

COMMENTS OF MORGAN STANLEY CAPITAL GROUP INC.
ON
BONNEVILLE POWER ADMINISTRATION'S APRIL 2006 WHITE PAPER:
CHALLENGE FOR THE NORTHWEST

Morgan Stanley Capital Group Inc. ("MSCG") submits these comments on Bonneville Power Administration's ("BPA") April 2006 White Paper, Challenge for the Northwest: Protecting and managing an increasingly congested transmission system, in response to BPA's request for such comments. MSCG appreciates the opportunity to provide input on the important issues that BPA has raised in its white paper.

I. SUMMARY

MSCG wholeheartedly agrees with BPA that the transmission congestion issues that BPA discusses in its white paper are both serious and important. Moreover, the manner in which BPA addresses its transmission congestion problems are equally serious and important. At bottom, MSCG urges BPA to take actions that will most effectively address congestion, but preserve the competitive, liquid wholesale power market that currently thrives in the Northwest.

MSCG emphatically supports the development of a Regional Transmission Organization ("RTO") in the Northwest. To that end, MSCG applauds BPA's commitment to ColumbiaGrid.¹ MSCG believes that RTOs are demonstrably the best approach to optimize and manage generation dispatch and transmission usage, while preserving and enhancing the development of competitive wholesale power markets. Recognizing that the development of an RTO is a longer-term solution, MSCG encourages BPA to adopt an interim approach to congestion management

¹ BPA states that it "is participating in the creation of ColumbiaGrid and remains committed to participation in an entity that can implement effective longer-term solutions..." White Paper at 4.

that encourages transparency throughout the transmission request/Available Transfer Capability (“ATC”) process. More specifically, MSCG supports something akin to BPA’s Approach 3, Method 1,² but with a transparent transmission access/ATC process, and the use of Transmission Loading Relief (“TLR”) in the event that congestion develops.

II. MSCG’S INTEREST

MSCG is a wholesale power marketer throughout the United States, including the Northwest. MSCG is an active participant in the Northwest wholesale power market. Currently, MSCG holds long-term firm intertie transmission rights, and uses non-firm transmission over the network. Therefore, the manner in which BPA chooses to address its congestion issues has a significant impact on MSCG and its business.

III. COMMENTS

MSCG agrees with BPA’s ultimate position – something must be done to address the increase in congestion on BPA’s transmission system. BPA is correct that the existing transmission system and the manner in which it is operated are insufficient to support the way in which the transmission system is utilized today and for the foreseeable future. Moreover, something more than a “band aid” is needed to address these issues.

A. Long-Term Solution- RTO

MSCG has long supported the development of RTOs. The benefits of RTOs are manifest. Under an RTO, the transmission system is operated and managed by an independent entity that helps to prevent undue discrimination or preference in transmission access. Moreover, placing operational control over the transmission system in the hands of an RTO ensures that an

² *Id.* at 20

independent entity is administering those functions which “touch the wholesale market,” including:

- OASIS Administration;
- OATT Administration;
- Reliability Coordination;
- Generator Interconnections;
- Coordinated Transmission Planning;
- Coordinated ATC Calculation; and
- Independent Capacity Benefit Margin Calculation.

The RTO would be the sole repository of market information and data concerning the transmission functions. The market must have access to that information, and the RTO’s operational processes would be clear and transparent. Moreover, the RTO would help to maintain the Northwest’s clear and transparent pricing. First, the RTO would help to maintain the executable price indices at which counterparties currently buy and sell physical quantities of energy and engage in financial transactions. Second, the RTO would be responsible for pricing transmission on a firm and non-firm basis. Ideally, energy and transmission pricing would be available to the market in the context of a functioning balancing market that clears each hour on the basis of market-based price signals which provide proper and adequate incentives to both buyers and sellers, rather than on the basis of imbalance and other penalties that may be punitive and fail to reflect actual market costs and prices.

Such a structure would be an improvement over the current market structure. MSCG recognizes that the development of an RTO and a Locational Marginal Pricing (“LMP”) congestion management system will require significant changes to the market in the Northwest.

Nevertheless, such changes are worth the work. LMP is the only tested and proven congestion management and pricing system that has been implemented in the United States. LMP-based energy markets have proven to generate more accurate price signals, increase transparency in the market, and better highlight where long-term investment is needed. However, such a structure must necessarily be viewed as long-term solution. In short, MSCG agrees with BPA that a shorter-term approach to manage congestion is needed in the interim between now the development of an RTO.

