

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Remedying Undue Discrimination)
through Open Access Transmission Service) Docket No. RM01-12-000
and Standard Electricity Market Design)

COMMENTS OF THE WESTCONNECT RTO, LLC APPLICANTS
ON THE STANDARD MARKET DESIGN
NOTICE OF PROPOSED RULEMAKING

Pursuant to the Notice of Proposed Rulemaking issued by the Commission on July 31, 2002, and the revisions to the public comment schedule issued on October 2, 2002, in the above-captioned docket, the WestConnect Applicants^{1/} submit their Comments on the Commission's proposal to establish a standard market design and a revised, uniform open access transmission tariff applicable to all public utilities with existing open access tariffs on file with the Commission.^{2/}

I. INTRODUCTION AND EXECUTIVE SUMMARY

1. Central Purpose Of SMD: The central purpose of the SMD NOPR should be to create wholesale power markets that support robust competition and innovation without impairing service to retail customers under existing service obligations or rights under existing

^{1/} The WestConnect Applicants include Arizona Public Service Company ("APS"), El Paso Electric Company, Public Service Company of New Mexico and Tucson Electric Power Company ("Tucson Electric"). Also participating in the development of the proposal were the Salt River Project Agricultural Improvement and Power District, the Western Area Power Administration ("Western"), and the Southwest Transmission Cooperative, Inc. (collectively "non-jurisdictional entities"). The non-jurisdictional entities have concluded, however, that it would not be appropriate to participate as WestConnect Applicants until further legal and regulatory issues are resolved.

^{2/} See *Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design*, FERC Stats. & Regs. ¶ 32,563 (2002), 67 Fed. Reg. 55,452 (2002) ("SMD NOPR").

contracts. These new markets must reflect the regional nature of bulk power commerce and permit the electric industry to evolve efficiently and reliably as new technologies emerge. The WestConnect Applicants support these objectives and have put forward a regional transmission organization (“RTO”) proposal that includes a comprehensive Southwest regional market design. Further, we are negotiating with others in the West to eliminate seams between the Southwest and other parts of the Western Interconnection.

2. Market Restructuring In The West: Numerous individuals and institutions have implored the Commission to allow the West to move on its own path toward restructuring. In approving the RTO West and WestConnect proposals, the Commission has signaled that it believes its market restructuring objectives can be achieved in the West through the creation of at least three RTOs with compatible (*i.e.*, seamless), but not necessarily identical market designs. The WestConnect Applicants urge the Commission to allow the Seams Steering Group – Western Interconnection (“SSG-WI”) process that is underway in the West for developing compatible, seamless wholesale markets to go forward. This process can be successful if the RTOs in the West are permitted to work together to achieve the common goal of compatible markets without undue barriers to trade. The Commission should not permit any one of the sub-regions in the West to move forward on its own path or timeline in a manner that may ultimately exacerbate seams issues. Specifically, although the Commission understandably wants to replace the existing California wholesale market design promptly, it should do so with the understanding that the California market may require additional change to effect a seamless wholesale market in the West as a result of the SSG-WI process. California and the Commission must view the SSG-WI process holistically to achieve a compatible, seamless western market.

3. Timing Of Market Restructuring: Any impatience the Commission may have with the pace of change in the West should be tempered by the recognition that the region is emerging from a period of considerable market turmoil that has created an understandable aversion in some quarters to rapid change. The aggressive implementation schedule set forth in the SMD NOPR, as it applies to the Western Interconnection, should be abandoned. It does not reflect the time required to negotiate and implement new market and system operating arrangements in regions that have no history of tightly pooled operations, nor the time required to obtain State approvals for the transfer of operating authority to RTOs or Independent Transmission Providers (“ITPs”), which must precede the expenditure of significant sums of money on RTO implementation. The Commission also should make clear that it does not expect utilities to temporarily transfer operating authority to an ITP when the Commission’s implementation deadlines are reached in circumstances where the utilities are already in the process of developing RTOs. Such a requirement would waste time and money and interfere with timely RTO development.

