NESCO COMMENTS ON GRID WEST/TIG PROPOSALS

I. INTRODUCTION

These comments are submitted by the National Energy Systems Company (NESCO) in response to BPA's early August request for comments on the Grid West and Transmission Improvements Group (TIG) proposals for addressing the region's transmission problems. NESC) is a regional independent power producer with one operating plant (Sumas Cogeneration Project @ 125 MW) and several pending power projects in the Northwest. We have been involved with development of regional transmission proposals since 1999.

II. NORTHWEST HAS REAL TRANSMISSION PROBLEMS

1. Reliability

The region has significant and increasing reliability problems. Although BPA has funded considerable transmission construction over the past five years, the symptoms of continued reliability problems persist: an exponential growth in the number of transactions with which utility schedulers and dispatchers must cope; an increasing percentage of dispatcher actions required in real time; an increasing frequency of "near misses" due to unexpected line loading conditions; and multiple other indicators of a transmission system under severe stress. Without new tools which will provide for greater system wide visibility and a single point of operational control over the entire grid, it is only a matter of time until we experience another major outage such as occurred in August 1996.

2. Increased Congestion

As BPA has extensively documented, the number of congested transmission paths has increased substantially since 1996. While BPA is taking near term actions to manage this problem (e.g. revising its ATC methodology, implementing a Constraint Schedule Management system), the region needs a more comprehensive approach. At a minimum, we need an ability to: (1) substitute regionwide generation redispatch for curtailments; (2) incent utilities to turn in their unused tx capacity and scheduling optionality in the day ahead market to increase tx transfer capacity; and, (3) eliminate rate pancaking and create more ATC so the region can access low cost but remote wind and coal resources.

3. Transmission Construction

The region needs an ability to move away from its historical BPA centric tx planning process, where other parties sit back and wait for BPA to build new tx, even if it is a more costly alternative from a single utility planning perspective, simply to preserve their own scarce capital. This "BPA builds everything" approach results in a

more costly system overall and unfairly increases costs to users of the BPA tx system. It is also particularly problematic in light of current limitations on BPA's borrowing authority.

4. Market Monitoring

Finally, the Northwest needs an independent market monitor to oversee transactions, both in the region and throughout the Western Interconnection, so gaming or other discriminatory behavior can be detected and stopped early on.. This function requires a truly independent party who will have complete visibility over tx schedules and market transactions and with whom market participants will be willing to share their commercially sensitive data.

III. GRID WEST IS THE BEST SOLUTION

In our view, Grid West offers the best approach to solving these numerous and steadily worsening tx problems. In every one of the aforementioned areas, it offers a realistic, concrete solution.

- - Grid West improves reliability by giving a single operator visibility over the entire seven state / one province footprint and having a central point of operational control for the consolidated system of BPA, PacifiCorp and Idaho Power (roughly 85 percent of the region's high voltage tx).

- - Grid West manages congestion by substituting real time generation redispatch for curtailment and by creating a tx rights reconfiguration service and energy balancing market to produce additional transfer capability in day ahead and real time scheduling.

- - Grid West ensures needed tx construction by establishing real backstop authority which, through the power of an independent board, will be able to identify the optimal solution for complex tx problems and ensure costs are appropriately allocated to the parties responsible for implementing such solutions. This approach will implement genuine single utility planning for the first time in BPA's 68 year history.

- - Grid West establishes a market monitor that is independent of market participants, which will have Interconnection wide transaction visibility and to whom market participants / tx owners will be willing to provide their commercially sensitive data.

IV. GRID WEST IS NOT AN RTO

Despite the concerns of some public power entities, Grid West does not suffer from the same maladies which have affected Regional Tx Organizations (RTO's) in other regions (e.g. lack of accountability, potential for uncontrolled cost growth). To wit:

- - Grid West will not use financial tx rights or locational marginal pricing, the principal drivers of cost escalation in RTOs in other regions of the U.S.

- - Grid West will only be subject to very limited FERC influence. This outcome is assured both by the recent FERC Declaratory Order on Grid West (which conceded that FERC has virtually no authority over BPA) and by political reality itself (i.e. BPA's dominance in the region, its non jurisdictional status and the ability of the Northwest Congressional delegation to make any FERC attempt to influence BPA politically cost prohibitive).

- - Grid West has built in checks and balances which ensure it will be accountable to the region.

- The Grid West Board will be elected by the members (who represent a cross section of all Northwest interests).

- Board members can be removed at any time for any reason by a 2/3 membership vote.

- A simple majority of the members can require a 7 of 9 Board vote to proceed on any of the major tx policy issues which most concern Northwest interests (e.g. moving off the Company rate, changing the losses methodology, using the tx backstop authority to resolve chronic congestion problems).

- The probable makeup of the Grid West Developmental Board itself will ensure an entity which will be accountable to the region. Candidates like Walt Pollock, (former BPA and PGE VP for Power Supply), Jerry Garman (former SCL VP for Power Supply and founder of PRM), Joe Marshall (former IPC CEO), and Bob Myers (former PSE VP for Power Supply) are all former employees of load serving entities with distinguished track records. They will prove quite capable of striking the appropriate balance between the independence needed to solve the regions' tx problems and respect for the interests of all affected regional parties.

V. TIG: GOOD FIRST STEP BUT NOT SUFFICIENT TO RESOLVE REGIONAL TX PROBLEMS

TIG is, by its own definition, not a comprehensive solution to Northwest tx problems. It is rather an incremental approach designed to address some near term tx issues by relying on voluntary contractual arrangements among regional utilities. The five TIG functional areas are a logical starting point for development of an eventual regional solution. However, the lack of any independence from vested interests in its governance structure and a design protocol whose primary goal is avoidance of FERC

jurisdiction, rather than doing what is required to solve the region's tx problems, are fatal flaws.

