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M-S-R Comments on NOS and GI.

M-S-R submits the following comments on the NOS and LGIA processes. M-S-R appreciates the opportunity to provide comments re these serious issues. What has become clear is that there are operational constraints, process anomalies, and a continuing need to balance the rights of BPA's existing customers with the support being provided to developers. BPA has asked for ideas on how to accelerate the current process for "serious" projects and separate them from the speculators betting "on the come

At the recent meeting to discuss possible changes to the NOS and LGIA procedures, there was considerable discussion regarding two things: 1.) the lack of coordination and connectivity between the LGIA process and the process by which a PTSA can be acquired and two.) The potential for stranded costs and new operational constraints. A critical third component was missing. There was no discussion of the availability or lack of availability of the balancing reserves required, particularly when the proposed project is for the development of a variable resource.

To provide some structure to the discussion it is helpful to review the essential requirements for the development of a variable resource project (for ease, "wind") and then evaluate the current procedures.

Elements of a Successful Wind Project

1. A site with economic wind characteristics
2. **A LGIA with the transmission Provider –**
3. **A transmission agreement (PTSA) to ensure delivery**
4. **The associated ancillary services including balancing reserves if required**
5. Financing
6. An assured revenue stream
7. Turbines and the associated balance of plant requirements

If any of one of these essential elements is missing, uncertain, or subject to material change, the commercial success of the project is placed at risk. Currently, BPA only considers two of in the initial process even though at least three are implicated.

The current Process

In the current process, the prospective customer makes a separate application for a LGIA (the right to connect to the grid) and for transmission service (the right to move the energy from the source to a designated sink). Both are essential for project success, but each is on a separate timeline with separate requirements. The disparity in time lines creates a likely time gap between the successful completion of one and the successful completion of the other. The current solution to these timing issues is the "right to defer" for up to 5 years with minimal financial commitment. This creates uncertainty as to which requests are "serious" and which requests are merely speculative, "betting on the come".

Noticeably absent from the discussion was any reference to balancing reserves. BPA has indicated in other forums that it has a limited ability to provide balancing reserves and expects that these limits will soon be reached. Current FERC policy dictates that once an LGIA has been signed, transmission providers MUST provide balancing reserves. That means that if BPA signs a LGIA and a PTSA, it must have the ability to provide balancing reserves. If BPA ignores its obligation to provide balancing reserves in the NOS /LGIA process, BPA may be unable to meet its obligation at any price or there may be a delay in acquiring the balancing reserves to the detriment of the project. This can occur because of disconnect among the various enabling agreements and the on-going obligation to provide balancing reserves in spite of market or system constraints.

Possible adjustments to the current processes

M-S-R suggests that the difficulties arise in part because interdependent agreements are separated and treated as independent. Revising the processes to recognize the interdependent nature of the agreements and to address the needs of the project in a single multipart process would be benefiting both the developer and BPA.

A wind developer would file a single request to integrate with the grid (LGIA), receive transmission service (PTSA), and acquire the necessary reserves (balancing). BPA would evaluate its ability to fulfill the request (LGIA, PTSA, and balancing reserves) and indicate both the timing and cost of meeting the request. The request would either be granted for all elements or denied for lack of resources.

If the integrated approach is adopted, there will no longer be a need for deferral arising from the time gap between the LGIA and PTSA. They will be offered as a package or denied as a package.

If a customer needs an "option" to address an uncertainty regarding the other essential elements (such as acquiring a power sale agreement or firm financing) an option fee can be established based upon the opportunity cost to BPA and the length of the requested deferral. It should be of enough significance to discourage excessive speculation.

When the request is granted, a binding agreement with appropriate credit support would be required. That means that the developer must meet normal commercial credit standards, the underlying financial terms should be considered to assure that they are "real," and there should be a provision addressing damages in the event that the developer fails to go forward. This eliminates the risk of "stranded investment" by having the commitment to provide the service balanced against a commitment by the developer to pay for it.

The cost of providing a timely response to valid requests should be known and an appropriate fee set. The timeline should be reasonable and in two parts – time period in which to say a maybe or no (i.e. when it is clear that, the hurdles are too high or that a study will be required. (Note: there is an important distinction between a timely response and the time that may be required to provide the requested service. The first hurdle relates to the initial screening. A full study may take substantially longer if done properly.)

Placement within the queue should be adjusted as frequently as necessary to reflect the reasonably expected ability to perform. The potential “setbacks” would be identified, such as the availability of financing, PPA, timing of equipment delivery, and siting approvals. For example, those with a PPA may move ahead of those without a source of revenue. Or those who have entered the turbine queue could be given priority over those without any turbine commitment.

