Department of Energy

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EXECUTIVE OFFICE

December 22, 2004

In reply refer to: R-3

To: Our Customers and Interested Parties

Subject: Close Out on Grid West Bylaws

After careful and deliberative consideration, the Bonneville Power Administration, along with all eight other Grid West utilities, decided to support the approval of the Grid West Developmental and Operational Bylaws. The RTO West board subsequently voted to restructure RTO West into Grid West by adopting revised articles of incorporation and the Grid West Developmental Bylaws. The restructured corporation will continue as a nonprofit organization under Washington State law. This action will enable the region to focus on and refine the more limited Grid West framework.

I want to emphasize that the decision to further develop the Grid West concept is *not* a decision to seat the Grid West developmental board or to enter into any agreement with Grid West. A decision whether to seat the developmental board would probably occur in mid 2005, based on review of the additional work that needs to be done. BPA and the other eight filing utilities are under no obligation to negotiate or sign transmission agreements (TA) with Grid West at this point. Those decisions, which are necessary to make Grid West operational, cannot be considered until two more years of development work on the proposal are completed.

However, this is a decision to develop a sufficiently detailed Grid West design and better assess Grid West's costs and its ability to deliver the potential benefits it promises. At this stage, Grid West has very limited authorities. If its further development is successful and shows net benefits to the region, then a decision could be made to seat the developmental board and in about two years, Grid West could offer TAs to regional transmission owners to operate their portions of the regional transmission grid and to plan for needed grid expansion.

Potential benefits may be substantial but are uncertain

Neither the costs nor the benefits of Grid West can be well understood without a more complete understanding of the technical elements of the services Grid West would offer. These technical elements can be developed now that the ground rules under which Grid West would operate – its organizational bylaws – are established.

We believe there is a substantial potential for benefits to be gained by establishing a common transmission operator and planner for the Northwest grid. The next step of Grid West development will give us an opportunity to test and evaluate whether these benefits outweigh Grid West costs. The potential benefits include:

- System-wide "one utility" planning for grid expansion supported by a "planning backstop." Grid West could contract to build transmission should transmission owners fail to build facilities needed for reliability.

- Voluntary consolidation of control areas. This would improve reliability and the efficiency of providing required ancillary services.

- Management of congestion on the grid. This could achieve more economical voluntary redispatch of generation and less curtailment of transmission schedules.

- Management of available transmission capability (ATC). This could replace the diverse and inconsistent methods now used by individual transmission owners and increase total availability grid-wide.

- Market monitoring. This could provide effective grid-wide detection of market abuses.

- "One stop shopping" for transmission service. This could ease and simplify access to the multiple services users frequently need in order to do business across the region. Users would reserve ATC and purchase related transmission services on a single OASIS website.

Primary reasons for moving forward

BPA reached its decision to support establishment of Grid West bylaws for two primary reasons.

First, BPA believes an independent entity has great potential to solve the transmission problems identified last year by the Regional Representatives Group (RRG), a broad forum for Northwest transmission stakeholders. Some of these identified problems included underutilized capacity, access and service issues, and infrastructure and cost recovery issues. Most in the region agree these and other problems identified need to be addressed and have not been addressed by the current institutional structure in the Northwest.

Put simply, an independent entity is probably necessary to define the need for new transmission projects and allocate the costs, get the most ATC out of the system as possible, distribute it equitably, and improve reliability. In our view, purely voluntary organizations have a place, but alone have not proven to be sufficient to solve the region's very real transmission problems.

Second, the bylaws, as amended, appear workable. Significant changes that BPA sought in the drafts of the bylaws in the past few months improved their workability and strengthened the Grid West board's accountability to the region's interests, without compromising the board's independence from market participants. Cost controls were added to significantly reduce the likelihood of unacceptable cost increases.

Public review of draft bylaws extensive, effective

After the RRG released draft Grid West bylaws in early July, BPA solicited public comments on them from July through September 2004. BPA received comments from over 65 entities including state public utility commissions, public power customers, members of the Northwest congressional delegation, public interest groups and other interested stakeholders.