4. Protection of Retail Customers: The success or failure of wholesale market restructuring will be measured by its impact on retail electric consumers, and the WestConnect markets were designed with this paramount consideration in mind. The Commission must convince State regulators and other stakeholders in the West that the interests of retail electric consumers will be protected, whether or not a particular State chooses to move away from the traditional model of vertically-integrated utilities providing service in exclusive retail service areas. Language in the SMD NOPR suggesting that vertically-integrated utilities are part of the problem is unfortunate, ill-considered and not fact-based. The reality is that responsible wholesale market design can be achieved without interfering with retail service obligations of

vertically-integrated utilities; indeed there is no reason to spend huge sums of money on restructured markets and institutions if they will not enhance the ability to reliably and efficiently serve retail load. The Commission should make absolutely clear in the Final Rule that it does not intend otherwise and additionally explain how its market design proposal protects retail customer interests, with or without vertical integration and retail choice.

5. Allocation of CRRs: In terms of protecting retail customer interests, no issue is more important than the allocation of Congestion Revenue Rights (“CRRs”). The WestConnect Applicants spent considerable time, with the involvement of all stakeholders in the West, developing their proposal on the allocation of transmission rights, which the Commission has approved.^{3/} The same critical issue arises under a financial rights model like the SMD. In the SMD NOPR, the Commission has not been sufficiently clear that all load-serving entities, whether they be vertically-integrated utilities in States without retail choice or competitive and provider of last resort (“POLR”) suppliers in retail choice States, will have sufficient financial transmission rights to maintain reliability, efficiently integrate resources and loads, and acquire power from third parties to reduce costs to serve retail customers. The notion expressed in some circles that transmission rights used on behalf of retail loads (or needed to support load growth) should be “released” to the market must be rejected. Widespread acceptance of wholesale market restructuring will require certainty on this point.

6. Retail Transmission Rates: The Commission has proposed to assert jurisdiction over the transmission component of bundled retail rates currently regulated by the States. This change in jurisdictional responsibilities can work *only* if FERC and the States are in

^{3/} *Arizona Pub. Serv. Co., et al.*, 101 FERC ¶ 61,033 at P 160 (2002) (“WestConnect Order”)

agreement that the FERC-approved rates will be included in retail rates and actually recovered from retail customers. In this regard, FERC must be clear about its expectations concerning State treatment of FERC-approved transmission rates so that utilities can design retail rates consistent with FERC's new assertion of jurisdiction and be assured of the recovery of their costs. It makes no sense and would be unlawful to design a new system of FERC-regulated retail transmission tariffs and then have States set bundled (or unbundled) rates that are charged to retail consumers independently and without regard to the FERC-approved rate components. To a significant extent, the Commission can assist in the transition by approving, as it did in WestConnect, a sufficient transition period from existing rate structures based on individual service territories (license plate rates) to other regional rate structures.

7. **Cost-Benefit Analysis:** During the appeal of Order No. 2000,^{4/} the Commission indicated to the Court that it intended to perform cost-benefit analyses of RTO formation in each RTO region. Many States will demand that these studies be performed because of the significant changes FERC is implementing and uncertainty over the results. The Commission needs to develop a joint process with the States to perform and review cost-benefit analyses of wholesale market restructuring.

The remainder of these Comments address the following subjects:

- *Through and Out Service.* The WestConnect Applicants support the application of an export fee on through and out transactions in order to mitigate cost shifts and are working, through the SSG-WI process, towards the adoption of a pricing reciprocity agreement among the Western RTOs.
- *Uniform Cost Allocation.* Regarding whether there should be uniform cost allocation of inter-regional costs among all zones within an ITP's system, the WestConnect Applicants believe that the ITP or RTO should retain the ability to decide this issue.

