NOTE FROM THE FILING UTILITIES
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This revised draft of the RTO West Pricing Proposal is a work-in-progress. It is being posted for further review and comments.

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Revised DRAFT

RTO WEST PRICING PROPOSAL

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A. Background: The Pricing Problem

Designing a pricing proposal that permits transmission owners to recover revenues comparable to those currently recovered from transmission uses in order to avoid substantial price increases and cost-shifting among loads, while improving market efficiency, has proved challenging. The goals of avoiding cost shifts, eliminating pancaking, and promoting economic efficiency by eliminating volumetric charges (other than load charges) to recover fixed costs have proved very difficult to achieve simultaneously.

Finding a method to replace historic short-term and nonfirm revenues has been a particularly vexing problem. At various times, participants in the RTO West process have proposed that some of these costs be (1) charged to historical purchasers as transfer and access charges, (2) left with the PTO to recover in its Company Rate, (3) uplifted to be recovered over all schedules or loads, and (4) charged to future users on a "pay as you go" basis. In addition, an earlier Stage 2 proposal attempted to reduce the size of the problem by assigning revenues from the sale of transmission rights to offset fixed costs and by designing a set of tools to allow the historical purchasers to receive value for their transfer payments. These proposals have met with various criticisms, including cost shifts, disparate treatment according to the type of customer, that some entities would be forced to pay many times the posted price for transmission (at the time they purchased it) because of the continuing transfer charges, that transfer payments would be required from other entities that received no value in return, that future guarantees would be provided to some entities based on aberrational short-term sales in 2000 and 2001, and certain failure because anticipated revenues are not likely to occur. Although different criticisms apply to different proposals and the degree of validity of the criticisms varies, they, and the number of pricing proposals considered, evidence the difficulty of achieving a workable pricing model in an already low-cost region.

Yet the dilemma persists and must be resolved. The filing utilities support each of these pricing goals. Nonetheless, given the utilities' obligations to retail customers, RTO West's pricing scheme must not result in significant cost shifts to those customers. Currently, some RTO West participating transmission owners recover a significant amount of revenue from the sale of short-term transmission. These short-term revenues were $287 million in 2000, of a total gross revenue requirement of $1.6 billion. Thus short-term revenues constituted almost 18% of the participating transmission owners' cost recovery in 2000. In Stage 1, the filing utilities proposed one method to replace these revenues (described below). However, further evaluation of the Stage 1 proposal led to the filing utilities' revisiting the method of recovery of short-term revenues in Stage 2. The pricing proposal presented below returns to the traditional notion of requiring all users, including short-term users, to pay a pro rata share of embedded costs of the RTO West transmission grid. The evolution of the pricing proposal from Stage 1 to Stage 2 is chronicled below.

1. Stage 1 Background

a. Use of Short-Term Transfer Payments To Avoid Cost-Shifting Among Loads

The Stage 1 filing proposed that each transmission owner would pay a transfer charge during the Company Rate period to each of the other transmission owners to replace revenues from short-term use. The transfer payment was equal to the representative levels of pre-RTO short-term firm and nonfirm transmission revenues paid by the participating transmission owners and their affiliates before RTO West's commencement of operations. (The NWPP participants were to pay an access charge calculated in the same manner.) These transfer payments were not accompanied by the assignment of any transmission rights. Instead, they were made solely to avoid cost shifts among transmission owners. In addition to the transfer payments between transmission owners, the Stage 1 proposal assumed that a transmission owner's affiliate merchants would pay an internal transfer charge for pre-RTO short-term and nonfirm transmission service or clear the cost through other internal mechanisms. As the internal transfers could be dealt with as the owners wished, RTO West did not have to come up with a mechanism to deal with these revenues (nearly $160 million in 2000) while avoiding cost shifts.

During Stage 1, the filing utilities recognized that payment of transfer charges by participating transmission owners and a comparable access charge by other Northwest Power Pool (NWPP) participants put the owners and NWPP participants at a competitive disadvantage as compared to new entrants and non-NWPP power marketers that would not contribute to the recovery of embedded costs of the RTO West transmission grid. Today, these customers pay the same short-term and nonfirm rates as transmission owners and other NWPP participants. However, in an imperfect world, the filing utilities found the level of transfer payments and access charges tolerable as a means to avoid cost-shifting among loads.

