RTO Car Talk – November 4, 2001 Edition

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BPA-PUBLICS' MEETING

Most of the mtg was devoted to outlining the new congestion management model, although BPA reps repeated that many key points in the proposal are not yet fleshed out.

FU reps met most of the week of 10/22 in the salubrious climes of San Diego to develop the proposal. They had a definite sense of urgency in light of the emphasis on RTO "standardization" at Camp RTO. They believe that if they don't move quickly to hammer out a congestion management proposal, FERC will preempt their discussions.

Major differences remain among the FUs: some thought that a key part of any proposal is that existing tx contract holders should have relative price certainty, while others thought that the demands of a "liquid, robust" model necessitate jettisoning price certainty for existing tx contract holders.

BPA characterized the FU proposal as a strawman, "non-consensus" model, though we hear that other FU reps are characterizing the model as a consensus model. Nothing is in writing, so the following description is based solely on BPA's report.

The proposal is described as an "injection-withdrawal" model (although BPA said the FUs were searching for another name, fearing how the current terminology would be characterized in Car Talk). The idea is that all tx transactions can be characterized as an amount of tx, a point of injection, and a point of withdrawl. Existing contracts will be catalogued using these criteria. Schedules will have to be balanced -- so one must submit equivalent amounts at both the point of injection and at the point of withdrawal.

This proposal is rather centralized compared to some other congestion management proposals that are floating around. The RTO itself (rather than the Scheduling Coordinators) would be responsible for calculating ATC based on actual use of the system. (ATC is Available Transmission Capability/Capacity, i.e., tx capacity available for sale.) The RTO would use forward incremental and decremental purchases to increase ATC.

Congestion costs of preexisting contracts will be socialized. Those requesting new tx service will recieve a financial right to the tx system. One can put a price limit in a request to show that no service is wanted if the tx price goes above a certain level. The RTO will accept all schedules up to the point where redispatch is required, and there will be a real-time, day-ahead market for redispatch.

Although current rights holders would still have physical rights to the system, these rights would not be tradable. In order to trade existing rights, parties would have to convert them to financial rights. The FUs are trying to devise "incentives" to encourage current rights holders to convert to financial rights. No decision has been made on how long a party has to convert a physical right to a financial one; six months has been suggested as the minimum term (so one could convert back to one's old rights at the end of six months). It was fairly easy to see how to convert existing PTP rights, harder to see how to convert existing NR rights.

The RTO would maintain a rights auction as a backstop, but bilateral deals are OK. If there are errors in calculating congestion costs in real time, both unexpected gains and unexpected losses would be socialized. The model would rely on "hubs" (rather than on individual buses) as the basis for determining the points of injection and points of withdrawal. The size of the hubs has not been determined.

[Ed. note: OK, I have said nothing, to date, about this injection/withdrawal business. Evidently I haven't needed to. ON THE OTHER HAND, you public power utility managers out there decide for yourselves whether you will be on the "injector" or the "injectee" and whether it's the size of the hub, or the size of the shaft, that's more painful.]

After three years the RTO would have to "actively evaluate" how well the congestion management model worked, so it's possible that the congestion model could be modified substantially in three years' time.

RTO West is still planning a filing on December 1. Preliminary draft materials show that the chief purpose is to demonstrate to FERC that we are resolving the seams issues with the other western RTOs and building the seamless westwide market, despite still having three planned RTOs in the west. FUs are still having internal problems, because Portland General, Sierra Pacific and Nevada Power still don't endorse the draft filing materials that have been distributed.

WeCon (the post-Desert Star transco) made a sizable filing at FERC, where it opined that it should be "the platform" for the marriage of RTO West and WeCon that FERC chairman Pat M. Wood wants.

TransConnect (our local transco) is expected to file with FERC on Monday, and is expected to claim a substantial planning role for itself (at the expense of RTO West), as well as argue that it should be allowed to earn substantially more money on new tx investments via "incentive ratemaking".

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FERC WORKSHOP IN SEATTLE

Chairman Pat M. Wood and Comm'r Nora Brownell convened the Western Energy Infrastructure Conference, billed as a "Technical Conference". The goal was to understand infrastructure needs, whether construction is occurring, and what may be preventing investment in infrastructure. FERC was to inquire what the state and federal decision-makers could do, with the aim of developing the "energy infrastructure . . . to support well-functioning wholesale energy markets."

Brownell said the conference was all about economic development. The several panels were configured to "[make] sure we ARE working together" to realize FERC's goals. Notably present en mass in the VIP circle were public utility comm'rs from the west. Bob Anderson from the MT PSC, Marilyn Showalter and Dick Hemstad from the WA UTC, and Marsha Smith from the ID PUC were strong voices for an approach that would account for NW-specific issues in forming RTOs.