^{4/} See *Pub. Util. Dist. No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

- *Assignment of CRRs to Customers in Another Region.* The WestConnect Applicants believe that long-term firm service should get the CRRs associated with their service. Under the WestConnect proposal, the transmission rights for existing contracts for long-term firm service over a congested path are grandfathered and excluded from the auction. Therefore, all unconverted existing contracts receive the Non-Converted Rights (“NCRs”) associated with their service regardless of their location. Further, transmission rights associated with converted existing contracts receive the Firm Transmission Rights (“FTRs”) associated with their service.
- *Pricing of New Transmission Capacity.* The WestConnect Applicants support the principle of Participant Funding to the extent that it represents an effort to impose incremental transmission costs on those who cause them to be incurred and therefore benefit from the upgrades to the transmission system. However, the Commission has not defined Participant Funding with sufficient particularity in the SMD NOPR to evaluate meaningfully what the Commission intends. The WestConnect Applicants, therefore, request that the Commission put forth a specific proposal for implementation of Participant Funding, so that interested parties will have an opportunity to comment.
- *Western Approach to Congestion Management.* The Commission’s proposed congestion management remedies in the SMD NOPR should not apply to the Western Interconnection. The West has already developed a process, which the Commission has recognized, through which congestion management issues will be resolved and which will address the differing congestion management mechanisms in the three RTO regions. The goal of this group, through the SSG-WI process, is to mitigate or eliminate seams related to congestion management in the Western Interconnection while accommodating, as much as possible, the basic attributes of each RTO’s congestion management model.
- *CRR Allocation for Existing Long-Term Uses.* The WestConnect Applicants support the Commission’s proposed approach whereby customers continue to pay their embedded cost charges in exchange for CRRs that reflect their current levels of point-to-point service, with the caveat that CRRs should be allocated to whomever pays the access charge. The WestConnect Applicants also advocate that the Commission allow the option of premature termination of existing contracts if the affected parties reach mutually acceptable terms.
- *CRRs Should Follow the Retail Load.* The WestConnect Applicants support CRRs following retail load and the WestConnect Tariff proposes such an approach. The WestConnect Tariff, at Appendix A.9.2, allows the FTR revenues to remain with the requirements loads.
- *Multi-Year CRRs.* The WestConnect proposal envisions initially offering transmission rights of a maximum term of one year with a variety in the transmission rights less than the one-year maximum, including month-long, multiple day and daily blocks of FTRs. The WestConnect Applicants recognize the need to issue longer-term CRRs in the future and are committed through the WestConnect tariff to develop longer-term (multi-year) and/or seasonal (multi-month) blocks of FTRs.

- *CRR Revenue Shortfalls.* The WestConnect Applicants believe that the Commission is looking to the wrong party for incentives on CRR revenue adequacy and oppose the Commission's proposal. Penalizing transmission owners for shortfalls would create further disincentives for them to turn over operation of their transmission facilities to an ITP. The WestConnect Applicants suggest that the development of ITP incentives is a more proper way to address this issue.
- *Scheduling Protocols.* The WestConnect Applicants believe that an RTO should have flexibility in structuring its scheduling protocols, and thus the Commission should not hard-wire specific requirements into the SMD Final Rule.
- *Transmission Losses.* The WestConnect Applicants believe that losses should be calculated on a forecast, marginal basis, and that there should be both seasonal and peak/off-peak differentiation. The WestConnect Applicants believe that customers should account for all transmission losses when they schedule transmission service. If the customer does not schedule enough power to cover its losses, it will be assessed an energy imbalance charge for the shortfall.
- *Day-Ahead Energy Market.* For the WestConnect region, this aspect of the SMD NOPR is inapplicable because the WestConnect proposal does not include a centralized, day-ahead energy market. The underlying issue of compensation for generators that create additional transfer capability is addressed in WestConnect, however, through the local generation resource aspect of the RTO proposal by which generators in the WestConnect region would be compensated for operating outside of the deadband. Thus, the WestConnect Tariff provides for full compensation of generators and, therefore, no further compensation is required.
- *Penalties for Uninstructed Deviations.* The WestConnect Applicants believe that penalty provisions for uninstructed deviations are necessary in order to ensure that the system runs efficiently and reliably, and the RTO and/or ITP must be able to assess adequate penalty charges for any uninstructed deviation.
- *State Participation.* The WestConnect Applicants believe that there are jurisdictional issues that must be addressed before the Commission involves itself in issues regarding the participation of States in the oversight of wholesale electricity markets. The WestConnect Applicants do not believe that the FERC should dictate to States, and other applicable regulatory authorities, how they are to participate in decisions that directly affect the cost and reliability of retail electric service and local siting decisions. Instead, the Commission should allow States and other applicable regulatory authorities within each RTO region to decide how they want to participate in this process.
- *Regional Planning.* The WestConnect Applicants agree that regional planning is necessary for the development of truly competitive regional electric markets, but disagree that this issue must be determined, or mandated, through the SMD Final Rule, particularly in light of the rapid progress the West is making in developing its regional planning process. The