During Stage 2, this proposal became unacceptable to the filing utilities for several reasons. Based on 1999 data available during Stage 1, the total of short-term transfer payments among participating transmission owners was estimated to be $35,655,166. However, by the end of 2000, that amount had increased to $78,278,222. The transfer charges were simply too high a price for loads to pay as a "charge for admission" to the RTO, particularly when one considers that RTO start-up and operational costs (estimated at $75 million) would impose additional costs on loads. The filing utilities were concerned that such transfer charges imposed significant state regulatory risks and, in some cases, would substantially threaten RTO approval. In other cases, transmission owners argued that the discrimination against transmission owners and NWPP participants as compared to new entrants was not tolerable given the changed cost estimates, particularly because they would not receive any transmission rights for their payments.

b. Payments of Lost Revenue Recovery Amounts To Avoid Cost Shifts

The Stage 1 filing also proposed that lost revenues would be recovered through the RTO West uplift charge that would be imposed on loads or transactions throughout RTO West. (Short-term revenues from customers other than NWPP utilities were referred to as "lost revenues" in Stage 1 because those revenues would not be recovered from these customers under Stage 1.) The lost revenues were expected to be offset in part by excess Firm Transmission Rights revenues from the auction of certain Firm Transmission Rights. This proposal became unacceptable for two reasons. The lost revenue numbers became much larger than anticipated, and there were no offsetting revenues from the sale of Firm Transmission Rights. In 1999, lost revenues were estimated at $12,266,778, and the filing utilities anticipated that the sale of certain transmission assets by Montana Power Company to PP&L Montana would reduce that amount. However, the sale has not been consummated and significant changes in usage patterns on the transmission owners' systems have increased the lost revenues to approximately $43,326,922 in 2000. Worse yet, lost revenues are estimated to be substantially higher in 2001. Moreover, the filing utilities were unable to make the physical rights congestion management model work and therefore switched to a financial option approach to congestion management during Stage 2. The Stage 2 congestion management model may or may not produce excess revenues. Consequently, the premise of the Stage 1 pricing model—that uplifting lost revenues and spreading them to all loads would result in a small incremental charge to loads and insignificant cost-shifting—proved to be false.

2. The Stage 2 Proposal To Replace Short-Term and Nonfirm Transfer Payments, NWPP Access Charges, and Lost Revenue Uplift with a Transmission Reservation Fee

The Transmission Reservation Fee proposal replaces the Stage 1 proposals for transfer payments for short-term firm and nonfirm transmission service, NWPP access charges, and lost revenue recovery charges. This proposal is based on the concept that transmission service that is not covered by existing long-term transmission agreements or existing load service obligations will pay a fee for the right to schedule on the RTO West transmission grid. As a result of this fee, all customers using RTO service will pay some portion of the system's embedded costs. Revenues from the Transmission Reservation Fee will be allocated back to the transmission owners to replace the short-term firm and nonfirm revenues that customers pay today. These revenues will also be used to replace revenues from long-term contracts that expire during the Company Rate Period. In addition, to the extent transmission expansion projects that are expected to be completed before RTO West's start-up are used for short-term service, the transmission owner will receive replacement revenues from the Transmission Reservation Fee. This was not true under the Stage 1 model. Although each transmission owner will bear some risk of underrecovery as compared to the Stage 1 proposal, the owners also may recover a larger credit against their Company Rate revenue requirements from the Transmission Reservation Fee revenues if short-term use of the RTO grid increases. The approach is similar to revenue recovery under Order 888 Open Access Transmission Tariff service, where all uses pay some portion of embedded costs, and transmission customers using the system on a short-term or nonfirm basis pay as they go, thereby producing varying revenues to offset rates that company loads pay.

As described in more detail below, under Transmission Use Service, loads will be able to transmit energy between the same points on the system that they use today under their long-term contracts and load service obligations (including points of receipt and delivery considered primary and secondary under today's tariffs) in exchange for payment of embedded costs through the Company Rate. The Transmission Reservation Fee will not apply to these transactions. Any incremental uses of the RTO West grid outside the scope of existing rights and obligations will be subject to the postage stamp embedded-cost Transmission Reservation Fee and any incremental congestion costs. Thus, as long-term contracts expire more users will pay the postage stamp rate.

