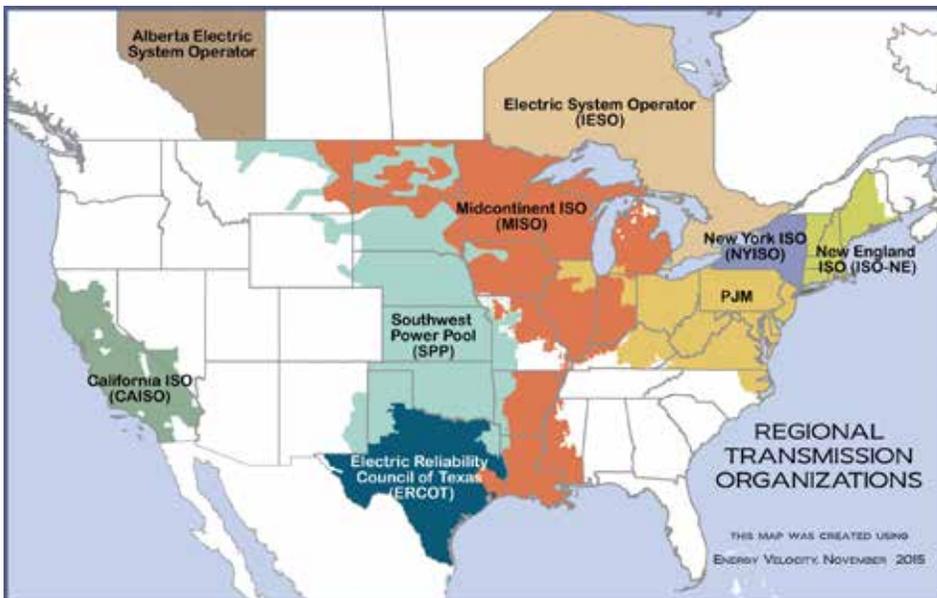
MAKING SENSE OF POTENTIAL WESTERN ISO GOVERNANCE STRUCTURES: THE ROLE OF THE STATES

The issue of governance is emerging as a foundational concern that must be addressed to move forward on creating an organized multistate grid operator in the West.

Governance is also perhaps one of the most difficult issue to face—but, given the demonstration of potential benefits stemming from regionalizing the current grid operator, it is well worth trying to find a workable option. A broader regional grid operator can provide substantial annual savings for customers across Western states. In California alone, for example, benefits from grid regionalization are estimated to increase over time from \$150 million a year to more than \$1 billion in 2030. It also allows for even more rapid and cost-effective integration of wind and solar power than is already happening and lowers the cost of satisfying state and federal environmental regulations with implications for the grid. Developing wholesale energy markets also provides an opportunity for competition in the power industry that has not existed previously across the Western Interconnection. Failure to regionalize grid operations to incorporate a broader western footprint will likely cost

consumers billions of dollars over time, require the development of duplicative infrastructure and generation because less resource sharing will be possible, and make regulatory compliance more difficult and expensive for states in the Western Interconnection.

It is critical, therefore, to achieve a governance structure acceptable to stakeholders.



Several sets of principles and proposed structures have been put forward by stakeholders to guide the conversations about how the governance of a broader multistate grid operator might work. Some proposals lay out principles that must be satisfied for certain groups of stakeholders to support expansion, and some proposals provide specifics around a potential structure. (A useful comparison of the various proposals is available [here](#).¹) In addition, CAISO has issued proposed principles for a regional governance structure before other issues—like states’ continuing roles in ensuring resource adequacy and the question of who should pay for new transmission infrastructure—can be settled. Many stakeholders want a clearer understanding of how the governance structure of a regional system operator would look, and specifically, what the role of states would be in that structure.

However, one piece of the puzzle that may be missing for stakeholders unfamiliar with regional grid operator processes is the relative value of tools states have to participate in a multistate grid operator. This issue brief addresses the critical issue of the role states can play in governance of a broader regional grid. It provides background and offers several ways in which states can influence outcomes in a regional grid organization. Specific attention is given to the concept of Section 205 filing rights and what it means for states to have them.

