Strategic Plan

October 24, 2006

Developed by the
Southwest Power Pool, Inc.
Strategic Planning Committee
Background

SPP developed its most recent Strategic Plan in July 2005. A component of that plan included the development of a new plan with a longer term view. This plan reflects that effort. The Strategic Planning Committee held a retreat June 26-28, 2006. Included in the planning retreat were members of the committee, SPP executive staff, Ric Abel (Prudential Capital Group) serving as a financial subject matter expert and outside participant, and Mark Rossi, serving as facilitator and electricity market subject matter expert (Gestalt).

Strategic Planning Committee

The Strategic Planning Committee is comprised of a diverse group of representatives from the SPP membership and the Board of Directors:

Richard Spring, Chair  
VP, Transmission  
Kansas City Power & Light

Mike Palmer  
VP, Commercial Operations  
The Empire District Electric Company

Ricky Bittle  
Vice President  
Arkansas Electric Cooperative Corporation

Mel Perkins  
VP, Transmission  
OG+E Electric Services

Michael Desselle  
Director Public Policy  
American Electric Power

Jim Stanton  
Director, Market Design  
Calpine Energy Services

Kevin Easley  
General Manager/CEO  
Grand River Dam Authority

Jim Eckelberger  
Chairman, SPP Board of Directors

Tom Grennan  
COO and Sr. VP  
Kansas Electric Power Cooperative

Harry Skilton  
Vice Chair, SPP Board of Directors

Joshua Martin  
SPP Board of Directors

Bill Wylie (OGE) and Kurtz Stowers (Calpine) attended the June retreat.
Strategic Planning Process

The strategic planning process utilized by the SPC considered four basic questions: Where are we? What is going on outside the region? Where do we want to go? How do we get there? The group sought to develop goals for SPP to move forward, but doing so while retaining SPP’s uniqueness in the industry and continuing to provide benefit to its members.

Where are we?
This data-gathering phase produced an understanding of where the organization is in relation to its environment with respect to both industry structure and SPP’s relative position. This phase began with a reaffirmation of the organization’s values - the principles that define SPP and have driven the decision-making processes of the organization. The SPC then reviewed SPP’s organizational structure, governance, staffing and finances. This phase also included a review of the regulatory environments to which SPP members are subject at both the state and federal levels.

What is going on outside the footprint?
This data-gathering phase included a review of the Energy Policy Act and its impact on the industry as a whole, but particularly as it relates to standards setting and reliability compliance. In addition, the group considered the status of other ISO/RTO market developments in North America as well as several new initiatives. This phase concluded with a report on how all of these initiatives have impacted the financial and credit industry and its view of the electric utility business.

Where do we want to go?
The SPC is recommending actions specific to the following:

1. Communication and Education
2. Center of Excellence
3. Balancing Authority
4. Membership Development
5. Transmission Project Tracking
6. Transmission Expansion/Economic Upgrades
7. Market Development/Design
8. Contract Services

How do we get there?
The SPC recommends that, in addition to its work, SPP organizational groups assist in further investigation of certain detailed issues to make appropriate recommendations through the SPP organizational structure, culminating with approval of the Board of Directors and Regional State Committee.
SPP’s Value Proposition

To provide guidance throughout the planning process, the SPC reviewed SPP’s values - the principles that have driven its history and frame its future. These principles are very familiar to SPP members. The SPP difference, the values and principles that set this organization apart from other regional entities performing similar services, was affirmed by the SPC as the guiding principles of the organization.

Relationship Based

SPP dates back to 1941 when 11 utilities across seven states pooled their generation resources by constructing a regional transmission network to serve a critical defense plant in central Arkansas. This same organization continued to exist and grow to a peak membership of 78 entities without any legal recognition until it incorporated in December of 1993. Until 1998, the membership agreement consisted of a single paragraph obligating members to abide by the organization’s bylaws. As in the past, relationships, rather than contracts, continue to keep this diverse organization together.

Member Driven

SPP’s organizational structure of broad-based committees, working groups and ad hoc task forces is the true source of SPP’s product. More than 360 persons are involved in SPP efforts that are driven by these groups. The rosters of these groups match the diverseness of the organization’s membership, requiring representatives from across the footprint and recognizing the varying member types and sizes. It is this principle that promotes member ownership in the organization’s products, reducing regulator interventions, and continues to keep SPP’s staff size the smallest in the industry.