WestConnect Applicants believe a right of first refusal for construction of new transmission facilities for TOs under an ITP or RTO is necessary in the new market design.

- *Merchant Transmission's Obligation to Build.* The WestConnect Applicants feel that no such obligation should be required of merchant transmission providers. Although the Commission initially needs to clearly define merchant transmission, the WestConnect Applicants believe that merchants should not be forced to upgrade their facilities if it would discourage their entry into the market. Merchant transmission providers should not, however, be allowed to hoard rights-of-way to corridors if upgrades are necessary and others are willing to invest in expanding the system.
- *Transmission Credits for Customer-Owned Facilities.* WestConnect Applicants believe that which facilities must be under the operational control of an ITP and which customer-owned facilities are entitled to a credit are separate questions. The question of credits for customer-owned facilities should not be resolved by the proposed seven-factor test or any other test for classifying facilities as transmission. Rather, the determinative question for credits for customer-owned facilities has been and should remain whether facilities are integrated into the transmission provider's transmission system and thus provide a benefit for all users.

II. RATES FOR BUNDLED CUSTOMERS

- *Whether all customers should be charged the same transmission rate either upon implementation of SMD, or after a reasonable transition period of four years? (SMD NOPR at P 178)*

The WestConnect Applicants as a group are not taking a position in these Comments on whether the Commission may lawfully assert jurisdiction over the transmission component of bundled retail rates. However, assuming the Commission chooses to follow through on its proposed assertion of such jurisdiction in the SMD NOPR, the WestConnect Applicants believe the Commission must be clear about what this means for utilities that are subject to State regulation of their retail services. To date, the Commission has not been clear on this issue, and this lack of clarity makes it difficult, if not impossible, for utilities to design retail rates in a manner that is consistent with the FERC's new assertion of jurisdiction.

In at least one prior RTO Order, for example, the Commission has suggested that it would be sufficient if utilities incorporate the transmission component of State-approved rates

for transmission service in their FERC tariffs.^{5/} In the SMD NOPR, the Commission does not state whether this is still the Commission's view or whether it now believes that States must allow utilities to include FERC-approved transmission service rates as the transmission component of their retail service tariffs. Assuming the Commission has not changed positions, it has not explained how the incorporation of the transmission component of State-approved bundled retail rates would be accomplished for utilities operating in States where retail rates are established on a bundled basis and no separate transmission rate or charge exists.

The Commission also has not made clear whether the Commission has the right (and/or obligation) to review the State-approved rates independently under Section 205 before they are included in FERC tariffs. If, as the Commission apparently believes, it can take jurisdiction over the transmission component of retail rates, this would imply that those rates would have to be filed with FERC under Section 205 and would be subject to FERC acceptance or approval. In other contexts, the Commission has stated that it may not carry out its responsibilities simply by allowing utilities to use the transmission component of State-approved bundled rates in FERC-jurisdictional rates.^{6/}

Finally, the Commission has not set forth the mechanisms that it intends utilities to use in preventing the "trapping" of FERC-approved costs, such as the costs of forming an RTO or ITP. The WestConnect applicants believe that they cannot be required to incur transmission costs without an opportunity to incorporate those costs into retail tariffs in such a manner that they can

^{5/} *Carolina Power & Light, Co.*, 94 FERC ¶ 61,273 at 61,999, *order on reh'g*, 95 FERC ¶ 61,282 at 61,990-61,991 (2001).

