Nicholas A. Brown, President & CEO

Honorable Jeff Davis
Commissioner
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

RE: Your January 11, 2011 letter

Commissioner Davis:

This letter is in response to your January 11, 2011 letter in which you raise various concerns. I hope to address both your concerns and questions.

Specifically, you have raised five issues: (1) the change to the Benefit Cost ("B/C") ratios between the December 8, 2010 "DRAFT" ITP 20 Report and the January 11, 2011 "DRAFT" ITP 20 Report; (2) SPP's use of a 40-year financial modeling timeframe for analysis instead of a 20-year analysis; (3) the lack of a natural-gas price sensitivity in the ITP 20 analysis; (4) the differences in wind assumptions used for SPP's Priority Projects and ITP 20; and (5) SPP Staff's use of "theoretical" or "illustrative" transfer payments pursuant to unintended consequences review per SPP's Tariff. Each issue is addressed herein.

<u>BENEFIT/COST CHANGES IN "DRAFT" ITP 20 REPORTS</u>

Before getting to the specifics of your first concern, I want to clarify that SPP Staff did not isolate the needed corrections solely to Robust Plan 1, but to all Plans in the ITP 20 "DRAFT" Reports. As noted, these reports are all clearly marked as "drafts." Even today as Staff prepares to present this information to the Regional State Committee (RSC) and Board on January 24 and 25, 2011, changes are being made to reflect comments received through SPP's open and transparent processes, including comments provided at last week's Markets and Operations Policy Committee (MOPC) meeting and those received from other stakeholders.

To put things in perspective, there have been a series of ITP 20 Report drafts prepared for stakeholder review and input. After sharing two drafts with stakeholders, SPP staff sponsored a technical conference on December 15, 2010 to present the draft report. As a result of that technical conference, stakeholders asked questions, raised issues, and voiced concerns via SPP's open and transparent process.

After his review of the draft report, David Ried of Omaha Public Power District (OPPD) sent an email to SPP staff on December 17, 2010, raising the following concern:

> The savings and costs of Figure 15.4 are overstated. For example, Robust Plan 1 total E&C cost is $2.45 billion in today's dollars. If you escalate that to 2030$ at 2.5% you would get $4.0 billion. At 17% annual fixed charge rate you would get annual costs of $682 million, not the $2 billion on the graph. The savings can't be right either.

Mr. Ried's email reflects the types of questions that are an integral part of SPP's open and transparent stakeholder process. Upon review of Mr. Ried's email, the relevant data, and corresponding calculations, SPP staff found that he was correct. Specifically, due to the use of a discount rate of 8% rather than a 2.5% inflation rate to bring the benefit numbers from 2030 dollars to 2010 dollars, the benefits had been understated. Hence, SPP staff made the change to the ITP 20 "DRAFT" report in January per the input of OPPD through SPP's open and transparent stakeholder process.

In sum, the analysis for the ITP 20 was conducted for the year 2030, so our benefit values are in 2030 dollars. The cost numbers used are in 2010 dollars. To calculate a B/C ratio, both values need to be in the same year. Either the cost numbers can be escalated to 2030 or the benefits can be brought back to 2010. We chose the latter, using the appropriate inflation rate, which as Mr. Ried pointed out should have been 2.5%. Thus, correcting this error caused the change in the B/C ratio.

<u>USE OF A 40-YEAR MODEL</u>

Your second concern, related to what you perceived as a shift by SPP from a 20-year analysis to a 40-year analysis. It is important to put the use of a 40-year analysis into a historical context.

In April 2009, the Synergistic Planning Project Team (SPPT) presented its Synergistic Planning Project Report to SPP stakeholders. One of the specific recommendations from the Report was that the ITP process should use a financial modeling timeframe of 40 years with the last 20 years provided by terminal values. The specific part of the final report stated:

> Cost-Benefit Analysis
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> The last component of the IPP [now the ITP] is the cost-benefit analysis. The SPPT recommends that SPP, in collaboration with the RSC, engage a consultant to perform a detailed cost-benefit analysis of the proposed long-range transmission plans. The analysis should be structured as follows:
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> 1. The cost-benefit analysis should be guided by the CAWG and the Economic Modeling and Methods Task Force (proposed to be called the Economic Study Working Group (ESWG)) with respect to assumptions and review of results

