PRICING PROPOSAL
RESERVE PRICES FOR NEW TRANSMISSION FACILITIES

Background

In Order 2000, FERC includes planning and expansion of the transmission system as one of the minimum functions of an RTO. Therefore it is important that RTO West's pricing methodology have sufficient incentives for making efficient new transmission investments and allow the costs of such facilities to be recovered.

The Stage One RTO West pricing proposal may create a cost recovery problem for new transmission that is built in anticipation of being used to export power outside the RTO, because transmission costs are recovered primarily through load based transmission access charges, with no export charge at the boundaries.

Transmission investment is lumpy. Often the least-cost long-term projects have considerable excess capacity during the early years of their life. In the RTO West proposed congestion management system, this excess capacity will reduce the market price for transmission rights (FTRs, RTRs and NTRs). Thus, the cost of an efficiently sized facility is likely to exceed the revenues generated from the service to load and the sale of transmission rights. This creates an "Excess Cost" which could discourage transmission investments.

FERC requires (FERC regulated) Transmission Providers to construct new facilities to accommodate the requests for transmission service that cannot be accommodated due to congestion on the existing transmission system. However, the PTOs and state regulatory commissions where these facilities are permitted and built may be unwilling to roll the Excess Cost into their Company Rate or pass these costs onto retail customers, particularly when these costs are not being incurred to serve the Company Rate payers or retail customers. And if the Excess Costs are included in Company Rates, they will cause the Company Rates to increase.

The inability to recover Excess Cost or the rate increases caused by Excess Cost will exacerbate a problem that already exists--new generators do not want to buy long-term firm service, because after establishment of RTO West, they and their competitors, some of whom may come on-line after RTO start-up, can get "free access" over unconstrained paths for exports.

The following reserve price proposal is intended to encourage transmission investments that enhance transfer capability by improving revenue prospects for such investments. It can be used both for merchant transmission additions for the life of the project, or for PTO projects included in Company Rates. In the merchant case, there is no intention of rate-basing the investment. For PTO projects included in Company Rates, the proposal is designed to enhance cost recovery from the portion of the project that is surplus to the needs of Company Loads.

RTO West Treatment of Existing Transmission Facilities

RTO West envisions load based payments to cover the fixed (embedded) costs of the transmission system. Existing transmission contract rights and load serving obligations are converted to FTRs by RTO West. These FTRs are not submitted to the RTO auction. All remaining transmission capacity is auctioned as FTRs by the RTO. At preschedule, all unscheduled FTRs are released and by RTO West as RTRs (use it or lose it).

RTO West Treatment of New Transmission Facilities

When RTO West becomes operational, it is envisioned that the parties expanding the transfer capacity will be compensated through the sale of the FTRs created by the addition. (Please Note: Reliability projects (or the portion of transfer-enhancing projects that is allocated to reliability) are added to company rate base.) The transfer-enhancing addition takes place as follows.

First an Open Subscription (Open Season) will be offered for shares of the new paths, with long term FTRs granted to parties financing the project. These parties retain any revenue from the sale of these FTRs.

Second, existing FTRs and new FTRs will be translated to take into account the new flow distribution (FTRs need to be re-mapped because new facilities change historical flow distributions).

Because major transmission projects are in discrete, lumpy sizes, it is expected that there will be an initial overbuild with most major transmission projects. For many years, the FTRs and RTRs associated with such a project can be expected to generate little transmission revenue to compensate the financing parties, because there will be will be no scarcity of FTR/RTRs on the path. A poor cash flow in the initial years of operation would severely reduce the likelihood of major capital projects being built. Perhaps only a load pocket would be willing to build in order to save on power purchase costs.

Reserve Price Proposal

To improve the incentives to build new (or transitional) transmission projects, the financing entities would be allowed to specify a "reserve price" or floor price on FTRs and RTRs associated with new or transitional transmission capacity. In order to insure that transmission capacity is not withheld from the market and that the transmission owner cannot exercise market power, the reserve price could be capped based on the cost of the project. The calculation of the cost-based cap could include consideration of the initial investment, risk factors, and past earnings on the project investment.

The ability to place a reserve price on the new project's FTRs and RTRs may cause some of the capacity to be unused. However, it is important to recognize that the new additions will still benefit all users. In addition to ATC, new transmission projects bring reliability gains and loss savings. When outages occur, both the old and new FTRs may be reduced, but the effect of the reductions should be less severe with more wire. These benefits accrue to all transmission users even if new FTRs and RTRs are unused. Therefore, the RTO rules should encourage transmission additions, not add disincentives.

The reserve price proposal would apply to all additions that were not in service by a specified date (e.g., 12/31/2000, the end of the Transfer Charge test year). Projects being planned and built during the transition to RTOs are available for long term service under current OATT tariffs, if contracted before RTO startup. The service contracted before RTO startup will pay the Company Rate or Transfer Charges, if converted to RTO service. Capacity not contracted for would qualify for the reserve price alternative described above.