For short-term users of the RTO West grid, Transmission Use Service generally will permit use of the entire grid for one postage stamp charge, plus congestion costs. Today, those short-term users frequently pay pancaked rates and are limited to uncongested time periods and paths. For example, an export from British Columbia to the California border today is subject to at least three transmission rates (BC Hydro's, Bonneville Power Administration's network rate, and Bonneville's southern intertie rate) for a total contribution of about $14/MWh to embedded costs of the transmission owners. Under Transmission Use Service, that same export would pay a postage stamp rate estimated at $3.60/MWh for comparable uncongested use. Moreover, the system will be able to accommodate more exports because of RTO West's "accept all schedules" congestion management model, providing that the customer is willing to pay any congestion costs in addition to the postage stamp contribution to embedded costs.

RTO West Transmission Use Service is different from the traditional point-to-point service in a number of respects. The RTO West Transmission Use Service is infinitely flexible to the extent that there is transmission made available through redispatch or transmission expansion. An RTO West Transmission Use Service customer has the right to schedule between any pair or pairs of injection and withdrawal points on the RTO West transmission grid up to the maximum quantity purchased for a designated time period—annually, monthly, weekly, daily or hourly.

B. The Pricing Proposal

RTO West will offer two services: Transmission Use Service and Non-Converted Rights Service. The RTO pricing proposal discussed in this section applies to Transmission Use Service. Non-Converted Rights Service is discussed **infra at ___.**

1. Transmission Use Service

Transmission Use Service provides transmission service from an injection point to a withdrawal point on the RTO West grid. Reservation Rights are required of any customer taking Transmission Use Service in order to schedule transactions. There are two kinds of Reservation Rights: (1) Unrestricted Reservation Rights and (2) Historical Reservation Rights. Unrestricted Reservation Rights allow a party to schedule between any injection and withdrawal points on the RTO West grid in exchange for the payment of a Transmission Reservation Fee (described below) or to purchase the rights in a secondary market. Historical Reservation Rights allow a party to schedule between designated injection and withdrawal points. Historical Reservation Rights are available to parties who convert Pre-Existing Transmission Agreements to Transmission Use Service and are limited in scope to the transmission use options catalogued by the RTO based on the party's Pre-Existing Transmission Agreement(s). As set forth in the description of the Transmission Reservation Fee below, the fee does not apply to customers submitting a schedule using Historical Reservation Rights, because those customers are paying for the service either through a Company Rate or a Transfer Payment. (See descriptions below.) All schedules submitted for use of the RTO West grid not accompanied by Historical Reservation Rights must be accompanied by Unrestricted Reservation Rights. Thus a customer that wishes to schedule service outside the scope of any Historical Reservation Rights must acquire Unrestricted Reservation Rights.[1] Thus, as long-term contracts expire and loads access more generation outside the scope of their pre-existing rights, the number of transactions at the postage stamp rate should increase.

The filing utilities propose to recover all costs of congestion management through a separate charge. Consequently, a customer with Reservation Rights remains responsible for congestion costs to the extent those costs are not offset by a Financial Transmission Option. (See section ___.) The RTO costs of providing ancillary services will also be recovered through separate charges. The pricing methodology for ancillary services is not yet finalized (and is not addressed in this document).

The RTO start-up and operation costs will be collected through a Grid Management Charge levied on all transactions. (See description below.) Payments for Non-Converted Rights Service and Transfer Payments will also be collected and treated as revenue credits to the Company Rate. The remaining costs of ownership and operation of transmission facilities will be recovered through two charges, the Company Rate and Transmission Reservation Fee. The Company Rate is load-based and calculated on the basis of each Participating Transmission Owner's revenue requirement with adjustments. (See description below.) The Transmission Reservation Fee is a postage stamp $/kW charge for a year, month, week, day or hour based on the embedded cost of the entire RTO West grid. Revenues from the Transmission Revenue Fee are treated as a Company Rate revenue credit through the use of a balancing account. As a result, the Company Rate will be adjusted at least annually to true-

[1] Although several parties submitting comments have urged that a load paying the Company Rate never be required to pay the Transmission Reservation Fee, loads today pay an additional contribution to the embedded costs of the system when accessing generation requiring transmission outside the scope of existing transmission rights. Consequently, there would be a significant reduction in the revenue credit to Company Rates and a corresponding

up the Company Rate to the actual allocated Transmission Reservation Fee revenues, thereby avoiding any double-charging or over-collection of embedded costs of the system.