Independence Through Diversity

SPP membership has been one of the most diverse of any regional organization in the industry since its inception. With membership comprised of investor-owned utilities, municipal systems, generation and transmission cooperatives, state authorities, wholesale generators, and power marketers, any and all opinions are heard loudly and clearly in organizational group meetings. As a member-driven organization, meaningful stakeholder involvement has driven SPP’s efforts and effectively balances diverse opinions. This independence has been further enhanced with the governance ultimately residing within an independent Board of Directors since 2004. In addition with the recognition of SPP as an RTO in 2004 the SPP Regional State Committee was formed adding an additional important formal layer of diversity.

Reliability & Economic/Equity Issues Inseparable

In 1968, SPP took on the responsibility of serving as a regional reliability council under the National (now North American) Electric Reliability Council (NERC). SPP members have long maintained that electric reliability issues cannot be debated in absence of economic/equity issues. This is why SPP, as a regional reliability council, undertook commercial tariff administration responsibilities and is implementing wholesale markets. History has shown that any attempt to separate reliability and economic/equity issues only results in the same people meeting in
different venues with confusion over which organization should be attempting to resolve problems. A single organization providing these services results in greater cost effectiveness and organizational efficiency.

**Evolution, Not Revolution**

SPP was initially created for a much different purpose than that which it currently serves. Reliability remains the preeminent value of the organization. However, a deliberate evolutionary process has guided the growth in services delivered by the organization, resulting in a carefully staged maturation.
The Industry Today

The SPC discussed the current environment of the electric utility industry as a means to identify the key drivers that may impact SPP and its members. This section highlights some of the topics discussed.

The electric power system continues to be characterized as vital, while strides are being made to calm turbulence, remove uncertainty, and minimize risk and costs by establishing and stabilizing market rules. Industry participants are realizing that an aging infrastructure and a lack of system reliability go hand in hand, and that the transmission infrastructure must be upgraded to provide for economic growth as well as reliability. Many utilities are in a ‘back to the basics’ mode, focusing on reliability and cost/performance improvement, which is resulting in improved financial performance by many. Strides are being made toward increased regulatory certainty with a cultural change focusing on investment in an updated infrastructure and new, more efficient and affordable ways to “keep the lights on.”

The Energy Policy Act of 2005 has significant implications for the industry. Major goals of the Act include: 1) stimulate fuel diversity and innovation; 2) stimulate investment in transmission infrastructure; 3) sustain end-user efficiency; 4) reinforce the hybrid structure of the industry; and 5) broaden ownership of the power industry.\(^1\) Direct impact for SPP originates in the expansion of the Federal Energy Regulatory Commission’s responsibilities to include mandatory reliability standards and enforcement, and siting authority in cases of national interest electric transmission corridors (NIETC). In addition to these same issues, there are broader implications to the members related to financing, tax incentives, and conservation.

The needs of the industry, particularly for transmission infrastructure enhancements and expansion, are capital intensive. While the capital markets can meet those needs today from a financial perspective, there are still numerous regulatory, political and implementation hurdles that must be overcome so that this infrastructure can be moved from the drawing board to in-service operation.

The role of markets in the industry continues to evolve. Many regions of the country have implemented some form of centralized market to facilitate the pricing and trading of various energy and ancillary service products and have had to address how these services and products meet the region’s reliability requirements. The following table summarizes the status of markets development in the Eastern Interconnection and the Electric Reliability Council of Texas.\(^2\)

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\(^1\) Prudential Capital Group

\(^2\) Gestalt
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SPP Today

As an RTO, SPP manages reliability, markets and transmission services on behalf of its members, using the transmission systems of its members. SPP’s members cover a 255,000 square mile region over all or part of eight states containing approximately 4 million customers. SPP currently has forty-six members, and its footprint includes seventeen separate control area operators that individually are responsible for matching electricity supply and demand within their territories. The peak electric demand in the SPP footprint in 2006 was 42,227 MW, approximately 5% higher than in 2005.

Electric energy usage also increased. In 2005 it was 202.1 million MWh, an increase of 4.2% over 2004. Customers within the five largest control areas in SPP (American Electric Power West, Oklahoma Gas and Electric, Westar Energy, Inc., Southwestern Public Service Company, and Kansas City Power and Light) account for 72.1% of the total electric energy usage in SPP.

At the end of 2005, the total generating capacity in the SPP region was 55,023 MW, resulting in a significant resource margin (generation capacity in excess of peak demand) of 14,836 MW or 36.9%, presuming all generating capacity would be deliverable when the peak electricity demand occurs. Since 2000, there has been a significant amount of construction of new natural gas-fired generating plants. Of the total generating capacity in SPP, 54% is natural gas-fired; 92% of capacity in SPP is either coal- or natural gas-fired.3

There are 52,301 circuit miles of transmission in the SPP footprint. These facilities are owned by eleven utilities. Approximately 120 transmission customers seek service on the system managed by SPP, averaging 650 schedules daily.

