PRE-EXISTING CONTRACTS AND OBLIGATIONS:

ENTITLEMENTS TO FIRM TRANSMISSION RIGHTS (FTRs)

Background

The principles and processes for determining the appropriate allocations of FTRs have not yet been finalized and are dependent on resolutions of other Pre-Existing Contracts and Obligations issues. However, the allocation process has been determined, the next question is form in which the FTR is received: the actual FTR, the auction revenue, or a combination of the two.

The RTO FTR auction currently being discussed by the Congestion Management Workgroup is a single-round, sealed-bid, market-clearing price auction. In any case where auction revenue is associated with an FTR, the revenue will equal the clearing price of the FTR auctioned by the RTO. As a result this revenue would enable the transmission customer to purchase the FTR at the auction.

The issue revolves around whether or not the transmission customer has a choice on whether he/she will receive FTRs or auction revenue, what are the conditions if FTR's are received, and if the customer does not have the choice, does the applicable regulator make that choice.

The four alternative positions are as follows:

1) The transmission customer may elect to receive either FTRs or the auction revenues associated with those FTRs.
2) The transmission customer shall receive the auction revenues associated with those FTRs.
3) The transmission customer may elect to receive either FTRs or the auction revenues associated with those FTRs; <u>provided that</u> if the transmission customer would be entitled to receive more than 10% of the FTRs on a flowpath, the transmission customer must participate in the auction by indicating the price(s) at which the transmission customer would be willing to sell those FTRs in the RTO-W's auction. <u>However</u>, under this provision, the transmission customer may elect to specify the RTO-W's "default maximum price" of $10 million/MWh, which the RTO-W shall interpret to mean that the transmission customer will not release the FTRs in the RTO-W's auction at any price.
4) The transmission customer may elect to receive either FTRs or the auction revenues associated with those FTRs; <u>provided that</u> if the transmission customer would be entitled to receive more than 10% of the FTRs on a flowpath, the transmission customer must participate in the auction by indicating the price(s) at which the transmission customer would be willing to sell those FTRs in the RTO-W's auction. and the price at which the customer would be willing to buy additional FTRs. The buy and sell prices may differ by no more than [10 percent].

5) Each utility's regulator would decide whether the utility's FTRs will be held out of the auction or be put into the auction and sold to the highest bidder. In the investor-owned utilities case, the regulators are the state commissions, for publicly owned utilities the regulators are the locally elected officials. The regulator's initial decision would be required to be made within 6 months of the receipt of the initial allocation of FTRs. If at any time, the regulator decides to withhold the FTRs from the auction, this decision would have to be reviewed at least every three years.

Shelly Richardson and Rich Bayless prepared the supporting statements for alternative 1, which is also the strawman. Carl Imparato provided the supporting statements for alternatives 2, 3, and 4. Coe Hutchison provided the supporting statement for alternative 5.

Alternative 1 (Strawman)

The transmission customer may elect to receive either FTRs or the auction revenues associated with those FTRs.

Permissive Participation in Annual Auction for Certain Loads Assumptions:

1. Assumes an annual auction (i) of transmission rights associated with RTO transmission capacity that exceeds preexisting contracts and load service obligations; and (ii) of transmission rights associated with PECs and LSOs on the RTO transmission facilities, at the discretion of the load serving entity.
2. Assumes an obligation arising from federal, tribal, state and local laws and regulations, upon a load serving entity, to serve requirements power loads.
3. Assumes a legal obligation upon a load serving entity to serve requirements power loads, the transmission service for which may or may not be memorialized in a stand alone transmission contract held by such a load serving entity.
4. Assumes that participation in the annual auction is mandatory, except in the case of transmission rights necessary to serve requirements power loads that are service obligations arising from federal, tribal, state or local laws and regulations.
5. Assumes that transmission rights associated with such requirements loads may be placed in auction at the discretion of the transmission rights holder.