HOW IS CAISO GOVERNED NOW?

The California Independent System Operator (CAISO) is one of seven independent transmission system operators across the country. (These system operators are often referred to as regional transmission organizations (RTOs) or independent system operators (ISOs); for the purposes of this paper, these terms are used interchangeably.) CAISO, which was formed pursuant to California statute in 1998, is unlike America’s six other regional grid operators, which formed by voluntary agreement of the involved utilities.² After an interesting governance history, CAISO is now governed, per state statute, by a governor-appointed five-person board whose members must be independent of any market participants.^{3, 4} For all of the nation’s other regional grid operators, board members are nominated via a stakeholder or stakeholder-board committee and then appointed or elected by the sitting board.

In light of CAISO’s unique legislative origins, the California legislature and the governor (via his board appointment power) currently have significant influence over CAISO’s operation.

The legislature in 2015 passed Senate Bill 350, the Clean Energy and Pollution Reduction Act, which opened the door to considering expansion of the grid operator beyond CAISO’s current footprint.⁵ Due to its statutory history, the California legislature holds the keys to moving forward, at least in terms of the next step. Several stakeholders recommend that the legislature pass simple, straightforward statutory language giving its blessing

for CAISO to move forward, in collaboration with other western states, to replace the current structure with an independent governance framework that offers sufficient avenues for stakeholder input and a central role for states. The California Energy Commission is currently facilitating a process by which stakeholders from across the region can consider specifics of a potential governance structure. Because legislation is not likely to address the kinds of governance specifics that the Energy Commission process is considering, once legislation moves the governance discussion outside of the California legislature, there is more work to be done.

In considering a new governance structure, state regulators and other state agency representatives, utilities, generators, public power, consumer advocates, environmental advocacy organizations, and other stakeholders must consider the board nomination and election/appointment process, committee structures, the role of states and other stakeholders, as well as the access and power questions that stem from the other pieces of the governance puzzle. Among the first issues that must be resolved is the role of California and other states in a regional grid operator.

STATES’ ROLE

As demonstrated around the country, states can influence in a variety of ways the rules by which regional grid operators function. States can:

1. Obtain Section 205 filing rights complementary to those held by regional grid operators and transmission-owning utilities;
2. Establish heightened stakeholder status by forming a regional state committee (or similar organization) that has voting or advisory authority and direct interaction with the grid operator board and senior management, or establish other heightened status;
3. Participate as stakeholders in RTO processes and initiatives; and
4. Intervene in proceedings at the Federal Energy Regulatory Commission (in those areas where states don’t hold Section 205 filing rights) in support of or opposition to an RTO filing.

States should consider the entire tool box of influencing mechanisms when considering what protections are necessary and what tradeoffs might be acceptable when it comes to the broader governance question. None of these mechanisms for state involvement is exclusive of the others, and all can be utilized in concert.

Much of the discussion surrounding the current governance proposals from various stakeholders involves consideration of how states can ensure adequate opportunity to exert influence in a regional system operator and how they can maintain their current authority in the electric sector. Since nothing about an organized western grid operator would deny states their traditional authority, the focus here is how states can influence outcomes within multistate regions.

SECTION 205 FILING RIGHTS

Section 205 filing rights are one important means for states to exert influence in a regional grid operator initiative—both substantively during stakeholder processes and for protective recourse should any final regional proposal differ from a state’s desired approach. Importantly, they are not the only tool that states possess.

The Federal Power Act (FPA), passed in 1935 to address states’ inability to regulate interstate sales of electricity, gives the federal government jurisdiction over transmission service in interstate commerce and wholesale sales of electricity. At the same time, the FPA preserves a significant role for states in electricity regulation, giving them authority over, among other things, retail rates and practices and “facilities used for the generation of electric energy.”