The number of transmission service requests in 2004 and 2005 were about the same. On average there were 15,317 requests per month in 2004 and 15,386 requests per month in 2005. However, the number of confirmed requests increased significantly in 2005 as compared to 2004. As measured by the number of requests, the number confirmed in 2005 was 20% higher than 2004. As measured by the MWh volume of requests, MWh in confirmed requests in 2005 were 44% higher than 2004. The increase in confirmations generally indicates improved performance.

Overall levels of TLR curtailment had been increasing over the three-year period from 2002 to 2004. However, in 2005, the MWh curtailed were 25% lower than in 2004. Of this total, approximately 98% of the curtailments were from non-firm sales. Non-firm curtailments are highest in off-peak hours. Firm curtailments were just a small share of the total and also were at their lowest level in four years.

Only limited transmission expansion occurred in SPP until recently. In 2005, $152 million was spent on transmission lines and transformers. In 2006, $90 million is expected to be invested. These investments have had a notable impact by reducing congestion on specific flowgates.4

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3 SPP 2005 State of the Market Report, Boston Pacific (paragraphs 1-3)
4 SPP 2005 State of the Market Report, Boston Pacific (paragraphs 5-7)
In 2005, the Board of Directors approved a strategic plan that included six primary areas of focus:

1. markets development
2. transmission expansion
3. administrative processes
4. retention and addition of participants
5. enhanced regional planning
6. long-range planning

SPP has made significant progress toward these goals. The Energy Imbalance Service market is scheduled to go-live in 2006, and work has begun on the next phases of market development. SPP members are investing almost a quarter of a billion dollars in transmission expansion projects to be completed in 2006-2007. In addition to reliability projects, members are sponsoring system upgrades to mitigate congestion and improve economic efficiencies. The Strategic Planning Committee has initiated an annual organizational effectiveness review, including data on each organizational group and a survey of members. This is presented at a Board of Directors meeting in December each year dedicated to an organizational review of the company. SPP continues to pursue new and expanded opportunities for membership. Enhanced regional planning will be further developed. Finally, this 2006 Strategic Plan was developed in response to the organization’s desire to engage in a longer-term planning horizon.
The Outlook for SPP

This section highlights some of the major issues that are facing SPP and its members. These issues can impact or influence the business plans, effectiveness or efficiency of SPP and its members in providing reliable and cost effective services to their respective customers.

Regulatory and Legislative Drivers

As a public utility, SPP is subject to the jurisdiction of the Federal Energy Regulatory Commission and the limited jurisdiction of some states’ retail regulatory commissions. As such, state and federal regulators have significant impact on SPP’s business, as can the state and federal legislatures. There is a high degree of turnover in these constituencies as some commissioners serve by appointment while others by election. Prior to the end of 2007, terms will expire for 48% of the commissioners who have authority over SPP and its members. Also, these commissions regulate much more than just the electric utility industry, including such complex industries as gas, water, telecommunications, and transportation. High turnover, steep learning curves, and numerous and diverse demands create a formidable challenge to developing and maintaining an adequate level of understanding of SPP and its values. This is particularly significant as members are under increased scrutiny and pressure to justify investments in the transmission system.

Human Resources

The pipeline of qualified technical resources electing a career in the utility sector is waning and causing a shortage in terms of human capital. This issue is not isolated to SPP’s region and is impacting both SPP and its Members.

Mandatory Reliability Standards

The Energy Policy Act of 2005 requires both SPP and its Members to comply with new mandatory reliability standards as well as to address other technical issues such as demand side management, interval metering and investments in renewable resources among others. Under the new electric power reliability system enacted by the Congress, the United States will no longer rely on voluntary compliance by participants in the electric industry. Congress directed the development of mandatory, FERC-approved, enforceable electricity Reliability Standards. FERC certified the North American Electric Reliability Council (NERC) to be the single Electric Reliability Organization, the ERO, to oversee the reliability of the United States’ portion of the interconnected North American Bulk-Power System, subject to Commission oversight. The ERO is responsible for developing and enforcing the mandatory Reliability Standards. The Reliability Standards will apply to all users, owners and operators of the Bulk-Power System. The Commission has the authority to approve all ERO actions, to order the ERO to carry out its responsibilities under these new statutory provisions, and also may independently enforce Reliability Standards.