Wood and Brownell, two former IOU regulators, have close ties to Nat'l Ass'n of Regulatory Utility Comm'rs (NARUC) and state regulators. They were respectful of all the state regulators, and there was some collegiality among the present and former state commissioners, particularly shown by Wood. Many have had key leadership positions at NARUC. FERC imposed the price caps after the former state comm'rs were on board. It may not seem so formidable for these FERC comm'rs to engage in the unprecedented regulation of RTOs, though there is no federal model to follow, because they are familiar with full-service regulation in their former states. One state comm'r pointed out that FERC has a unique "power to convene" that the states do not have, and this can be used to bring people and states in the region together.

AZ Governor Jane Hull: FERC should make sure it knows the differences in the west, including its unparalleled diversity in generating resources and varying summer and winter peaks. The western states' governors have taken the lead in RTO and energy development and FERC must understand that the states are not a "blank slate." FERC should better understand the western system before undertaking policy development. She was dismayed at the beltway proposal to grant FERC eminent domain for tx. The real hurdles have been federal agencies on federal lands in opposing tx development. The Western Governor's Association (WGA) has put considerable thought into the regional tx issues. It formed a work group that produced a conceptual plan addressing a wide range of issues from resource and load diversity to market power, from environmental concerns to predicting future bottle necks, from to demand side solutions to distributed generation.

Bradley Johnson, FERC staffer from the Office of Markets, Tariffs and Rates: Gave a brief overview of FERC's Western Infrastructure Assessment. This assessment contains data on energy demand growth, consumption levels, generation output levels and growth (for both gas and electric), market statistics (trading volumes, prices, estimated costs, etc), tx data (total miles, and asset values), and tx projects to improve "interconnected system operation". The western electricity markets have lighter trading volumes when compared to those in PJM. Thus western markets are less liquid and more susceptible to price

volatility. It is understandable that our spot markets are not as liquid (do not have as many participants) as PJM's because most of the energy market transactions in the west are made through long-term bilateral contracts. Long-term contracts, by their nature, generally guarantee price stability. So even though our spot market prices are more volatile, overall our prices are not. Those who enter into long-term bilateral contracts are generally seen as more risk-adverse than those who buy on the spot market. There is a catch-22 associated with increased market stability in the spot market. In order to reduce spot market volatility, participation must be increased (increased liquidity). In order for participation to be increased, otherwise risk-adverse market participants having long- term contracts must have some confidence that they are not going to be burned by price volatility. One might argue that western markets are "broken" because of the lack of liquidity and price volatility in the spot market. One might just as well make the argument that western market participants are expressing their risk-aversion by entering into long-term contract. Marilyn Showalter observed that FERC's assessment stopped at WA's northern and therefore ignored the integral nature of Canada to our supply and tx systems. Besides some gaps in the data presented, Johnson was not familiar with the assumptions that went into preparing them. When an audience member asked how much the data factored in plant retirements -- Johnson replied that the data had been complied by a firm called RDI, and that information was embedded in their assumptions.

WA Governor Gary Locke: The NW has spent 18 months responding to the challenges presented by CA's fouled energy structure, compounded by the drought. He urged caution on restructuring energy markets, which had disastrous repercussions in CA and MT, and urged not rapidly reorganizing the tx infrastructure. FERC should be careful in attempting to alter the federal/state roles. Energy policy making is not an exercise in abstract theory. As CA and MT have shown, restructuring energy markets is a grand experiment that can go terribly wrong.

Locke was skeptical of the benefits of restructuring, and noted that the WA legislature wisely declined to legislate in this area. Competition in energy markets is not possible in the same way as in other markets. The demand/elasticity does not work where there is no substitute for electricity. Curtailment is not a solution for most electric users. Free market entry and exit does not apply where the lead time to develop new generation and tx is lengthy. Dereg and competition should not be policy; the only policy should be to assure reliable, efficient energy for consumers. Regulation of wholesale rates should be a complement to regulation of retail rates, not a substitute. FERC should not entertain change just for the sake of change.

Locke said the NW is unlike any other region. BPA has 80 percent of the tx and the power of eminent domain. BPA has plans to construct 300 miles of new tx between 2002 and 2005. The problem is that BPA needs borrowing authority, and the solution is for FERC to urge Congress support BPA's borrowing authority. BPA already offers open access benefits. There is no need to resolve the issue of open access through RTOs in the NW. The region is more than 50% hydro. Locke said that the NW and BPA do not fit in a westwide RTO.

Eight industry reps addressed near-term infrastructure needs. They were asked to address the following questions: What needs to be built today? What happens if these are not built? Which are first priority?