2. The financial modeling time frame should be 40 years (with the last 20 years provided by a terminal value)[1]

Following the presentation of the Report of the SPPT at the April 27, 2009 RSC meeting, the RSC "endorse[d] the principles and concepts as set forth in the SPPT report and endorse[d] the recommendations" upon an unanimous vote of the RSC.[2] The SPP Board of Directors and Members Committee met the following day with the Members Committee voting unanimously in favor of accepting the SPPT report and recommendations followed by the Board's approval of the report. Ultimately, Attachment O, Section III.e.i of the SPP Tariff was modified to accommodate the financial modeling timeframe for the analysis to be 40 years in the Integrated Transmission Planning Process. Thus, SPP staff performed the ITP 20 B/C analysis following the direction set by the SPPT Report, the RSC, SPP's Members Committee, SPP's Board of Directors and ultimately the Federal Energy Regulatory Commission's approval of modification to SPP's Attachment O.

<u>LACK OF NATURAL GAS SENSITIVITY IN ITP 20 ANALYSIS</u>

Your third concern expressed in your letter relates to the ITP 20 analysis not including a natural-gas price sensitivity. SPP did not and does not plan to perform a low and high natural-gas price sensitivity analysis before the January 2011 cycle of RSC and SPP Board meetings. SPP's Tariff Attachment O Section III.4. applies to all the assessments conducted under the Integrated Transmission Planning process, not just the 20-year assessment. Section III (8) states that the ITP analysis shall take into consideration multiple factors. Section III (8)(e)(iv) provides a non-inclusive list of factors as scenarios to analyze, including sensitivities to fuel prices, load forecasts, and other relevant factors. Importantly, it also says that SPP will consult the stakeholders for guidance in the development of these scenarios.

SPP did exactly what the Tariff requires by considering the sensitivity of these factors in developing the scenarios/futures analysis for fuel prices as required in Tariff Attachment O Section III (8). SPP staff worked with stakeholders during the course of several meetings to develop the scenarios to be utilized. The minutes from the January 25, 2010 RSC meeting include Staff's presentation, "Priority Projects and ITP 20 –Year Assessment Update" that included these scenarios. At the June 28, 2010 Economic Studies Working Group (ESWG) meeting, Black & Veatch, an independent consultant assisting SPP, reported its results from the analysis requested by the ESWG. The minutes from the June 28, 2010, meeting contain Gary Wilmes' (Black & Veatch), report that there were not significant differences in fuel consumption per future and therefore there

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[1] See page 10 of Synergistic Planning Project Team Report. A copy of the report is available at: <u>http://www.spp.org/publications/SPPT%20Report%20Version%20v6-1.pdf</u>

[2] The minutes of the April 27, 2009 RSC meeting reflect that the motion to "endorse the principles and concepts as set forth in the SPPT's report" was made by Commissioner Davis from the Missouri Public Service Commission. The April 27, 2009 minutes are available at: <u>http://www.spp.org/publications/RSC042709.pdf.</u>

would not be significant differences in fuel costs among the futures. He recommended that the initial results be used as an indicator that there would not need to be much change in the fuel prices used in the models. The consensus of the ESWG was to leave the fuel prices as they are based on the fuel consumption being similar between the futures."[3]

WIND ASSUMPTIONS

Your fourth concern relates to the differences in the wind assumptions used for the analysis for the Priority Projects and the ITP 20. The SPP staff used 11 GWs of wind for the Priority Projects and 16 GWs of wind for the ITP 20 for very simple reasons.

The analysis for the Priority Projects used 11 GWs of wind as an assumption based upon the responses provided through the RSC's Cost Allocation Working Group (CAWG), which were designed to determine what was needed to meet each state's renewable requirement/target. A similar application was used in the ITP 20, but with 16 GWs of wind as an assumption based upon a projected SPP load in 2030 and a twenty percent (20%) National Renewable Energy Standard (RES) applicable to the entire region. SPP staff used a 20% RES assumption based upon the determination of the ESWG.[4] Thus, the Priority Projects used each state's renewable requirement/target as identified by the CAWG, while the ITP 20 assumed a 20% RES requirement with a projected 2030 load.