Argument in Favor or Permissive Participation in Annual Auction

The load serving entity must meet requirements loads. As such, the load serving entity must possess transmission rights necessary to serve such requirements load. If such a load serving entity fails to have a successful bid in mandatory auction of transmission rights, it may not be able to fulfill its legally required service to requirements loads. Therefore, the load serving entity -- a transmission rights holder with a legal obligation to serve requirements load -- should have discretion whether to participate in the annual auction.

A. Mandatory Auction Participation Unnecessarily Increases Administrative Burden for Requirements Load Service

The proposed system for implementing transmission rights and obligations under RTO-West is expected to dramatically increase the administrative burdens of requirements load serving entities (e.g., translation of existing rights into physical transmission rights). Mandatory participation in an annual auction is an administrative burden with significant legal and economic repercussions if the burden is not fulfilled.

The load serving entity may choose to reduce the RTO-West imposed administrative burden associated with its requirements load by withholding transmission rights from the auction and applying such rights to serve the requirements loads.

B. Mandatory Auction Unnecessarily Increases Economic Burdens for Requirements Load Service

The implementation of transmission rights and obligation under RTO-West is expected to increase the economic burdens of requirements load serving entities. For example, the anticipated imposition of a "scheduling coordinator" on all transmission transactions will increase the transactional costs over the status quo, particularly for smaller consumer-owned requirements load serving entities (where BPA currently performs functions that a scheduling coordinator would pick up).

Participation in an RTO-West mandated auction will impose additional costs, requiring the utility to acquire additional services in order to meet its statutory load service obligations. Such services will be procured either from an outside schedule coordinator, for many requirements-serving utilities will not be equipped to perform the schedule coordinator function in-house; or from specialized in-house staff. Neither service will be free of charge. Therefore, the transmission rights holder with a statutory obligation to serve requirements load should be permitted to withhold transmission rights associated with all its requirements loads from auction, in order to reduce the RTO-West imposed economic burden associated with load that it must serve.

C. Permissive Participation Ensures the Transmission Component Necessary to Fulfill Statutory Obligation

A "monetize everything" auction of all transmission rights assumes that (a) everything has a price and that (b) a liquid market will in fact serve all requirements loads. Where the auction is mandatory, there is always the possibility that the requirements load serving entity may not procure the transmission rights it needs to serve its requirements loads – in which case, the liquid market failed to permit delivery on the statutory obligations of the requirements load serving entity.

A mandated auction presumes that a requirements load serving entity will always end up with adequate transmission rights to serve its requirements loads (at least those established on day one, if not load growth as well). Mandated participation in an auction cannot guarantee who the victor in an auction will be; only by withholding rights from auction for all of its load plus load growth can the load serving entity be guaranteed that it possess the necessary rights to fulfill its obligations under the statute.

By requiring each small utility to participate in an auction, the RTO risks a higher transaction cost for all transmission customers and an increased risk of non-delivery. Maybe the price signals get through, at least to the managers of the utilities -- but have we really made things better off?

A more rational approach is to allow load serving entities with requirements service obligations to preserve transmission rights across the annual strip, with provisions that allow them to sell unused rights by means of a secondary market.

D. Auction Fails to Recognize Pre-existing, Long-term Resource Choices

Many of today's most economical long-term load/resource plans are dependent on transmission services that are provided under long-term agreements with and without rollover provisions. Many non-cost factors and compromises are embedded in these decisions and plans. It will be time consuming and costly to unwind the myriad components that comprise the underlying planning decisions and operational support systems used to manage these resources. All parties, transmission customers and owners alike, should mutually agree that such contacts would be subject to a monetization process (auction or secondary market transaction) if such is to occur.

E. Monetization Complicates Multi-State Regulatory Treatment of Revenues and Costs

The regulatory treatment of revenues and costs are different in each state. For multi-state PTO's or for TO's with CSC paths with assets that cross state boundaries, this could complicate auction revenues, asset cost treatment, and rate recovery. This could result in the inability to obtain or utilize revenues to buy back FTR's. This will be a problem until it is know how States will or would treat FTR auction revenues and costs.