BPA needs to include the availability and potential cost of the required balancing reserves in the evaluation. While the issues of LGIA and NOS (open season) seem to be the focus of current concern, the issue of the availability of balancing reserves may very well limit the ability of BPA and the Region to integrate and provide transmission service, no matter how good the NOS/LGIA process.

Balancing reserves are not only a matter of available generation, *but also of available transmission*. Under the current processes only transmission from the proposed project (POR) to the proposed sink (POD) is considered. However, if third Party reserves are necessary, there also must be transmission available from the generation from which the balancing reserves are acquired to the POD. Currently that availability is not considered in the application process even though it may be the primary constraint. The more remote the reserve generation source, the more significant the availability of the necessary transmission becomes. In an addition, when the need for available transmission capacity needed to provide balancing reserves is explored, it may be that its use in that way will prevent another developer to integrate onto BPA’s system.

It is fair to note that the issue(s) of operational limitations are likely to take on increased significance as the Region experiences increased penetration of variable resources. The ability to provide firm transmission may differ depending upon operational limitations – a developer situated with balancing reserves available with transmission available would be treated differently from one in which it is unclear where the balancing reserves will be acquired. M-S-R recommends a tiered approach to recover both the cost to integrate generically and the costs associated with a specific plant to integrate. It is critical to recognize current system limits and to develop protocols that appropriately identify the constraints and the costs to remove the constraint. BPA’s current customers should not have to shoulder these costs when they did not cause them nor are they gaining any benefit from them. Similarly, developers who are unable to provide an identified source and sink place greater burdens upon BPA and thus should be charged accordingly.

M-S-R encourages BPA to revise its processes to reflect more accurately their interdependent nature. These revisions should result in a more timely process, reduced financial risk for both the applicant and BPA, and a reduced likelihood that commitments will be made only to discover they cannot be fulfilled.

Financial/Commercial considerations

The typical cost of a wind project is \$1.5M - \$2.5M per MW. If the typical project is 100-200MW this means a project likely will require \$150m-\$500m. LGIA costs, while material, are not primary in the economic pro forma. What is primary is the timing of full service and the durability of the services provided.

Once the project commits to turbine purchase (potentially 50% or more of the cost) and once the PPA is signed it is imperative that deadlines for service be met and terms and conditions of service be honored. Significant delays in service and or unanticipated changes in the quality and dependability of service can place a project at financial risk.

It appears that less emphasis on tariff provisions and more reliance on contract terms and conditions would provide greater financial certainty and reduced financial risk to both BPA and the developer. With a contract structure, costs can be specified, credit analyzed, collateral arranged for, and future “surprises” minimized. Wind projects are finite in size, have limited life, and known requirements. A tariff is open ended; a contract is close ended. A tariff is general in nature; a contract can be site and time specific. If BPA continues to integrate variable resources in a constrained system, it must have an approach that is commercially sustainable and reflects the actual conditions facing the developers.

Credit Policy

At the workshop a concern was raised by BPA staff that there was uncertainty regarding the adequacy of current practices to protect existing customers from potential non-payment by new customers. The extent to which BPA was /was not following typical industry practices with regard to credit and collateral was unclear.

Based on M-S-R and its members’ actual recent experience with contracts, the following practices seem to be the industry standard:

1. The current credit worthiness of each party is estimated (typically based on rating agency ratings-no rating no credit);
2. Each party is given a threshold “credit line”;
3. Material adverse changes in credit worthiness are defined with a defined was to address such changes;
4. If the threshold amount is exceeded or a material adverse change occurs performance assurance is immediately required (i.e., within one or two business days);

These policies protect both parties from the credit lapse of the other. Tail events still occur but credit is not extended to parties who lack strong credit at the outset.

M-S-R strongly encourages BPA to impose industry practices to protect both the Agency and the Agency’s customers.

Additional Comments and Observations.

NOS cluster studies try to balance system capabilities and stated needs. AS M-S-R understands it, power flow analysis is critical in making the analysis it does. However, the “flow of the river” is changing specifically in terms of climate changes and reservoir operations. As stated in BPA’s Climate Change Initiative, there is increased winter runoff, less spring/summer runoff as well as increased reliance on stored water vs. natural water. Given these issues, BPA should re-examine past studies and wait u=on new decisions until the 2010 Modified Flow Analysis is complete and determine how that might inform the NOS determinations.

