Pricing Work Group Report

May 27, 2005
RRG Meeting

Today the Pricing Work Group will focus on two areas:

- Ideas for pricing new long-term service
- Ideas for a revenue replacement mechanism for transmission owners' "lost revenues" (if the revenue loss is due to Grid West implementation)
- Work on other issues (some of which have had preliminary discussion at RRG) is ongoing

RRG Feedback

The Pricing Work Group seeks feedback from the RRG concerning which ideas outlined today it should carry forward into its pricing proposal white paper.

Pricing New Long-Term Service; Some Background

- A fundamental principle of Grid West is honor all existing contracts
- Those who wish to maintain their current rights may do so, as long as
  - their transmission agreements or obligations give them the right to continue receiving service (or they are subject to an obligation to serve native load) AND
  - they continue to pay for those rights

Pricing New Long-Term Service; Background (cont'd)

- The revenues paid under continuing legacy service will go directly to the legacy transmission providers, not to Grid West
- Accordingly, most transmission revenue for Grid West transmission owners will come from payments under "legacy" arrangements (service to native load, transfer payments among transmission owners, payments under pre-existing transmission agreements)

Pricing New Long-Term Service; Background (cont'd)

- Paying for existing rights maintains those rights as they are – Grid West will neither expand nor diminish the reach of customers' existing rights
  - This contrasts with the RTO West Stage 2 proposal (loads that paid their share of a transmission owner's fixed cost gained the ability to schedule anywhere on the combined system)

Ideas for Pricing New Long-Term Service

- What is "new long-term service"?
  - Brand-new service
  - Expansion of service beyond the terms of existing arrangements

Ideas for Pricing New Long-Term Service

- o New long-term service is **NOT**
  - Continuation of existing service where a party with existing rights (providing for rollover) has exercised the rollover option
  - A utility's increased use of capacity on its own system (or addition of a capacity on its own system) to meet growing load that it is obligated to serve

What is New Service?
Example 1

Say:

- o A load ("Customer") on Utility A's system has an NT contract with Utility A (and the NT contract provides for load growth)
- o Customer's load grows from 60 MW to 65 MW
  - Customer's increased use of transmission on Utility A's system under the NT contract would **NOT** be new service; it would be a **continuation of existing service** because the contract allows for load growth that is satisfied using Utility A's system.

What is New Service?
Example 2

Now say:

- o Customer of Utility A system wants to serve part of its 65 MW load from a 10 MW generator located on Utility B's system
- o Customer maintains its NT rights on Utility A's system and can use transmission service on Utility A's system necessary to meet its full 65 MW load from resources on Utility A's system

What is New Service?
Example 2 *(cont.)*

- o BUT, to get power from Utility B's generator, Customer will need to buy a new IWR for 10 MW (injection point at the generator, withdrawal at point of integration under the NT contract with Utility A)

  - The 10 MW IWR is **new service**

What is New Service?
Example 3

Say:

- o A new entity begins conducting business in the Grid West “footprint.”
- o The new entity:
  - is a load
  - owns or has long-term rights to the output from resources to serve its load
  - qualifies as an eligible transmission customer under FERC rules
  - wishes to obtain long-term transmission service to deliver resources to its load

What is New Service?
Example 3 *(cont.)*

- o The new entity could request from Grid West either point-to-point service (an IWR "pair") or network service (an IWR "constellation")
  - ▪ The service this entity receives from Grid West (whether possible from existing facilities or requiring some upgrade or expansion) would be **new service**.

What is New Service?
Example 4

- An existing generator in the Grid West footprint that currently serves local load enters into a new long-term contract to sell its output to a load on the Cal ISO system
- The generator requests a long-term IWR from its location (injection point) to the boundary between the Grid West system and the Cal ISO system (withdrawal point)
  - The service from the generator to the Grid West system boundary would be **new service**.