The Federal Energy Regulatory Commission (FERC) is the federal agency tasked with implementing the FPA. FERC’s authority over wholesale rates comes largely from two relatively brief sections of the FPA: Sections 205 and 206.

Under Section 205, FERC must assure that rates charged for the transmission service and sales of electricity it regulates are “just and reasonable and not unduly discriminatory or preferential.”⁶ The Federal Power Act was originally conceived as a consumer protection statute, and this just and reasonable requirement essentially requires FERC to ensure that wholesale prices are fair and that no class of customers or individual customer is treated unfairly when it comes to prices or access to the transmission system. FERC does this by requiring the entities it regulates—transmission-owning utilities or “transmission owners”—to file documents with FERC requesting approval for rates they want to charge (hence the term “205 filing rights”).⁷

When transmission owners in some regions of the country came together to establish single-state or regional grid operators, they handed over control and operation of their transmission lines to independent grid operators but retained ownership of the transmission assets.⁸ FERC determined that regional operators needed their own Section 205 filing rights, in addition to those maintained by the owners, to appropriately identify rates for the transmission service that they now controlled. Otherwise, according to FERC, they would risk their ability to remain independent and treat all of the member utilities fairly.

FERC did not leave the owners emptyhanded, however; it preserved transmission owners’ rights to determine their own transmission revenue requirements—the total annual cost that each transmission owner must recover from its customers to support its ongoing capital investment and its operations and maintenance costs. (The transmission-owning utilities had paid to build and maintain their assets before the regional operator formed, and would have to continue to pay those expenses and build necessary new lines and upgrades.)

The D.C. Circuit Court of Appeals in 2002 provided additional clarity, determining that transmission owners cannot be forced to surrender Section 205 filing rights, either for their total revenue requirements or for transmission service over their lines.⁹ The Court made clear that while transmission owners can voluntarily relinquish their rights as part of becoming a member of a regional grid operator or for other reasons, they cannot be forced to do so.

As regional grid operators have emerged across the country, transmission owners have decided to share their Section 205 filing rights in various ways and for a variety of reasons, including enhancing the roles of the states within the region. In almost all cases, the regional grid operator itself has Section 205 filing rights over the rates for transmission service over the lines it operates, sometimes in conjunction with and sometimes independent of member transmission owners. Across the regions, owners at least maintain their own Section 205 rights for determining their total revenue requirements. In several regions, committees of state regulators have obtained complementary Section 205 filing rights—meaning the regional grid operator maintains its Section 205 rights to determine transmission rates charged for service over the lines it operates, but the states exert influence over those rights in certain defined ways to protect their own state interests. The Midcontinent Independent System Operator (MISO), which serves a large part of the Midwest and South, and the Southwest Power Pool (SPP), which serves the Plains and Southwest, are already being considered as potential models for providing states with Section 205 filing rights as part of a regional grid operator in the West.

The MISO experience

In MISO, Section 205 filing rights are delineated in the transmission owners’ agreement, which is subject to approval by FERC. Each of the MISO transmission owners maintains exclusive filing rights for transmission rate design within its own footprint, and for capital investments that will be charged exclusively to customers within its own footprint. The transmission owners and MISO have overlapping Section 205 filing rights for costs associated with transmission projects and upgrades for which recovery will be sought across multiple utility footprints.

The Organization of MISO States (OMS), an entity outside of MISO with unique stakeholder status, can influence these rights. OMS has an executive director and several staff members, and its board is made up of a commissioner from each member state.¹⁰ OMS also hosts several working groups for the member state regulators and staff, including groups focused on markets and tariffs, governance and budget, and transmission planning. OMS has Section 205 filing rights that stem from the integration of Entergy’s utility footprint into MISO in 2013.¹¹ MISO and the transmission owners agreed to provide OMS complementary 205 filing rights for cost allocation.