John Prescott, Veep (Generation), Idaho Power: The simple answer is to build tx to relieve constraints. We need to focus on developing political and regulatory certainty (market certainty is not a problem). We need to understand regional issues; the west is different from other regions. We need to involve consumers in "managing risk parameters".

Michael Moore, Comm'r, CA Energy Comm'n: Need better planning, particularly in the area of natural gas infrastructure. Winter gas demands are increasing and interstate pipelines are nearing full capacity.

Jacob Williams, Veep (Generation Development), Peabody Energy: Coal supply and coal generation are sufficient to meet current needs. The most important issue is tx constraints. The value of building tx is the avoided cost of constraints (reduced price of power). Once a project is built, we need sustained higher prices to offset the risk of the project and compete with BPA.

Danny O'Hearn, Northwest Portfolio Manager, Powerex: Tx upgrades are economically efficient. According to recent analyses, several tx projects could be paid for in less than two years with the avoided costs (i.e., reductions in power prices). It is difficult to get the necessary upgrades built because of dealing with two non-FERC jurisdictional entities in this area. Right-of-way issues are a struggle. (It appears that the projects would be primarily located in Washington -- to relieve the constraints faced when shipping power from Canada to California.) BC supports any FERC effort to solve tx problems in the NW. [Ed. note: Canada, I've heard, will be a big winner if an RTO is established. Who do you suppose the losers will be?]

Robert Howard, Veep & Gen'l Mgr, PG&E Gas Tx - NW: We must establish a robust wholesale market for natural gas. PG&E is the largest importer of natural gas from Alberta (99% comes from Canada) and thus wants future pipeline capacity to be assured. The market needs to make long-term investments. One difficulty is the discordant nature of state regulations.

Mark Maher, Sr Veep (Tx), BPA: BPA needs immediate tx expansions and upgrades. We cannot wait for RTO West, which will not be up and running until late 2004/early 2005. BPA needs approval of increased borrowing authority now. The system has exceeded its capacity. Realistically, an additional 5-7,000 MWs will be coming on line with in the next few years (this is 1/3 of the current proposed plans). We do not have the necessary tx capacity to handle this increase. BPA has been forced to de-rate parts of its system. Chairman Wood asked if BPA could start on any of these projects now (without the increase in borrowing authority). Maher said that two or three of the projects are included in BPA's current budget, but most are in the planning stages and hinge on the borrowing authority increase. In response to Maher's suggestion of a RTO West start-up date, Brownell noted that that's that's a loooong time. Maher said that if the filing is submitted to FERC on March 1 and FERC approves the filing within 90 days; the six states take one year to review and approve the filing; the FUs spend 12-18 months appointing a board, hiring staff, buying a building, purchasing computers and software; and the operational personnel spend six months getting the system up and running, RTO West will be open for business in late 2004. [Ed. note: Hubris may dictate building a huge new edifice for RTO West, adding another couple of years to the schedule.]

Bob Anderson, Comm'r, MT Public Service Comm'n: Discussed demand side management. The supply side has been liberated by deregulation and demand remains constrained. More deregulation is not necessarily the answer. The region needs to focus on ensuring reliability, reasonable prices, and a clean environment. FERC must recognize the demand side when allocating the price of tx constraints. Howard (PG&E), agreed, saying that tx is truly constrained during only 5% of the year. Prescott (Idaho Power) said that digging too deep on the demand side puts barriers on business -- we need regulatory and political certainty.

The second panel focused on identifying factors inhibiting adequate energy infrastructure investment. (Why is needed infrastructure not being built? What barriers have to be overcome? What must state and federal governments do to overcome these barriers?)

Christine Uspenski, Electricity Analyst, Charles Schwab & Co.: It is misguided to look at dereg from the perspective of doing no harm. From her perspective, "life isn't about doing no harm." Ironically, she noted shortly thereafter that there is a lack of trust in between "us". Move our focus away from low retail rates and toward securing reasonable long-term investments. Use water dereg as a model for success. State regulators need to know the difference between investors and ratepayers. [Ed. note: I love this panelist. "Trust us, we're gonna screw ya!"]

Walt Higgens, Top Dog, Sierra Pacific Resources (and representing TransConnect): The greatest barrier to tx projects is the fragmented rules of federal regulatory agencies. For example, a project was delayed for two years and cost an additional $35 million due simply to the federal hoops his company had to jump through. Sometimes the solution to a tx problem will not be a fix in one state. Sometimes the solution is needed in an adjoining state. Not only are there jurisdictional hurdles to solving these problems, but often there are complicated cost allocation problems as well.