Proposed Types of New Long-Term Service

- What types of new long-term service does the Pricing Work Group propose for Grid West to offer?
  - **IWR pairs** (like today's point-to point)
  - **IWR "constellations"** for network service (like today's NT, including restrictions)

Four Ideas for Pricing New Long-Term Service

Reminders:

- Pricing ideas presented for feedback today refer **ONLY** to new long-term service that can be granted from existing transmission facilities
- The TSLG expects that most requests for new long-term service WILL require upgrades or expansions

Criteria for Evaluating Pricing Ideas

- Reduce or eliminate pancaking
- Avoid or mitigate cost-shifts
- Provide revenue sufficiency for transmission owners
- Compatibility with Grid West Operational Bylaws
- Compatibility with Grid West market design

Pricing Ideas

- Idea 1: Long-term IWRs are priced by withdrawal point

- Idea 2: Long-term IWRs are priced at the higher of injection or withdrawal point

Pricing Ideas *(cont'd)*

- Idea 3: Long-term IWRS on a single system pay the "local" system's rate; multi-system IWRs pay the system average rate (but not additive)
- Idea 4: Long-term IWRs pairs (point-to-point) are auctioned; IWR constellations (network) are sold at system-wide average

Pricing Ideas

RRG feedback:

Which ideas should be further developed for the Pricing Work Group white paper?

Revenue Replacement Mechanisms

- The Pricing Work Group has refined the concept of **"lost revenues"**
- Lost revenues (attributable to Grid West implementation) could occur for two reasons:
  - Transmission owners no longer sell new transmission service (short- or long-term)
  - Multi-system rights that would have been sold by multiple transmission owners at "pancaked" rates will be sold by Grid West at a single rate

Revenue Replacement Mechanisms

- o Transmission Owners no longer sell new transmission service (short- or long-term)
  - For transmission owners that used to sell short-term or nonfirm, revenue loss occurs on "Day 1"
  - There is no revenue loss related to long-term sales until an existing contract expires (transmission owner doesn't get to "resell" the freed-up capacity)
  - These revenue losses could be tracked on an individual transmission owner basis

Revenue Replacement Mechanisms

o De-pancaking

- Grid West will allocated revenues from new long-term service to transmission owners, but de-pancaking will almost always result in a net loss of revenue compared to what pancaked charges would have produced
- In most cases, it will also cost the transmission customer less to purchase these multi-system rights

Lost Revenues Related to Expiring Long-Term Contracts

- The Pricing Work Group does not expect that a high proportion of existing service agreements that could roll over will be allowed to expire
  - Expected exception: NorthWestern Energy's current long-term point-to-point transmission service agreements (and perhaps a few of its NT service agreements)
  - Remember transfer payment requirements for transmission owners

Fixed Cost Recovery

- A way to look at fixed cost recovery under Grid West – three "layers"
  - Layer 1: "Legacy" payments
    - Native load service
    - Transfer payments among transmission owners
    - Payments under existing long-term agreements between transmission owners and non-transmission owners

Fixed Cost Recovery *(cont.)*

- Layer 2: Revenue allocation from Grid West sales of new service
  - Grid West will receive revenues when it sells new service from existing AFC
  - Grid West will sell short-term AFC through the Reconfiguration Service
  - Grid West will sell long-term AFC through requests for new long-term service (unless the proposal to auction long-term rights is adopted)

Fixed Cost Recovery *(cont.)*

- Layer 2 (cont.)
  - The Pricing Work Group proposes to aggregate all revenues from Grid West AFC sales (short-term and long-term) in a “communal bucket” to be shared among transmission owners
    - Allocation approach to be decided later by the Grid West Developmental Board

(Note - new short-term and long-term service will be in the form of IWRs)

Fixed Cost Recovery *(cont.)*

- Layer 3: If needed, Regional Revenue Requirement Adjustments ("R^3A")
  - R^3A would be activated if some (or all) transmission owners have remaining "lost revenues" after receiving all layer 1 and layer 2 revenues