In the Priority Projects analysis, the wind assumption was made that only the entities that are under a requirement/target were required. This excludes certain load such as municipals, cooperatives, etc. Only 11 GW of wind capacity was necessary to meet the renewable requirement/target under that assumption. This assumption was changed for Future 2 and 4 (i.e. 20% National RES) in the ITP 20 such that all load will be subject to the 20% requirement. This required that the wind capacity increase to 16 GW for ITP 20.

ILLUSTRATIVE TRANSFER PAYMENTS

Your last concern relates to the depiction in the ITP 20 report of unintended consequences and illustrative transfers in Appendix A9.2. Both the December 8, 2010 "DRAFT" Report and the January 11, 2011 "DRAFT" Report contain the following statement, "Since the analysis shows four zones that continue to reflect a cumulative benefit-to-cost ratio less than one, **a theoretical set of transfer payments are calculated** to adjust benefits by zone to result in a minimum benefit-to-cost ratio of 1 for all zones." (Emphasis added) Moreover, presentations made at the December 15, 2010 technical conference and the January 11, 2011 MOPC meeting introduced this subject with a slide that clearly states that this is a conceptual and illustrative framework. That presentation also stated that the materials are "Not a recommendation but a discussion topic."

There is nothing in the SPP Tariff, or in any existing proposal presented to stakeholders that specifically calls for the implementation of transfer payments. Therefore, there is no

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[3] See Agenda Item 2(b) to the ESWG's June 28, 2010 minutes. The June 28, 2010 ESWG minutes are available at: http://www.spp.org/publications/ESWG%20Minutes_6-28-2010.doc
[4] See Agenda Item 2 to the ESWG's April 28-29, 2010 minutes. The April 28-29, 2010 ESWG minutes are available at: http://www.spp.org/section.asp?group=1437&pageID=27

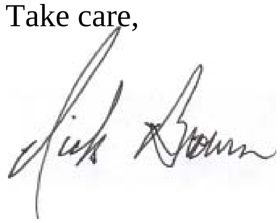
reason to expect implementation of transfer payments absent further action -- action that can be initiated by the RSC as provided for in SPP's Tariff. The theoretical transfer payments shown in the draft ITP 20 Reports are basic, simple, transfers from zones having a B/C ratio of 1.0 or greater to zones having a B/C ratio of less than 1.0 and were presented for illustrative purposes only.

Commissioner Davis, you have expressed mistrust of us and our analysis. As can be read, the December 8, 2010 and the January 11, 2011 ITP20 Reports are clearly labeled "DRAFT". As is SPP's policy, our work is guided by diverse stakeholder input and drafts were presented in multiple forums seeking stakeholder feedback through our open and transparent process. The B/C change came as the result of stakeholder feedback received after the December 15, 2010 meeting. You comment as to whether the due diligence was complete in terms of scenarios. More than one stakeholder at last week's MOPC meeting stated that Staff had done all that had been requested in the efforts to analyze the scenarios that were presented.

The SPP process is open and transparent, and with significant levels of detail. Staff was charged with putting forth a Report and a strawman recommendation for stakeholders. We've done both with clear conscience. The SPPT Report placed great emphasis on robustness, as did Staff, in recommending Robust Plan 1. Despite, SPP staff's recommendation, the MOPC recommended the Cost Effective Plan instead. This should not be interpreted to mean the report or the Staff recommendation was inappropriate or unprofessional, but that the majority of the MOPC disagreed with Staff's recommendation. This is the basis of SPP's open and transparent stakeholder process, of which we are very proud. We will continue to live up to our core ideology of doing the right thing for the right reason in the right way.

I hope I have addressed your concerns and answered your questions. As some of these questions are similar, if not identical, to questions posed to SPP as a result of discussions at the Missouri Public Service Commission meetings, more detailed responses will be provided as formal responses to those questions and filed in the EO-2011-0134 docket. If I can be of any additional help, please let me know.

Take care,



cc: FERC Commissioners
SPP Regional State Committee
SPP Board of Directors/Members Committee
Missouri Public Service Commission
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