Simultaneously, BPA sponsored a review of the proposed Grid West governance structure by the National Academy of Public Administration (NAPA), an independent, nonprofit organization chartered by Congress to identify emerging issues of governance. NAPA found that "the operational bylaws have struck a reasonable balance between regional accountability and independence and that the bylaws, taken as a whole, are workable." NAPA made a number of recommendations to improve regional accountability and workability.

The Bylaws Workgroup of the RRG also explored the governance structures of transmission organizations in other parts of the country. The workgroup questioned representatives of three regional transmission organizations and focused primarily on mechanisms for board accountability, cost control and member representation.

Based on public comments, NAPA's review and the assessment of other transmission organizations, BPA presented to the RRG a list of 35 recommended revisions to the draft bylaws to strengthen regional accountability, cost control and workability. Subsequent bylaws amendments resolved the vast majority of these issues in a manner satisfactory to BPA.

Some of these changes include:

- Requiring that members affirmatively vote for implementing Grid West before it may become operational.
- Adding a budget committee composed primarily of members to develop and propose Grid West budgets.
- Making it easier to elect and remove members of the board.
- Increasing the voting representation of states and provinces.
- Allowing members to require a supermajority vote of the Board of Trustees before adopting a major change in policy, scope or budgets that the members do not support.
- Removing bylaws provisions many felt showed a bias in favor of financial transmission rights.
- Decreasing the influence of marketers and brokers who have no significant ties to the region.

The changes came at the end of more than a year's study of these bylaws by BPA and other members of the RRG. In BPA's view, further study and delay are not likely to improve the quality of the bylaws.

Grid West is not RTO West

When the RTO West Stage 2 filing failed to gain enough support in the region to move forward, the RRG renewed efforts in the summer of 2003 to take a fresh look at the problems and opportunities that the region could agree on. This renewed effort resulted in the current Grid West proposal that is different from the RTO West proposal:

- Its design is a direct result of trying to solve identified regional problems and opportunities and not a response to any FERC directive.

- It does not require consolidation of control areas.

- It is not Standard Market Design and has no financial transmission rights (thus there is no conversion of contracts).

Because the Grid West proposal is limited in its scope, changes to the existing way of doing things should be minimal and positive.

BPA also agrees with many of the recent American Public Power Association (APPA) recommendations regarding regional transmission organizations. In fact, the Grid West proposal addresses some of their points, including removal of financial rights/LMP and inclusion of cost control provisions.

Concerns still to be addressed

A number of concerns must be addressed successfully before BPA could sign a Grid West TA, including but not limited to the following:

- The costs of Grid West must be significantly less than the costs experienced to date by full-blown RTOs elsewhere in the country, or BPA will have little interest in moving forward. This is one of the areas to be tested in detailed design of the Grid West proposal. The intent is to take advantage of "best practices" of independent system operators that have successfully implemented functions similar to those intended for Grid West. Full use of existing control facilities, rather than building a new control center, will be important to this equation.

- Key characteristics of existing BPA contracts must be preserved. BPA is committed to working with its customers to address this issue prior to making any decision to sign a TA with Grid West.

- Federal generation must be dispatched through BPA. Just as it does now, BPA must be able to work with the Corps of Engineers and Bureau of Reclamation to optimize the hydrological and electrical operation of the Federal Columbia River Power System. BPA will need to find ways to authorize Grid West to use the federal transmission assets without violating the legal limitations on subdelegation of federal responsibilities to nonfederal entities.

- All markets proposed for Grid West operation must be voluntary.

- Practical termination rights must be provided in the TA. BPA believes the ability for it to terminate is necessary to protect its federal responsibilities and to act as a restraint on unacceptable scope changes to Grid West.