Fixed Cost Recovery – Contribution from Exports

- o The Pricing Work Group does not expect a separate methodology for charging exports
- o Export transactions will contribute to fixed cost recovery because export transactions will require:
  - Pre-existing long-term rights to the export point
  - Short-term rights (IWRs obtained through the Gird West RCS) to the export point
  - New long-term rights (IWRs obtained from Grid West, with applicable embedded or incremental cost pricing) to the export point

Replacing Lost Revenues

- Lost revenues attributable to the existence of Grid West include:
  - discontinuing transmission owner sales of short-term and nonfirm service
  - discontinuing transmission owner sales of new long-term service
  - effects of de-pancaking

Replacing Lost Revenues

- Lost revenues attributable to the existence of Grid West would **NOT** include:
  - failure to seek appropriate retail regulatory relief
  - failure to file updated OATT rates at FERC
  - shortfalls not related to transmission
  - decreased earnings or increased costs resulting from normal business risks

Replacing Lost Revenues

Members of the Pricing Work Group think

- The Grid West lost revenue replacement mechanism should not operate to cause the region to make up costs that regulators have not recognized
- Transmission rates for transmission owners should be up-to-date (accurately reflect current costs of service) when Grid West begins operations

Replacing Lost Revenues

- The Pricing Work Group has two ideas about how R^3A funds could be generated:
  - Idea 1: Transaction-based charges (a.k.a. "peanut butter" – energy schedules or usage)
    - These charges would be established and posted ahead of time (not after-the-fact backcharging)
  - Idea 2: A charges assessed to each transmission owner in proportion to each transmission owner's share of the system-wide peak load
    - This might tend to track more closely with embedded costs

Replacing Lost Revenues

- What if there are surplus AFC revenues?
  - If revenues from layers 1 and 2 are *more* than the transmission owners' revenue requirements, surplus funds could be credited back using the same formula for generating R^3A funds
- Fine Tuning
  - We could have rules about a "bandwidth" of tolerated under- or over-recovery before an R^3A mechanism kicks in
  - We could require reserving some portion of surplus to provide a "cushion" against possible future lost revenues

Potential Lost Revenues

- o How much "lost revenue" will need to be replaced?
  - It depends …
  - Even in a "worst-case scenario," transmission revenue dependent on AFC sales (might be "lost") is small in comparison to total annual transmission revenue requirement for combined system
    - The problem is bigger for NorthWestern Energy than for others
    - Potential lost revenues not necessarily small compared to total revenue earned by Grid West from AFC sales

Potential Lost Revenues

- What do we mean by “it depends”?
  - We know or can estimate:
    - Approximately how much transmission owners earned from short-term and non-firm service in 2003
      - (about $40 million)
    - Approximately how much annual revenue is associated with existing long-term contracts that might expire (not roll over) in the next 10 years
      - (in the ballpark of $80 million)

Potential Lost Revenues

- We do **NOT** know:
  - How much revenue will be generated from Grid West RCS sales
    - We don't know how much AFC will be sold through the RCS and we don't know the prices at which the rights will be sold
  - How much additional long-term service Grid West will be able to sell from existing capacity (even without capacity from expired long-term contracts), especially given a new flow-based methodology

Potential Lost Revenues

- We do **NOT** know (cont'd):
  - Where new requests for long-term rights will be be located (this could affect the rates that apply to the new rights)
  - How many contracts that *could* be allowed to expire actually *will* be allowed to expire
    - In a physical rights system, those with existing long-term rights will have important reasons to maintain them rather than letting them expire with the hope of re-acquiring necessary rights through the Grid West Reconfiguration Services or long-term queuing system (certainty, in particular)

Potential Lost Revenues

- We do we mean by “worst-case scenario”?
  - A “worst-case scenario” would assume
    - all long-term contracts that might expire any time in the 10-year example period all expired on “Day 1”
    - no incremental revenues generated by Grid West through new short-term or long-term AFC sales
  - Pricing Work Group members do not think these are realistic assumptions

Potential Lost Revenues

- o Concerning potential revenue loss from existing long-term agreements that might expire:
  - These contracts *will NOT* expire all at once on “Day 1,” so any effects will evolve over time

Questions?

Comments?

Suggestions?