

**RTO WEST: SUMMARY OF PROPOSAL FOR ENSURING LIQUIDITY IN THE
SECONDARY MARKET FOR FTRs (COM-6)**

[July 24, 2001]

This document summarizes the July 5 proposal for ensuring liquidity in the secondary market for FTRs. [Note: the July 5 document contains additional background information, the rationale for this liquidity proposal, a more-detailed explanation of the proposal and its protections for incumbent rights-holders, and lists additional features related to the mitigation of market power (COM-8).]

If the RTO West flowpath approach to congestion management is to operate effectively, a well-functioning market must exist for the exchange of Firm Transmission Rights (FTRs). For a well-functioning market to exist, there must be: (i) a marketplace in which FTRs can be exchanged at reasonably-transparent prices and reasonably low transaction costs; and (ii) sufficient volume to ensure that FTRs will generally be available to market participants during the time frames in which market participants must make commercial decisions regarding the use of the transmission grid, and sufficient liquidity so that FTR prices are not subject to high volatility stemming from limited supply. RTO West shall ensure that requirement (i) is met by ensuring that an effective FTR marketplace is created, as described in the FTRC-6 paper. Requirement (ii) is addressed in the "liquidity proposal" described below.

Liquidity Proposal¹

1. Transmission contract holders will be preallocated transmission rights as proposed in the RTO West Stage 1 proposal.
2. If insufficient FTRs have been placed into the FTR market (i.e., the RTO-certified Transmission Exchanges - TXs) by the entities who have received preallocations of FTRs, RTO West will require that entities who have received preallocations of FTRs and who do not meet the exemption criteria described below exchange a portion of those FTRs for "FTR Chits." The FTR Chits will entitle the recipient to the rights to receive the auction revenues from the sale of the actual FTRs in the next monthly and/or seasonal FTR auctions.
3. The FTRs acquired by the RTO through the Chits-for-FTRs swap will be made available at the next monthly and/or seasonal FTR auctions. The auctions will be designed to guarantee that holders of the FTR Chits can choose to reacquire, at no net cost, the FTRs that were exchanged in the swap. The FTR Chit-holders will be required to submit explicit bids to purchase the FTRs, just as any other bidders in the FTR auctions; but the auction mechanism will ensure that, in the event of a tie bid, the tie-breaker mechanism would allocate the FTRs to the FTR Chit-holders.²
4. The trigger for the RTO's Chits-for-FTRs swap will be an observed insufficiency of FTRs in the RTO-certified TXs. The trigger will be implemented on a flowpath-by-flowpath basis. I.e., RTO West's swapping of FTR Chits for FTRs on a particular set of flowpaths will be triggered by a low number of offers to sell FTRs on a particular set of flowpaths.
5. The trigger mechanism will operate as follows: One month prior to the next RTO West FTR auction (this could be a semi-annual auction, a seasonal auction or a quarterly auction - as determined in the FTR

¹ This draft acknowledges that there are additional details that must be addressed to complete this proposal. However, these details would not change the proposal's basic concepts.

² Note: this is more a matter of academic interest than a practical issue, since the only parties who could ever afford to submit astronomical bid offers were the FTR Chit-holders. No party that had to pay out-of-pocket for FTRs could afford to submit bids far beyond the expected market value of the FTRs.

Release proposal), RTO West will look back at the period of time since the most-recent RTO West FTR auction.³ For each flowpath: if (i) the number of FTRs for the flowpath that were voluntarily released through the auction was less than 20% of the flowpath's rating and (ii) the average daily quantity of offers to sell FTRs for the flowpath was less than 10% of the flowpath's rating, then non-exempted FTR holders (see Item 7 below regarding exemptions) will be required to swap a portion of their preallocated FTRs in the next FTR auction, so as to bring the level of auctioned FTRs up to the 20% level. Each non-exempted rights holder's obligation to swap Chits-for-FTRs will be pro rata to that rights holder's preallocation of FTRs on the flowpath.⁴

6. The Chits-for-FTRs swap mechanism will be in operation for the first year of RTO West operation. The RTO West Governing Board will be required to make a determination, prior to the second year of RTO West operation, as to whether or not to continue the Chits-for-FTR swap mechanism. The Governing Board will also have the authority to consider modifications to this liquidity mechanism and to implement different tools, including those that may have been found to work in other arenas.
7. The requirement to participate in the Chits-for-FTRs swap will apply to only those entities whose non-participation in the FTR markets would have significant impacts. Therefore, entities that have no alternatives (other than the pre-allocated FTRs) to meet their load service obligations and entities whose mandatory participation in the Chits-for-FTRs swap could not contribute much to market liquidity (because their preallocations of FTRs are small) may opt to be exempted from the Chits-for-FTRs swap.

In order to be eligible for exemption, an entity must meet the following requirements: (i) it has load service obligations only, whether interconnected with the grid or served through the intervening facilities of third parties; (ii) it has few or no alternative means available to meet loads (e.g., full requirements customers, customers at end of the transmission line, etc); (iii) absent a discrete large load (e.g., a mine or mill retail load), its load is relatively small; (iv) it cannot contribute significantly to transmission market liquidity; (v) it is unlikely to have or take advantage of market power.⁵

Exemptions that would be available to entities would extend to a party acting on behalf of such entities (such as a joint action agency, Scheduling Coordinator or other entity), provided that an exemption extended to such a party may only be used to the extent that it is used on behalf of the qualifying entities.

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³ A special procedure will be used for the initial FTR auction, since the RTO will not have historical data to look back upon. One month prior to the initial auction, entities that have been preallocated FTRs will be required to notify the RTO as to how many of their preallocated FTRs they intend to offer into the auction. The RTO shall treat this information as confidential. If, based on this information, the quantity of FTRs that will be made available on a flowpath (by both the RTO and the entities that have been preallocated FTRs) in the RTO's FTR auction will be less than 15% of the flowpath's rating, the RTO will use the Chits-for-FTRs swap mechanism to bring the quantity up to the 15% threshold.

⁴ For example, if a flowpath's rating is 2000 MW, the 20% requirement would require that 400 MW be made available in the next auction. If RTO West would preallocate 1900 MW on the flowpath and release 100 MW to the auction under the preallocation rules; and if entity j was preallocated 600 MW of 1900 MW that were preallocated for that flowpath, entity j's Chits-for-FTRs requirement would be $[600/1900] * [400 - 100]$ MW.

⁵ These are, at this time, rough characterizations. It is acknowledged that further work will need to be done to refine the exemption criteria. It is currently contemplated that these criteria would encompass most, if not all, of the smaller publicly-owned utilities and rural electric cooperatives in the region. If that is the case, it might be efficient for the exemption criteria to simply explicitly recognize these types of entities as eligible to opt for exemption from the Chits-for-FTRs swap.