The ERO may delegate its compliance and enforcement responsibilities to a Regional Entity (RE). The ERO may also delegate to an RE authority to propose Reliability Standards to the ERO. A delegation agreement sets out the role of an RE in relationship to the ERO, concluding
that the ERO holds the primary responsibility for enforcement of Reliability Standards and that any delegation of this responsibility to a Regional Entity is subject to ERO oversight. Delegation is effective only after FERC approves the Delegation Agreement. SPP intends to be a Regional Entity under the ERO and has worked with NERC to modify its governance to accommodate fulfilling the delegated responsibilities of standards development and compliance enforcement.

Coordination of Regional Reliability
Maintaining and monitoring the reliability of the transmission system has become more regional in nature as the number of transactions involving multiple Balancing Authorities has increased. There are currently 17 Balancing Authorities within SPP. As the markets evolve within the region, there is merit to consolidating the number of Balancing Authorities to facilitate a more efficient market.

Expansion of SPP Services and Cost Containment
Implementing SPP’s current mandates from members and regulators will put upward pressures on its costs and its administrative fees to its Members, primarily due to investments in infrastructure.

There are a number of entities within the current geographic footprint or in neighboring jurisdictions that are interested in retaining SPP to provide certain services but are not interested in full SPP Membership at this time; this offsets some of that upward pressure. However, providing these services must be balanced with maintaining a high level of support to the SPP Membership.

Transmission Expansion
Although recent emphasis has been on establishing a sound transmission expansion and planning process, the region must also have in place a means by which to implement these plans and get the transmission facilities built. Members are under increased scrutiny and face significant hurdles in the approval and cost recovery process. The approval and implementation processes are complicated and require significant time and resources, which only adds to the delay in getting additional facilities built.

In addition, the development and construction of economic upgrades has been hampered by a number of policy and technical issues. SPP’s current policies do not easily permit non-Transmission Owners from investing in expansion of the transmission system. Ensuring cost-recovery (i.e. regulatory approval of cost recovery), better enabling 3rd party project sponsorship, and equitable cost allocation (i.e. who pays for this facility) are key to moving economic upgrades forward particularly when the proposed project impacts multiple jurisdictions. SPP must continue to refine the process of determining whether a project is a reliability or economic upgrade to facilitate funding and construction.
SPP Markets
While the current emphasis has been on implementing the Energy Imbalance Services market, the overall direction of market policy is not yet defined. This lack of overall policy may be causing uncertainty and a lack of confidence in the future of SPP’s markets. The RSC has been given primary responsibility for the development of market-related transmission rights and resource adequacy requirements in the region, but has not yet addressed these issues explicitly. There is a concern that the overall implementation costs may be higher than necessary if a long-term vision and understanding of market design is not more clearly defined. That is, information systems may have to be unnecessarily redesigned if a piecemeal approach is taken.
The Strategic Plan

COMMUNICATION AND EDUCATION
In an effort to further enhance credibility and to align its mission with its members, SPP will have in place a systematic program to communicate with and educate the region’s federal/state regulatory and legislative constituencies. The purpose of this is to build relationships and enhance credibility for the organization with these constituencies. This will allow SPP to better assist its members in advancing projects in the region. When appropriate, execution of this initiative will be coordinated with the Regional State Committee.

The following steps should be taken:
1. SPP will develop a systematic approach to communicate and educate these constituencies.
2. SPP will continue to be proactive in assisting its Members on these fronts on issues that impact the region’s transmission system or markets.

Assigned to: SPP Staff

CENTER OF EXCELLENCE
SPP will establish a Center of Excellence (COE) to leverage collective knowledge and provide thought, leadership and shared services to its members in areas such as: a) enhancement of reliability operations; b) compliance programs; c) conservation and efficiency (IRP, DSM); d) best practices (including the development and use of enhanced metrics); e) training; and f) regional transmission planning. This will provide a significant point of differentiation for SPP as a regional organization.

The following steps should be taken:
1. SPP Staff will identify specific topics or areas of interest that may be topical for the COE, distribute these suggestions to stakeholders in an effort to broaden and prioritize the areas of interest, and collectively report to the Board of Directors the results of this survey.
2. The Board of Directors will then assist SPP Staff in establishing and measuring the progress being made in the selected topic areas.
3. An assessment will be made concerning the possible participation of a university (ies), interest groups, etc. as an integral part of the COE.
4. Assess availability of member R&D monies/staff to support the COE.

Assigned to: SPP Staff; Strategic Planning Committee members
**BALANCING AUTHORITY**

SPP will offer Balancing Authority (BA) services to its members to facilitate ancillary services market development and compliance efforts in the region.