F. Retail Access Initiatives Complicates FTR Auction Revenue Treatment

Several States have initiated Retail Access Programs. One such proposal in Oregon would require assignment of certain out of state resources to various load segments within the state. It could be expected that the corresponding FTR's for transmission spanning several or many RTO West states would also be required to be assigned along with the resource stack slice. Allocation of FTR's used for multiple purposes and in multiple states will require regulatory agreement, which is presently unknown.

G. Flow Based Reservations and Scheduling Requires FTR's on New Paths

Because flow tolerance and margins are not yet defined for CSC paths, residual levels unknown given phase shifter assumptions and other variables, and because schedules that span several zones will need to have flow based components on perhaps many flow paths (some “fuses”), purchasing a complete flow based schedule path may be impossible using collected FTRs auction revenues.

Impedance based flows and TTC’s are not necessarily proportional. There are many key “fuse” paths that will be constrained, be effected by residual congestion by varying degrees, and be effected by tolerance or margin rules differently.

This will cause at least two problems: First it may be impossible to buy onto a fuse path and complete a total schedule because residual congestion or margins have left little ATC to bid on resulting in price being unreasonably high. Secondly, there will be a transition period in which the transmission customers will have to adapt, re-tool and educate their schedulers as to which flow paths are needed and how much to bid for each and all the paths necessary to complete a transaction. This will be a problem especially if many parallel or series paths are required for the transaction. While this problem may be transitional, it will depend on how configured & how many paths and zones there are in the commercial system. If parties are unable to collect enough auction revenues on the paths they have most of their FTR mapped into and the “fuse” paths are highly priced there will be an adjustment time where “rookie” or smaller customers loose out and cannot serve required loads.

Alternatives 2, 3, and 4

See “Discussion Paper: Honoring Pre-Existing Rights in the RTO Environment,” by Carl Imparato

Alternative 5

> Each utility’s regulator would decide whether the utility’s FTRs will be held out of the auction or be put into the auction and sold to the highest bidder. In the investor-owned utilities case, the regulators are the state commissions, for publicly owned utilities the regulators are the locally elected officials. The regulator’s initial decision would be required to be made within 6 months of the receipt of the initial allocation of FTRs. If at any time, the regulator decides to withhold the FTRs from the auction, this decision would have to be reviewed at least every three years.

Much of the argument for requiring all FTRs to participate in the annual auction has revolved around making sure that the utility’s regulator is aware of the value of the FTRs and makes a conscious decision whether or not to participate in the auction. Proponents have argued that the regulator should be allowed to trade off holding FTRs with demand side management, added generation and other alternatives to transmission.

This proposal takes those ideas one step further and gives the decision of whether or not to participate in the auction to the regulator. Each utility's regulator would decide whether the utility's FTRs will be held out of the auction or be put into the auction and sold to the highest bidder. In the investor-owned utilities case, the regulators are the state commissions, for publicly owned utilities the regulators are the locally elected officials.

The regulator's initial decision would be required to be made within 6 months of the receipt of the initial allocation of FTRs. If, at any time, the regulator decides to withhold the FTRs from the auction, this decision would have to be reviewed at least every three years.

<u>Pros:</u>

- Ensures that informed, public and visible decisions are made about the value of the FTRs.
- Requires open and public tradeoffs between FTRs, demand side management & generation.
- Provides opportunity for input to decision making process by interested parties.
- Continues to allow the <u>option</u> for utilities to put all or some of their FTRs into the annual auction.
- Maintains ability of utilities to meet statutory obligation to serve.
- Avoids unnecessary transaction cost of putting FTRs into auction that the utility never intends to sell.
- Ensures the best decision is made for utility's customers.
- FTRs that are truly willing to be sold will go into the market, thereby bringing to the market any liquidity that truly exists.

<u>Cons:</u>

- There may be conflicts between the regulators of different states when allocating the FTRs of a multi-jurisdictional utility.
- Requires participation of interested parties in the proceedings of numerous regulatory bodies.