B. Short-Term Solution- Approach 3, Method 1/TLR

MSCG encourages BPA to develop a congestion management solution that: 1) preserves the strong, competitive wholesale power market in the Northwest; 2) provides transparency the process for obtaining transmission service and determining ATC; 3) provides transparency and consistency in how congestion is managed and how it will impact the market; and 4) preserves the value of firm transmission. Along these lines, MSCG believes that Approach 3, Method 1, as described in the White Paper most directly meets those goals. However, MSCG further encourages BPA to enhance that approach by establishing a transparent transmission reservation queue process and utilizing TLR to manage congestion as necessary.

Approach 3, as provided in the White Paper, would seek to “anticipate and avoid congestion” rather than act reactively to it.³ Method 1 provides that BPA could meet that goal by having customers provide schedules a day ahead of flow, with more information about generation and transmission utilized in meeting the schedule. BPA would then calculate and post Available Transfer Capability (“ATC”) on an hourly basis for all constrained paths. BPA

³ *Id.* at 20.

then would be able to limit schedules to the available capacity on a path in order to avoid congestion.⁴

MSCG agrees with BPA that Method 1 would provide BPA with more prescheduling information than it now has. Moreover, BPA would be able to properly value firm and non-firm transmission with respect to one another. These basic foundations are similar to how transmission is managed in non-RTO control areas in the Eastern United States, and consistent with how Open Access Transmission Tariffs are intended to function. MSCG acknowledges that Method 1 would lead to “more stringent process requirements” and potential added costs for modifying existing scheduling systems.⁵ Nevertheless, enhancing the operation and management of BPA’s transmission system is not going to be free. If money is to be spent, then it should be spent in support of enhancements that will protect what is good about the system and best help to alleviate what is problematic.

MSCG would enhance Method one by ensuring that the transmission reservation process is transparent and straightforward. To that end, MSCG suggests that, once BPA obtains the relevant information in the Day Ahead time frame, BPA should then post the ATC on OASIS on a Day Ahead basis. Market participants then would request Firm and Non-Firm transmission based upon the posted ATC, and BPA would allocate such transmission, pursuant to its Tariff, as available. This would allow market participants to schedule transmission using more and better information.

⁴ *Id.* MSCG disfavors the use of Method 2 as it requires BPA to “predict flowgate overloads.” *Id.* Admittedly, this could lead to “artificially limiting access to transmission.” *Id.* MSCG opposes operational techniques that do not maximize efficient use of the transmission system. Clearly Method 2 would not maximize operational efficiencies, if the result is stranded transmission capacity.

⁵ White Paper at 21.

To the extent that congestion develops, MSCG urges BPA to implement a flowgate-based TLR process. The flowgate-based TLR process is set forth in the NERC guidelines and should be implementable on the BPA transmission system.

First, BPA bases its long and short-term firm ATC calculations using a flowgate methodology. Therefore, flowgate-based TLR would build upon an existing BPA methodology. Second, Under a flowgate-based TLR, points of congestion are identified and valued prior to flow, allowing market participants to see where congestion will occur and readjust their schedules accordingly. The transmission system operator also has the ability to clear congestion through pro rata priority-based curtailment. MSCG would further support the development of an auction to distribute transmission rights, which in turn would lead to the development of a secondary transmission rights market.⁶

In sum, MSCG supports a transparent, forward approach to congestion management. By enhancing its current OATT process to include day-ahead scheduling and hourly posting of ATC, market participants and BPA as the system operator will be able to act proactively to adjust schedules and clear congestion. Moreover, the development of further TLR-based methodologies, including transmission rights auctions, will ensure that transmission is utilized by those who value it the most. This would serve to help identify where additional infrastructure investment is needed most.

IV. CONCLUSION

MSCG endorses BPA's efforts to proactively address the transmission congestion issues that are affecting its transmission system. MSCG appreciates the opportunity to provide these

⁶ Although MSCG would prefer that such transmission rights be financial, it recognizes the existence of a number of physical transmission rights contracts in the Northwest.

comments and looks forward to participating on a going-forward basis in the process to develop the means and methodology to address these important issues.