Specifically, if MISO decides to develop or amend a regional cost allocation methodology, or in response to a request from OMS for MISO to examine a change in methodology, MISO will initiate a stakeholder process that either is co-chaired by a member of OMS (if other stakeholders approve) or involves a parallel and separate OMS process to ensure that the views of OMS members are heard.¹² MISO will provide the financial and technical support necessary to develop OMS's position. If at any point during this stakeholder process 66 percent of voting OMS members agree, OMS can request that MISO file an OMS alternative cost allocation proposal or modification with FERC. MISO, however, is not required to make the filing; if it doesn't, it must provide a written explanation to OMS as to why it did not. OMS can always protest the proposal by intervening in the FERC proceeding in which MISO makes its desired filing.

The transmission owners' agreement makes clear that no aspect of OMS's complementary filing rights diminishes the Section 205 filing rights of MISO or its member owners. However, the existence of heightened influence for OMS has proved effective at influencing outcomes in MISO processes related to cost allocation.

The SPP experience

The SPP bylaws lay out the Section 205 filing rights of the Regional State Committee (RSC), which is the SPP committee made up of one state utility regulator from each SPP state.¹³ These filing rights cover a broader scope of topics and are easier to realize than in MISO. Individual transmission owners within the SPP maintain broader Section 205 filing rights than in MISO in that they have the exclusive right to make Section 205 filings for any transmission service over their own facilities. The RSC has filing rights in the areas of cost allocation and resource adequacy. The RSC is responsible for determining the resource adequacy approach for the region. Upon making a resource adequacy or cost allocation determination, the RSC is authorized to file its proposal at FERC.¹⁴ The bylaws note, however, "nothing in this section prohibits SPP from filing its own related proposal(s) pursuant to Section 205 of the Federal Power Act."

As has been noted in stakeholder forums discussing potential western grid integration and in former Colorado Public Utility chairman Ron Binz's western grid operator governance proposal,¹⁵ the states in SPP think that their Section 205 rights, together with the existence of their regional states' committee, provide them an effective means to influence SPP. There is a sense that states are able to reach consensus with other stakeholders and the SPP board on most issues in light of their elevated status.

Looking ahead for the West

A few guiding principles for Section 205 filing rights can be gathered from SPP and MISO experiences, from FERC rules and decisional orders, and from the D.C. Court of Appeals' interpretation:

1. FERC has determined that "in order to ensure their independence from market participants," regional grid operators must have independent Section 205 filing rights for the transmission lines they control.¹⁶ As has been demonstrated in practice, FERC does not mean that transmission owners and/or committees of state regulators cannot have separate Section 205 filing rights to make their positions known at FERC.
2. Transmission owners cannot be forced to relinquish 205 filing rights over transmission rates and investment decisions within their own footprints, but they can voluntarily share them or give someone else the contractual right to use them.
3. FERC recognizes and values regional differences and favors flexibility. To the extent that a potential regional grid operator proposes sharing Section 205 filing rights around cost allocation and resource adequacy in a manner that doesn't run afoul of the principles listed above, FERC is likely to support a spectrum of possible arrangements.
4. Additional considerations include what type of support the regional grid operator will provide to states if they want to develop an alternative Section 205 proposal, whether states have resources to engage in the development of alternative proposals and the FERC review process, and whether directing efforts toward alternative proposals is a valuable use of time as compared with other avenues for participating in regional grid operator processes.

Section 205 filing rights are a demonstrated means of ensuring that states' perspectives are provided due deference in the development of regional grid operator rules and procedures. In addition, obtaining Section 205 filing rights is only one aspect of the full package of options states have to protect their interests in regional grid operator governance and operations.

ROLE OF REGIONAL STATE COMMITTEES AND OTHER HEIGHTENED STAKEHOLDER STATUS

Regional state committees

Former Colorado Public Utility chairman Ron Binz's western regional system operator governance proposal provides a good description of state organizations and committees that exist in the other multistate organized grid regions around the country. In the New England (ISO-NE), mid-Atlantic (PJM), and midcontinent (MISO)

regions, organizations of state regulators exist outside of the grid operator organizational structure but are funded by the grid operator. In the Plains and Southwest (SPP), the Regional State Committee is an established committee within the committee structure and receives annual funding by submitting a budget that SPP's board of directors must approve. As the Binz proposal specifies, the different states' groups have varying degrees of interaction with, and access to, the regional grid operators' boards and senior staff.