Each rate component of the pricing model designed to recover embedded costs of the participating owners and start-up and operational costs of RTO West are described below. Although pricing for congestion costs (as well as pricing for ancillary services and losses) is being developed separately, a discussion of the relationship between the Transmission Reservation Fee and congestion costs is also set forth below.

a. Grid Management Charge

The Grid Management Charge will be calculated to recover all the RTO West start-up and operation costs, including the annual costs of RTO facilities not included in Company Costs and RTO West operating costs (other than the costs of clearing congestion and providing ancillary services). The Grid Management Charge will be paid on a $/MWh basis for all schedules (whether from generation within the RTO West Transmission System or imports or through wheeling) and is applied at the point of injection on the RTO West Transmission System.

b. Company Rate

Through December 14, 2011, the loads served by each of the filing utilities will pay a load-based access charge for RTO West transmission service equal to the transmission costs of such filing utility, adjusted for revenues from long-term transfer charges, any non-converted service payments (if a customer is not paying the Company Rate), and allocated Transmission Reservation Fees, as set forth in

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rise in the Company Rate if such short-term users were not required to pay the Transmission Reservation Fee.

items c through h below. The Company Rate formula is set forth in Exhibit G to the Transmission Operating Agreement, a copy of which is [**will be]** attached hereto.

c. Transfer Charge

Transmission customers may convert their pre-existing long-term transmission agreements with participating owners and take Transmission Use Service in return for Financial Transmission Options and Historical Reservation Rights, or transmission customers may retain their pre-existing transmission rights under long-term agreements and receive Non-Converted Rights Service. Such converting transmission customers, in turn, would be obligated to pay Company Rates or Transfer Charges to the former transmission provider for such portion of the Company Rate Period as the Financial Transmission Options and Historical Reservation Rights remain in effect. Any transfer charge will be in an agreed amount comparable to the amount estimated as payable under the pre-existing agreements absent RTO West. The agreed amounts for long-term transfer payments are specified in **Exhibit ______**. [Note: The transfer payments are proposed to be based on the year before the RTO commences service. Thus they will not be filed with the March 1 filing.] Comparable contract suspension arrangements will be offered to all parties (participating owners in their capacity as transmission customers and others) holding agreements for long-term transmission service.

d. Transfer Charge Adjustment

Long-term transfer charges among the transmission owners generally are not adjustable for changes in loads, as most of the underlying contracts do not allow for an increase in service for load growth. Transfer charges among transmission owners may be adjusted, however, to the extent the preexisting rights provide transmission service for load growth. An example of such rights would be some of the General Transfer Agreements. For converted agreements, additional Historical Reservation Rights and Financial Transmission Options on an owner's transmission facilities will be provided for growth of loads served pursuant to these agreements, up to available capacity.

A number of Bonneville customers also expressed concern that the unit costs of Bonneville transmission might substantially increase during the Company Rate Period, without any provision for a corresponding increase in a transfer charge. To allay such concerns, the Transmission Operating Agreement permits a participating transmission owner to make an initial election that any transfer charge increase or decrease if its <u>unit</u> transmission costs increase or decrease. For a participating transmission owner so electing, the adjustment (1) will be made only upon a filing for a change in its Company Costs, (2) will be based on actual transmission costs during a historical period and pursuant to a formula determined by RTO West, and (3) will apply only to a transfer charge for pre-RTO agreements that had adjustable charges.

e. Transmission Reservation Fee

Payment of the Transmission Reservation Fee provides access to the RTO West transmission grid, that is, Unrestricted Reservation Rights to schedule megawatts between any pair or pairs of injection and withdrawal points on the grid up to the maximum quantity purchased for a designated time period. For example, if an eligible customer purchases 100 MW for a week's duration, that customer may schedule up to 100 MW over any combination of injection and withdrawal points each hour of the week. Unrestricted Reservation Rights are offered in strips with the same quantity of megawatt-scheduling rights available each hour. The quantity of Unrestricted Reservation Rights the RTO will sell is unlimited, consistent with the "accept all schedules" congestion management model.