The following steps should be taken:

1. SPP will offer Balancing Authority Services on a fee basis to any Member organization that wishes to enter into a contractual arrangement for the services.
2. SPP will continue to assist and evaluate alternatives that may lead to greater efficiencies within existing BAs including the possibilities of further consolidation of the number of BAs.
3. As provision of Balancing Authority services reaches a critical mass, this will be converted to service under the SPP OATT.

**Assigned to:** Operations Reliability Working Group; SPP Staff

**MEMBERSHIP DEVELOPMENT**

SPP will continue to pursue expansion of its membership and geographic footprint to further leverage its capabilities and lower costs.

The following steps should be taken:

1. The Board of Directors will receive a quarterly report from the President on Membership status, pending opportunities for Membership expansion and/or the provision of Contract Services.
2. Existing Members will be engaged in the recruitment of new members.
3. Develop a communications piece focused on the benefits of membership in SPP.

**Assigned to:** SPP Officers

**TRANSMISSION EXPANSION/ PROJECT TRACKING**

SPP will put in place a program to actively monitor and support the progress of approved transmission expansion projects, emphasizing the necessity to initiate, seek regulatory approval, construct and operate approved projects. Additionally, SPP will endeavor to find ways to streamline the processes necessary for the development and completion of transmission upgrades.

The following steps should be taken:

1. SPP staff will develop a tracking and reporting tool for transmission expansion projects for quarterly reporting to the Board of Directors, Members Committee and Regional State Committee.
2. SPP Staff will be proactive in its support of the Membership in terms of Project approval, siting and cost recovery.
3. SPP Staff will report to the Board of Directors annually on its evaluation of the processes, planning, approval and construction of needed transmission, emphasizing areas of strength and weakness resulting in enhanced processes to streamline these efforts.

Assigned to: Transmission Working Group

**TRANSMISSION EXPANSION/ECONOMIC UPGRADES**

SPP will continue to identify potential economic upgrades and develop a more direct means to decouple the ownership and operation. SPP will develop a mechanism to allow the recovery of the costs of approved economic upgrades.

The following steps should be taken:
1. SPP, through the Regional State Committee, will develop and implement a methodology to provide for the recovery of the cost of an approved level of economic upgrades.
2. The adopted methodology will provide a mechanism that allows all interested parties to submit financing options so that the capital portion of the facilities requirements are provided in a reasonable and prudent manner.
3. SPP, through the RSC/MWG/TWG, will enhance its abilities to quantitatively and qualitatively identify all benefits potentially associated with economic upgrades.

Assigned to: Cost Allocation Working Group; Regional Tariff Working Group

**MARKET DEVELOPMENT AND DESIGN**

SPP will evaluate a comprehensive market services design for the region including the requisite cost/benefit studies. A strategic decision will then be made concerning further market services development in the region.

The following steps should be taken:
1. Develop a comprehensive market services assessment to be presented to the RSC and Board of Directors considering the next steps to be taken, estimated costs and a timeline for the evaluation.
2. The RSC and Board will approve the next steps; i.e. strawman approach, cost/benefit analysis and approach.

Assigned to: Market Working Group

**CONTRACT SERVICES**

SPP will continue to offer services on a contract basis, pursuant to Board-approved assessment criteria, in order to increase revenues, further membership in SPP, and enhance the quality of existing services.

The following steps should be taken:
1. SPP will continue to provide services to non-SPP Members that leverage SPP’s existing infrastructure.
2. SPP will continue to evaluate these opportunities as they arise to ensure they fit within SPP’s Mission and Value Statements and provide benefits to the existing SPP Members (in terms of reduced administrative fees).

Assigned to: SPP Contract Services Staff

**SPP REGIONAL ENTITY**

SPP will seek to become a Regional Entity (RE) under the new Electric Reliability Organization (ERO) in order to continue offering reliability and transmission services to its members in an efficient and cost effective manner.

The following steps should be taken:

1. SPP will work with the ERO to successfully complete the RE application process at FERC.
2. SPP will pursue the necessary governance, standards setting and compliance program changes to achieve recognition as the RE for the region.

Assigned to: Strategic Planning Committee, Compliance Committee, SPP Staff
Recommendation

The Strategic Planning Committee recommends that the SPP Board of Directors adopt the proposed Strategic Plan included in this report, and authorize the delegation of responsibilities to SPP organizational groups also contained herein under the coordination oversight of the Strategic Planning Committee and the Markets and Operations Policy Committee.

Upon approval by the Board of Directors, the Committee will prioritize the initiatives in the Plan. After the Committee prioritizes the initiatives in the Strategic Plan, SPP Staff will develop an implementation plan for approval by the Board. The implementation plan will include quarterly reporting regarding the progress of these strategic initiatives.