In determining the appropriate positioning of a committee/organization of state regulators in the context of a potential western regional system operator, factors to consider include:

- 1. Membership eligibility:** Should the committee/organization include only state regulators or also permit membership of commission staff and possibly other state agencies (e.g., consumer advocates and state energy office representation)?
- 2. Voting structure for decision making:** Can western states support a voting structure similar to that of the Western Interstate Energy Board, in which actions are not approved unless they are approved by one half the load and one half the states? Or is there another appropriate voting structure?
- 3. Organizational structure:** Is it more appropriate to maintain the committee/organization within or outside a regional grid operator's official organizational chart?
- 4. Funding:** What type of arrangement is best? Should yearly funding be guaranteed, or proposed and approved annually? Should it be allocated as a set amount or as a percentage of RSO revenues of some type? Is there compensation available for travel?
- 5. Access:** What type of access to the RSO's board is appropriate? For instance, should there be regularly scheduled meetings, guaranteed direct interactions at RSO board meetings, attendance of RSO board members at committee/organization meetings, and/or official channels for communication around particular issues? And what types of access to the RSO's senior staff is appropriate?

Other heightened stakeholder status

In other regional grid operator systems around the country, states exert influence in specific roles that are separate from the regular stakeholder processes.

For example, as part of implementing a FERC rule requiring regional transmission planning, states in the New England regional grid operator (ISO-NE), the mid-Atlantic grid operator (PJM), and the New York operator (NYISO) each established heightened stakeholder status with regard to the study and potential development of transmission

projects driven by public policy. In PJM, the states have an Independent State Agencies Committee (ISAC), established in the PJM operating agreement, which works with PJM staff to develop transmission planning inputs and scenarios.^{17,18} ISAC meets directly with PJM staff on a regular basis. Through ISAC, states influence how public policies are studied.

MISO provides an example not tied to FERC's regional planning rule. OMS has recourse if it is concerned about the direction that any proposed transmission project in the MISO regional planning process is taking. Built into MISO's tariff, OMS may request additional study of a transmission project if it has concerns over a defect in the process used to determine a proposed project's need, or if the cost of a project has increased by more than 25 percent since first introduced into the regional planning process.¹⁹ OMS can exercise this right with the support of two thirds of its members.

STATES AS REGULAR STAKEHOLDERS AND INTERVENORS AT FERC

In addition to the official points of influence that can accompany Section 205 filing rights and establishment of heightened stakeholder status, states also retain the ability to participate as stakeholders in the more general sense, both in RSO proceedings and when issues are considered at FERC. The agency has made clear that states are priority stakeholders, and there is a shared belief that states' views will hold weight once a filing makes it to FERC. As a result, regional stakeholder processes at times give deference to the views of states, with an eye toward avoiding disagreement once a cost allocation or resource adequacy proposal reaches the FERC filing stage.

Regional stakeholder processes require time and financial resources for travel, two things that are not easily accessible within state utility commissions and other interested state agencies. Stakeholder participation should be used together with some of the other protections described above to ensure states' ability to participate in pursuit of their interests.

What is the best combination of tools to ensure that states have adequate representation and protection when it comes to grid organization outcomes? The wide variety of arrangements for states' participation in the existing multistate regional grid organizations affirms that there is no one single answer. States that desire to participate effectively in regional processes can do so—and should consider all tools available to them.