RTO West will facilitate a secondary market for resale of Reservation Rights. The secondary market price is capped at the applicable access charge paid by the seller (yearly, monthly, daily or hourly) and may be discounted. Because the supply of Unrestricted Reservation Rights is unlimited, the secondary market is likely to discount the price for Reservation Rights.

f. Financial Transmission Option Credit

A customer paying the Transmission Reservation Fee also receives a credit in the dollar amount of the payment, which may be used to offset the cost paid for Financial Transmission Options in the day-ahead auction (FTO Credits). The FTO Credits may be used at any time during the time period for which the strip of Unrestricted Reservation Rights was purchased. For example, the total payment for a monthly Transmission Reservation Fee strip could be used to cover the cost of Financial Transmission Options for a single day during that month. The credit may be used only in the day-ahead auction and not in annual, monthly, or any other auction of financial options or to cover charges for congestion.

FTO Credits and Unrestricted Reservation Rights may be remarketed together or independently of each other. As a result, Unrestricted Reservation Rights on the secondary market may or may not be accompanied by the FTO Credit.

The day-ahead Financial Transmission Options auctioned by the RTO will be limited to the unencumbered physical capacity of the RTO West grid. By limiting the day-ahead auction to the unencumbered physical capacity of RTO West's grid, the RTO should not experience any incremental congestion costs based on the sale of Financial Transmission Options in the day-ahead market. Thus the Transmission Reservation Fee revenues should be available for allocation to Participating Transmission Owners as a surrogate to short-term historical revenues, thereby benefiting Company Loads. An underlying assumption is that there is value in acquiring Financial Transmission Options in the day-ahead auction. RTO West will continue to accept all schedules day-ahead or real-time (subject to the ability to obtain redispatch). Thus, potential buyers of Financial Transmission Options in the day-ahead auction will face uncertainty about the real-time congestion costs because of the "accept all schedules" regime's effect on real-time prices. This should create a demand for day-ahead Financial Transmission Options.

g. Calculation of the Transmission Reservation Fee

The Transmission Reservation Fee is estimated below. The actual charge will be based on updated revenue requirements of participating owners and loads used in the calculation of Company

Rates. RTO West will adjust the Transmission Reservation Fee annually to reflect any changes in the FERC-approved revenue requirements for participating owners and any changes in the total 12 CP loads within RTO West, plus exports.

The estimated charge for a yearly strip of Unrestricted Reservation Rights is calculated as follows:

$$\frac{\text{Sum of PTOs' Annual Transmission Revenue Requirement}}{\text{Total 12 CP Loads plus Exports}} \times 0.9$$

$$\frac{\$1{,}590{,}697{,}413}{[\approx 45{,}658 + \approx 4{,}500]} \times 0.9 = \$28.54\ /\text{kW-yr}$$

The estimated charge for a monthly strip of Unrestricted Reservation Rights is calculated as follows:

$$\frac{\text{Sum of PTOs' Annual Transmission Revenue Requirement}}{[(\text{Total 12 CP Loads plus Exports}) \times 12\ \text{months}]} \times 0.93$$

$$\frac{\$1{,}590{,}697{,}413}{[(\approx 45{,}658 + \approx 4{,}500) \times 12\ \text{months}]} \times 0.93 = \$2.46\ /\text{kW-mo}$$

The estimated charge for a weekly strip of Unrestricted Reservation Rights is calculated as follows:

$$\frac{\text{Sum of PTOs' Annual Transmission Revenue Requirement}}{[(\text{Total 12 CP Loads plus Exports}) \times 52\ \text{weeks}]} \times 0.97$$

$$\frac{\$1{,}590{,}697{,}413}{[(\approx 45{,}658 + \approx 4{,}500) \times 52 \text{ weeks}]} \times 0.97 = \$.592/\text{ kW-wk}$$

The estimated charge for a daily strip of Unrestricted Reservation Rights is calculated as follows:

$$\frac{\text{Sum of PTOs' Annual Transmission Revenue Requirement}}{[(\text{Total 12 CP Loads plus Exports}) \times 365 \text{ days}]}$$

$$\frac{\$1{,}590{,}697{,}413}{[(\approx 45{,}658 + \approx 4{,}500) \times 365 \text{ days}]} = \$.087/\text{ kW-day}$$