BPA's assumptions used in the cluster study should be reexamined and hypotheses tested to make sure the assumptions continue to be valid. This is particularly true with respect to which resources will be needed to be backed off to address other operational or market conditions and whether that will have an impact to other operations.

The recent down grading of US financial instruments has had a domino effect on BPA's ability to borrow and at what price. BPA must identify actual costs and timing involved if it finances construction. How does that affect BPA's treasure borrowing authority?

Stranded costs may occur if a project is not completed or if the project fails (even when using an integrated NOS/LGIA process such as the one describe above.) One way to think about what actual "stranded costs" is is to consider how a similar situation is handled in the commercial market. For instance, one could liken the arrangement to a commercial lease. There are upfront costs (which should be covered as they occur on an ongoing basis – including costs of studies themselves.) Like a lease, in addition there are "build outs" that must occur. In a commercial lease that might be designing and building out an office suite. Typically, those costs are recovered from the tenant as an adder to the base rent. Then there is an anticipated stream of revenue based upon the rent. It would seem that the transmission rate paid is equivalent to a stream of revenue roughly equivalent to the rent paid. In a commercial lease that is calculated so that a tenant and the landlord would know what it would be for the term of the lease and would have those numbers available to determine actual loss, but the revenue stream is not the loss per se. The loss is the net present value of the remaining payments due under the lease, less revenue earned by renting that space to someone else. BPA should calculate the potential "stranded cost" similarly to avoid double recovery or inflating the actual unpaid revenue that it seeks to recover in rates.

Study and financing costs should be a cost to the developer. Identified costs moving forward, such as the cost of NEPA or engineering, should be secured by a letter of credit or other commercially available security instrument. BPA should not be fronting money for projects and developers that are not investment grade or using it's borrow authority to finance projects that cannot be financed in the commercial market.

BPA should reconsider its willingness to allow deferrals except in identified circumstances, such as when it is not able to supply reserves. The length of the deferral requested should set the cost, priced like an option. It should be not be collected from OATT or NOS participants unless BPA can show an n actual benefit to the system by allowing it. The deferral fees should not be off the rack flat fee arrangements. To the extent that a deferral fee fails to cover the costs, it will become a general expense of BPA transmission customers. By allowing deferral without requiring strict standards about how, when, and duration, it affects the cluster or other studies being done to assist other developers who are ready to move forward. It allows gamesmanship -- if "A" defers, it can prevent its competitor "B" to move forward (since it remains an assumed part of the system going forward) or as the system changes over time, it could make it less likely that either A or B can move forward.

It is important to realize that other stakeholder processes, including ones in which BPA is an active participant, may be making decisions that could turn all of the studies on their heads. For instance, Columbia Grid and the Joint Initiative are doing planning studies that could impact the regional system moving forward as well as the ability to find balancing reserves.

BPA must make sure that its processes (both LGIA and NOS) do not result in making BPA the cheap alternative for integration and financing. By making the process based more upon commercial practices, it will make it more likely that those developers will seek to integrate with BPA because that is the place that makes the most sense.

FERC's pro-forma tariff does not require that the transmission provider decide which project goes forward by queue position alone. All things being equal, a queue request determines which project moves forward only if the project moves forward in a timely fashion. When confronted with multiple requests, BPA must assess how soon that the developer can financial and operational requirements. BPA should develop a more stringent checklist of items to be completely and evidence of performance than it uses currently.

BPA should allow a minimum number of projects a fast track approach based upon whether the initial review shows no likelihood of impact on the system. The reason for a minimum number is to make sure that not so many handled in a fast tracks that that they skew the modeling and system assessment going forward

BPA could allow queue rights to be assigned providing that the location of the assignee project benefits the system (by, for instance, having local reserves available, or avoiding constraint points) or by having the assigning project pay the costs for additional studies to determine the impact.

Cluster studies should not be performed in a vacuum. The assumption that wind will continue to be developed within BPA's BA may be correct -- or -- due to such things as EIM or the loss of investment tax credits -- be very wrong. BPA must consider changes in river operations, system requirements, and competing uses in the cluster studies. Because the cluster studies depend upon assumptions, every analysis must have a conservative assumption, a moderate assumption and a no holds barred assumption so that BPA does not encourage development when it is no longer feasible or which results the costs of an overly optimistic analysis become costs to system customers.

BPA is faced with an increasingly complex system, a complicated set of seemingly ever changing regulations, and a hydro system that is used in ways not contemplated 10 years ago. M-S-R applauds BPA for its efforts to examine the NOS and LGIA processes to better reflect the current times and future possibilities.

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