Judi Johansen, Pacificorp: A self-described shameless evangelist for RTOs. FERC should not wait for Congress to solve problems; push RTOs now. FERC should work with the White House to coordinate the federal agencies. The Clean Air Act is the next big issue and we must align the region's environmental agenda with our future energy plan. Comm'r Brownell told Johansen (outside the hearing room) that it was nice to have someone sane on the panel in reference to Johansen's opinions about RTOs.

James Martin, Environmental Defense Fund: We must balance the region's need for power with the environmental impacts of tx and generation expansion.

Lindy Funkhouser, Director, Residential Utility Consumer Office (AZ): Ratepayers are suffering from rate shock. We must include consumer education in our regional energy plan. Consumers will get behind infrastructure expansion if they are informed about the region's needs.

Paula Burgess, Natural Resource Advisor, BLM (WA and OR office): BLM supports energy infrastructure improvements and is working on issues relating to defining utility corridors, solving right of way issues, and streamlining the siting process for projects on or near federal lands. Existing federal and state permitting processes are complex. There is a great need for an integrated planning process. BLM conducted a study and was able to identify utility corridors and build them into the land use plans. This saved time and money and should become common practice. Sixteen FERC licenses are up for renewal; they are important to the region and will require much work of many parties.

William Keese, Chairman, CA Energy Comm'n: Demand side solutions need to be part of the equation. California reduced demand by 10% during the energy crisis.

Finally, there was a discussion among state and federal officials of next steps, particularly what FERC can do to help the states. Marilyn Showalter said that FERC can monitor markets; address problems of siting on federal lands; help states participate in hydro licensing with funding; support additional borrowing authority for BPA; and support RTOs that address actual NW issues, especially hydro.

Bill Chamberlain, CA Energy Comm'n: Re Wood's skepticism on whether three RTOs can work in the west, states will participate in WECC. Congestion management is the most difficult issue.

Dick Hemstad, WA UTC, was troubled by warp speed process. Most westerners are appalled at CA.

A rep from a New Mexico energy agency does not believe that FERC siting is necessary. The problem is with federal agencies, not states. Maybe Congress should give FERC authority to make decisions when federal agencies don't agree. Congress should support the states and give them a role in reliability. Marsha Smith said that there should not be a FERC side and a state side.

Carl Wood, Comm'r, CA PUC: Agreed with everyone and said there was unanimity. There was a breach when CA took off on its own, with catastrophic consequences for CA and neighbors. We are not self-sufficient, but rather mutually dependent. The states need FERC protection. [Ed. note: Pls excuse any barf you may see on your screen. It's mine.]

A UT energy policy analyst said that the next steps should be to develop a framework through the Western Governors' Ass'n and have an energy policy plan that would involve DEQ, interstate siting and other, e.g., environmental, concerns. Then the next step would be for FERC to join with the states.

Brownell said to state regulators, "we were you, we are you." It can be done right. She said she learned a lot and asked "Wow, can we absorb it all?" [Ed. note: Obviously, this mtg went way too long.]

Chairman Wood summarized a FERC "to-do-list" of seven big things:

1. Western "energy strategy" -- keying off the Western Governors' Ass'n, he could support the states' effort on integrated resource planning.

2. Demand-side participation in the market is a valuable component of wholesale market as power plants. FERC will work with the WGA and others to develop a plan.
3. Infrastructure -- develop a short-run conceptual plan that can be acted upon soon. Work with CREPC, WECC and other organizations to identify and move forward with these projects.
4. Infrastructure -- look at supply and demand loads over 10 years and develop a long-term plan. The RTO will be responsible for this. (This may be a hint that FERC intends to grant the RTO broader planning authority than the FUs have currently built into their planning protocol.)
5. Gas -- have to get $$ back to investors -- support incentives and innovative rate designs.
6. Streamline and standardize processes (note similarity to the theme of Camp RTO).
7. FERC will come back to region and visit us again. [Ed. note: Apparently a good time was had by all.]

FERCers said that we must move on. Treading water results in "tired infrastructure." We're good at knowing who should be at the table, and when they can't decide, FERC will.

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FERC DOCUMENTS ATTACHED
Last Friday, FERC posted the four attached materials concerning demand, supply (gas and electric), markets and tx in the west. (If you view the attachments, the infrastructure research document has some blank pages. They are to be filled in by the graphics from the attached graphics document.) A highlight is the bullet that says just 20 entities (10%) own 73% of total western capacity, while 20 entities produce 71% of the generation. The accompanying notes says

These are a couple of points that are not on the chart. 10% of the entities in the Western states (most of them are holding companies) own 73% of the capacity and 10% of the entities produced 71% of the generation output. Also, from 1996 through 2000, generation output from gas-fired units increased a whopping 221%, while hydro decreased 17% and other types of generation increased only 20%, and all this, while installed capacity changed very little. The increased output can be seen on the next graph.


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