The estimated charge for an hourly strip of Unrestricted Reservation Rights is calculated as follows:

$$\frac{\text{Sum of PTOs' Annual Transmission Revenue Requirement}}{[(\text{Total 12 CP Loads plus Exports}) \times 8{,}760 \text{ hours}]}$$

$$\frac{\$1{,}590{,}697{,}413}{[(\approx 45{,}658 + \approx 4{,}500) \times 8{,}760 \text{ hours}]} = \$\ .00362\ /\text{kWh}$$

The above formulas provide incentives to purchase longer-term service by providing a 10% discount for annual service, a 7% discount for monthly service, and a 3% discount for weekly service.

In the rare event of curtailment of schedules, RTO West will rebate an amount equal to the hourly charge multiplied by the quantity of megawatts curtailed. The “accept all schedules” congestion management model should ensure this happens very infrequently.

h. Transmission Reservation Fee Revenue Allocation

The revenue credit to the Company Rate will be the sum of (1) all Transmission Revenue Fee revenues paid by a participating owner's merchant function to the RTO for use of its RTO West Controlled Transmission Facilities for transactions that could have been accommodated pre-RTO by using only its own system (Note: essentially this means that load growth on one's own system is not charged a Transmission Revenue Fee, as it can be accommodated by the existing system and rights), and (2) the participating owner's allocated share of Transmission Revenue Fee revenues paid to the RTO for all uses other than a merchant's use of its affiliated owner's RTO West Controlled Transmission Facilities.

The reference year for the determinations of a participating owner's allocation will be the last full calendar year before RTO West commences service. A participating owner's allocated share of Transmission Revenue Fee revenues will be based on the participating owner's relative share of the sum of the following:

(1) Reference year revenues from short-term and nonfirm use between (a) Participating Transmission Owners and (b) third-parties and Participating Transmission Owners;

(2) Revenues from expiring long-term contracts. "Revenues from expiring long-term contracts" is the amount, if any, by which long-term contract revenues fell below reference year long-term contract revenues.

Revenues from the Transmission Reservation Fee paid by an affiliated merchant for transactions over more than one participating owner's RTO West Controlled Transmission System will be allocated based on the methodology above. However, RTO West will directly allocate revenues generated through the application of the Transmission Reservation Fee to the merchant's use only of its affiliated owner's RTO West Controlled Transmission. This direct allocation will reduce its Company Rate. [Merchant affiliation will be defined in this document or another RTO document.] This also allows load growth on one's own system capabilities and pre-existing rights to be accommodated without payment of an additional Transmission Reservation Fee. The load paying a Company Rate has paid for this existing transmission capability already. It also greatly simplifies the RTO West's task of avoiding cost shifts that could arise among the participating transmission owners with the inclusion of revenues from their internal use of transmission in the allocation formula. In 2000, total short term payments to all the participating transmission owners totaled approximately $287 million. Of that amount, $160 million was payments by merchants to their affiliated transmission owners. These payments typically were part of a pancaked wheel to an off-system sale (as own-system wheeling was usually covered by network load service). On these off-system sales, the internal merchant payments do not change the profitability of a transaction, only the allocation of revenue between a company's merchant and transmission function. The RTO will have difficulty designing a mechanism to collect these revenues and redistribute the money without shifting costs and profits, particularly as there is wide variation in the amounts paid by internal merchants for such use. Some owners rely on long-term rights and others short-term transmission. For example in 2000, Bonneville's Power Business Line payment to its Transmission Business Line was over $33 million and Idaho Power Company's payment was approximately $13 million; whereas PacifiCorp's and Portland General's merchants used less than $120,000 of short-term transmission on their systems. If reference year internal payments were included along with other Transmission