ENDNOTES

- 1 Jennifer Gardner, staff attorney in the Clean Energy Program at Western Resources Advocates, created this comparative tool.
- 2 California's AB 1890, signed by the governor in September 1996, authorized the formation of the ISO. See "ISO History," California ISO, www.caiso.com/about/Pages/OurBusiness/UnderstandingtheISO/ISO-history.aspx.
- 3 When it was first formed, CAISO had an oversight board made up of California residents only, representing at least 11 stakeholder groups. FERC approved it only as a temporary board due to concern about a lack of independence from market participants. Later, during the energy crisis, FERC ordered that the board be removed and replaced with an independent board; at the same time, the California legislature decided the board should be replaced with a five-member, governor-appointed board. The D.C. Circuit decided that FERC didn't have the authority to effectively replace CAISO's board, but it did establish that the independence principles contained in a landmark FERC rule known as Order 888 must be followed in the determination of regional grid operator boards.
- 4 The board selection process is described at "Our Leadership," California ISO, www.caiso.com/about/Pages/OurLeadership/Default.aspx.
- 5 Section 13, article 5.5, 359.5 states: "(a) It is the intent of the Legislature to provide for the transformation of the Independent System Operator into a regional organization to promote the development of regional electricity transmission markets in the western states and to improve the access of consumers served by the Independent System Operator to those markets, and that the transformation should only occur where it is in the best interests of California and its ratepayers." See "SB 350 Clean Energy and Pollution Reduction Act of 2015," California Legislative Information, leginfo.ca.gov/faces/billNavClient.xhtml?bill_id=201520160SB350.
- 6 Under Section 206, FERC has the authority, on its own accord or in response to a stakeholder complaint, to investigate rates it has reason to believe are not just and reasonable.
- 7 FERC's regulation has evolved so that a seller of electricity subject to its jurisdiction can achieve "market based rate authority" and so does not have to get specific FERC approval for every instance in which it wants to change the competitive rate it charges. On the transmission side, transmission owners and regional grid operators can get approval of a "formula rate" so that they, too, can operate without what would prove effectively to be a constant need for approval.
- 8 The rules that provide the basis for creating regional transmission organizations and independent system operators are Order 888 and Order 2000, see <http://www.ferc.gov/legal/maj-ord-reg/land-docs/order888.asp> and <http://www.ferc.gov/legal/maj-ord-reg/land-docs/RM99-2A.pdf>.
- 9 *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 20-22 (2002).
- 10 See <http://www.misostates.org>.
- 11 143 FERC ¶ 61,165, May 23, 2013, www.ferc.gov/EventCalendar/Files/20130523143002-ER13-708-000.pdf.
- 12 MISO Transmission Owners Agreement Section III.E.3.a. Per the agreement, "examin[ing] a change or changes in methodology" shall not include the methodologies and definitions employed for Baseline Reliability Projects, but shall mean changing any other MISO regional cost allocation methodology, changing the definition of the classes or types of transmission projects subject to any MISO regional cost allocation methodology, or any combination of the foregoing."
- 13 See <https://www.spp.org/organizational-groups/regional-state-committee>.
- 14 Section 7.2 of the SPP bylaws states: "The RSC has primary responsibility for determining regional proposals and the transition process in the following areas: (a) whether and to what extent participant funding will be used for transmission enhancements; (b) whether license plate or postage stamp rates will be used for the regional access charge; (c) FTR allocation, where a locational price methodology is used; and (d) the transition mechanism to be used to assure that existing firm customers receive FTRs equivalent to the customers' existing firm rights. The RSC will also determine the approach for resource adequacy across the entire region. In addition, with respect to transmission planning, the RSC will determine whether transmission upgrades for remote resources will be included in the regional transmission planning process and the role of transmission owners in proposing transmission upgrades in the regional planning process."
- 15 See http://docketpublic.energy.ca.gov/PublicDocuments/16-RGO-01/TN211283_20160429T073623_Considerations_in_Establishing_a_Western_Regional_Grid_Operator.pdf.
- 16 Order 2000, at 234.
- 17 See "Independent State Agencies Committee," PJM, www.pjm.com/committees-and-groups/isac.aspx.
- 18 See Section 1.3 of Schedule 6 <http://www.pjm.com/media/documents/merged-tariffs/oa.pdf>.
- 19 See <https://www.misoenergy.org/Library/Tariff/Pages/Tariff.aspx> under "Attachments."