As we see it, TIG suffers from two key flaws:

1. Lack of Independence

All five TIG functions are ultimately subject to the control of the TIG Executive Committee - - a group comprised principally of tx owners and utility users of tx. This construct relies on a Standards of Conduct type of approach to safeguard against inappropriate influence from market participants or other affected parties. It is this very approach which has produced many of the region's current problems. More importantly, this lack of independence will ensure that key regional players (e.g. IPPs, tx owners like Idaho Power and PacificCorp) simply will not join. The resultant non-participation by essential regional parties will likewise ensure that benefits will be limited to non-existant.

2. Voluntary Approach Will Not Succeed

In the real world, TIG's voluntary approach is unlikely to succeed principally because voluntary organizations cannot allocate costs. This dynamic will doom TIG attempts in every area except possibly market monitoring. In retrospect, this result is not surprising. Tx owners and users have been trying to solve these same complex issues (e.g. tx expansion, congestion, consolidated control areas) for the last 20 - 30 years without success. Indeed, the main reason for creating the Grid West Developmental Board was to have a counterparty to act in the region's interest and thereby enable the parties to rise above their parochial self interests. Ironically, the only way in which TIG can succeed is if Grid West also moves forward. In this way, Grid West would act as a forcing function which creates a potential consequence for inaction and thus motivates all parties to stretch for regional tx solutions (as opposed to taking the path of least resistance and defaulting to the status quo).

VI. CONSEQUENCES IF BPA CHOOSES TIG

1. PacifiCorp and IPC Will Not Participate

As they made quite clear at a recent Oregon PUC briefing, PacifiCorp and Idaho Power will not participate if BPA chooses the TIG approach. It is likely that they will instead combine with Northwestern, Sierra Pacific and Excel (Colorado) to form an eastside RTO / ITC which has the independence and ability to actually work. Given their size and strategic location, the consequence of PacifiCorp's and IPC's non-participation will be no meaningful control area consolidation, thus eliminating the principal source of both reliability and economic benefits for either Grid West or TIG. BPA will be left with a Westside only entity which produces few if any benefits, especially in the reliability function.

2. TBL Becomes a Regulator

Since no control area consolidation will occur and most tx problems (e.g. declining reliability, increased congestion, continued rate pancaking) will remain unresolved, this Westside only approach will quickly devolve into a BPA "muddle through" alternative - - the very outcome which Bonneville says is least acceptable.

However, the muddle through choice will also produce a more profound result over time. Since BPA will be unable to build much additional tx (due to borrowing constraints) and will not have Grid West created tools to increase tx capacity (e.g. the balancing and tx reconfiguration markets), it will have no choice but to push the existing system harder to meet the multiple demands placed upon it. TBL initiatives during 2005 have already signaled this direction. Whether liberalization of BPA's ATC methodology, creation of a Constraint Schedule Management procedure or development of a Conditional Firm product, these changes will have two inevitable effects: (1) the substitution of firm for current non firm tx uses of the FCRTS; and, (2) Network curtailments. Both results will increase costs and decrease service for tx sytem users.

While NESCo is concerned about the effect on its projected new generation projects, a more problematic result will be the change in tx service for BPA's existing utility customers. Rather than solving the region's tx problems by increasing the size of the proverbial tx "pie", TBL will have to allocate ever smaller portions of a shrinking tx resource. This result will, over time, cast the TBL in the role of allocator/regulator, rather than the provider of a valued tx service, which will produce a contentious and politically difficult management problem with most of BPA's tx customers.

3. No Contract Lock

To further complicate this picture, BPA (quite appropriately) has told its public utility tx customers that their tx contract rights will only be protected if Grid West goes ahead. Many of these "contract rights" are codified, not in tx contracts, but rather in tx tariffs or business practices, all of which can be unilaterally changed by BPA. Given the need for BPA to push the existing tx system harder (without the tools available under Grid West), it is highly likely BPA will need to change many of these defacto rights simply to preserve its flexibility to manage a severely constrained tx resource. Such a result will produce considerable controversy among BPa's public customers and do nothing to solve the region's long term tx problems.

VII CONCLUSION

1. Go Ahead with Grid West

BPA should move ahead with Grid West at Decision Point # 2. Grid West is superior to TIG on virtually all counts:

- - Grid West's governance structure balances independence and regional accountability, thus ensuring that improvements actually are accomplished while respecting regional interests.

- - Grid West creates real tools to resolve congestion through system-wide generation redispatch, and a tx reconfiguration market for unused tx capacity / scheduling optionality.

- - Grid West provides a real backstop for tx construction and the prospect of genuine single utility planning.

- - Most importantly, Grid West will substantially improve reliability, within consolidated control areas covering 85 percent of the region, by having a single entity with visibility and operational control of the entire grid.

2. Incorporate Five TIG Areas

In addition to proceeding with Grid West, it might be helpful to use the five TIG areas as the basis for developing Grid West near term services. Since these five areas will need to be pursued under either approach, it might be helpful to use them as the building blocks for near term Grid West development and operations. This point of departure would only be viable, however, if the five TIG functions were implemented under direction of the Grid West Developmental Board. This approach would be incremental in nature and would also, because of the Board's relative independence, provide much greater confidence that the TIG functions would actually be developed.

We believe this combined approach holds the greatest potential for success. It moves the region toward a comprehensive solution but achieves progress in modest, feasible steps. NESCO sincerely hopes BPA will proceed on such a path. We believe it will benefit both our company and the region.