Reservation Fee revenues to calculate a transmission owner's pro rata share of Transmission Reservation Fee revenues, over one-half of the Transmission Reservation Fee allocation would be based on internal merchant payments. What had been an internal company allocation of revenues now drives nearly 60% of the RTO's short-term allocation. As a result, merchants that rely heavily on short-term use of their affiliated owner's transmission systems, would receive a higher percentage allocation of Transmission Reservation Fee revenues than other participating transmission owners. For example, Montana Power Company's allocation of Transmission Reservation Fee revenues is 13.8%, based on lost short term revenues from other participating transmission owners and third parties in 2000, and PacifiCorp's is 19.4%. However, if the internal merchant revenues are included in the formula, Montana Power's share of the allocation falls to 7.3%, and PacifiCorp's falls to 8.6%. The cost shifts among participating transmission owners that would result from inclusion of revenues from internal Transmission Reservation Fee payments in the allocation formula are not appropriate or necessary. By directly allocating Transmission Reservation Fee revenues for merchants' use of their affiliated transmission system and using the resulting revenue credit to reduce the Company Rate, the allocation formula assures each participating transmission owner of the opportunity to recover its equitable share of short term transmission revenues generated through use of its system by other participating transmission owners and third parties. This accomplishes the primary goal set in Stage 1 of avoiding cost shifts through the loss of short-term revenues by providing those revenues directly from internal merchants and allocations of revenues among participating transmission owners, while establishing a postage stamp rate for short-term transmission use.

Summary of Rationale and Problems Solved

Our proposal attempts to ensure that all users of the RTO's transmission system pay a fair share of the embedded costs of the system and attempts to avoid shifting responsibility for sunk costs from some users to the loads. This is necessary to avoid shifting costs among the RTO West filing utilities in a manner that is unacceptable and might well prevent some owners from participating voluntarily in RTO West. While we recognize that this pricing proposal may not be as efficient as some other models, it combines improvements in economic efficiency with rate design measures to avoid large cost shifts, at least during the transition stages of RTO West.

The pricing model more closely integrates the pricing and congestion proposals to allow traditional short-term transmission users the ability to obtain more "value" for the reservation payments. One complaint we have heard is that the reservation fee and congestion costs together represent a cost that is too high. This assumes that some users should pay a smaller portion of sunk costs or be exempt from paying any portion of sunk costs. Even assuming this is correct, our proposal gives short-term users FTO Credits that can be used to bid for Financial Transmission Options in the day-ahead auction. By effectively reducing the price users pay for Financial Transmission Options in some circumstances, we believe that we have at least partially addressed the concern raised.

In addition, there is the possibility that the auction revenues from the sales of Financial Transmission Options will exceed the RTO's costs of redispatch and administering the congestion management model. If so, RTO West may decide whether to apply some or all of those revenues to reduce the Transmission Reservation Fee or to use the revenues for another purpose, such as offsetting the Grid Management Charge. This flexibility provides RTO West a means of lowering the Transmission Reservation Fee in the event it believes that is the highest-priority use for Financial Transmission Option revenues.

C. RTO West Losses Methodology

RTO West proposes a bifurcated method to recover losses through the Company Rate Period.

1. For Non-Converted Transmission Agreements, continue to charge loss factors of the existing participating transmission owners.

Because this is Non-Converted Rights Service, the RTO would know which participating owner's system is being used by each schedule and would charge the customer the participating owner's individual loss factor(s). This methodology is included in the RTO West filing as part of the pricing proposal agreed to through December 14, 2011, the end of the Company Rate Period.

This methodology ensures existing rights holders that the RTO losses methodology will not produce cost shifts for their Non-Converted Transmission Agreements.

2. For converted service and new service, the filing utilities will not develop a specific losses methodology before selection of the independent RTO West Board. Instead, principles have been developed to guide the Board in developing a losses methodology, and the principles will be specified in the participating owners' agreements with the RTO. The primary rationale for this approach is that little work has been done to date on a losses methodology, making it very unlikely that a

methodology could be developed in time for the March filing, given the complexity involved.

The principles to guide the RTO's development of a losses methodology are:

- Avoid cost shifts;
- Recover actual losses;
- Allow the customer to choose between providing losses (concurrently) and buying losses at the imbalance price;
- Eliminate pancaking;
- Send appropriate price signals about resource/load location and operation; and
- Let the customer know the loss factor associated with a particular transaction before submitting a schedule. Loss factors should not be computed after the fact.

The losses methodology proposed by RTO West will be subject to review and approval by FERC.