FERC control remains an issue

The ability of the Federal Energy Regulatory Commission (FERC) to require changes that are not supported in the region remains a concern to many. BPA intends to mitigate this risk by insisting on appropriate provisions in the TA between Grid West and BPA (*e.g.*, assurances that TA provisions will

not be negated by later changes in the Grid West tariff, prohibitions on unilateral changes to the TA, termination rights, etc.).

These protections will be in addition to the considerable control, relative to FERC, that BPA and the Northwest already possess, as evidenced by NAPA's conclusions in its report on the Grid West bylaws. NAPA also said it expects Grid West board members and its CEO to be highly consultative with BPA and other large transmission owners on policy matters. BPA agrees, and with the recent changes to the bylaws, is convinced that accountability to the transmission owners and the region will be a controlling principle for the Grid West board. BPA will work with regional stakeholders and the FERC to assure that there are commitments to key concepts that are necessary to realize the regional control envisioned for Grid West before any decision is made to implement Grid West.

Transmission Issues Group movement needed if it is to produce a viable alternative

Even as BPA has been participating in Grid West activities, it has been monitoring and participating in another users' group, the Transmission Issues Group (TIG). BPA also helped create and has been an active participant in a regional planning group, the Northwest Transmission Assessment Committee (NTAC) that TIG describes as the solution to the region's transmission planning needs. BPA will remain involved in TIG and NTAC activities because a number of the ideas coming from each have had merit. However, BPA believes the TIG proposals developed to date do not go far enough to offer needed solutions to the region's transmission problems.

For example, while NTAC has facilitated development of a base of planning information, it lacks backstop authority to solve reliability problems or even an approach for identifying the beneficiaries of transmission projects or for obtaining agreement on a regional plan.

Without an independent entity that has effective decision-making and dispute resolution processes, the region's ability to deal with complex, difficult decisions in a timely and effective manner will remain not much better than the status quo. BPA believes a proposal for moving forward should address the following:

- Effective "one utility" system-wide planning with an adequate backstop, so that important grid additions are implemented and costs assigned to those transmission owners that benefit.

- Effective regional market monitoring to detect market abuses.

- A common OASIS that provides real one-stop shopping using a common flow-based ATC methodology.

- Reliability enhancements through voluntary consolidation of some control areas, with an ancillary services market for those who want to participate in consolidation.

- A flow-based method for managing congestion on a forward basis.

TIG has yet to demonstrate how its approach could provide these outcomes since it has not dealt with the need for effective decision-making independent of market participants. TIG's challenge in the months ahead is to determine how an alternative independent entity would be structured to capture these benefits

while avoiding or minimizing FERC jurisdiction and to actively engage a broader range of regional stakeholders in the process. We urge TIG to address these issues and develop its proposal to maturity by the time Grid West reaches its next major decision point in mid 2005. BPA is ready to participate if TIG takes the lead in such an expanded effort but BPA doesn't believe the TIG proposal can hold real promise for adequately satisfying the region's important needs until it deals with the decision-making issue.

The region must decide

The region has been discussing these regional transmission issues for ten years. There is broad agreement that the status quo needs to be improved upon, and that a new approach is needed. Years from now, the region can't afford to still be talking about which approach to solving them is best.

During the coming months, BPA's focus will be on assuring that necessary Grid West details, such as the proposed market design and the consolidation of control areas, are developed for evaluation. Then, the region can properly consider the proposal and its costs and make a decision next summer on whether to seat an independent Grid West Developmental Board that would negotiate a TA with BPA and the other transmission owners. If, in this timeframe, the TIG is able to develop an alternative approach that holds real promise, BPA and the region will need to examine it as we decide whether proceeding with Grid West development should continue. BPA's future decisions to stay involved with Grid West or to move to an alternative will be driven by what we believe will be in the collective best interest of the regional customers and stakeholders who depend on the Northwest transmission grid. We intend to use an open, transparent and deliberative process that involves all key regional stakeholders.

Sincerely,

Stephen J. Wright
Administrator & Chief Executive Officer