^{6/} *See Appalachian Power Co.*, 65 FERC ¶ 63,008 at 65,049 (1993); *Consumer Advocate Division v. Allegheny Generating Co.*, 69 FERC ¶ 63,016 at 65,115-16 (1994); *Allegheny Generating Co.*, 65 FERC ¶ 63,026, at 65,178 (1993).

be recovered in full. In a large number of cases, utilities have previously agreed to lengthy fixed rate periods or rate caps at the retail level and do not have the ability to charge retail customers for FERC-required costs they incur. This situation is unacceptable and unlawful in circumstances where FERC is asserting jurisdiction for the first time. Even where utilities are not subject to fixed rate agreements or rate caps, there needs to be a clear understanding of how FERC-approved transmission service rates should be incorporated into retail rates that are charged for bundled retail service.

For example, one workable solution would be to allow utilities to pass along the cost of transmission through a separate line-item charge, in much the same way as local telephone companies. Another possible solution would be for utilities to include a separate, unbundled “FERC-transmission” component in addition to their retail rates for generation and distribution service, which would include all of the FERC-approved transmission costs and would operate like a fuel adjustment clause in that the component would change as FERC rates change.

At the end of the day, unless FERC and the States are in agreement regarding this issue, the Commission’s new assertion of jurisdiction will not work correctly, and utilities will face the trapping of costs between wholesale and retail jurisdictions. While the Commission may believe that this is a problem for individual utilities to work out with their States, the WestConnect Applicants believe that the above issues must be resolved contemporaneously with the FERC’s new assertion of jurisdiction to assure the recovery of their costs and thus avoid an unlawful result. In particular, the WestConnect Applicants have no interest in spending large sums of money to form an RTO or ITP in circumstances where they have no ability to recover those costs. Such cost recovery may come entirely from the wholesale customer class or from a combination of wholesale and retail customers, but the methods and procedures for recovering

those costs cannot be swept under the rug.

III. INTER-REGIONAL TRANSFERS

A. Adjustment Mechanism For Through-And-Out Service

- *What approach should FERC adopt to recognize the import/export quantities in establishing the revenue requirement to be recovered through the access charge? (SMD NOPR at P 185)*

In its discussion of inter-regional transfer issues, the Commission recognizes the need for a transmission charge for through-and-out service to avoid cost-shifts.^{7/} The Commission has proposed two possible approaches to recognize the import/export quantities in establishing the revenue requirement to be recovered through the access charge: (1) the “source” ITP allocates a portion of its revenue requirement to the “sink” ITP’s transmission customers (“Option 1”); and (2) under a revenue crediting approach, inter-regional transfers could be priced at the load ratio share charge (or a similar transmission charge) (“Option 2”).^{8/}

The WestConnect Applicants support the Commission’s view that these types of transactions should be subject to a charge mechanism so that systems such as WestConnect’s, that are net exporters of power, are compensated adequately for such transactions. Indeed, compensation for such transactions was an important part of the stakeholder negotiations that resulted in the WestConnect proposal.

The WestConnect Applicants continue to support the application of an export fee on such transactions to mitigate cost shifts. Under the WestConnect proposal, all transmission service provided by WestConnect for purposes of exports or wheel throughs (exclusive of transactions under existing contracts that are not converted to WestConnect transmission service) would be

^{7/} SMD NOPR at P 184.

^{8/} SMD NOPR at P 186-187.

assessed the higher of the average WestConnect system-wide rate or the applicable access charge of the zone where the transaction exited the WestConnect system. Such a proposal would still result in transmission charges less costly than those currently incurred due to the elimination of pancaking within the WestConnect region. The Commission has approved a through and out approach as a transitional pricing mechanism for WestConnect.^{9/}

While the WestConnect Applicants have proposed a rate for export and wheel through transactions, the Applicants are active in determining solutions for pricing reciprocity among the Western RTOs, one of the key goals of the SSG-WI process. The Pricing Reciprocity Work Group under SSG-WI is working toward reciprocity pricing arrangements regarding the treatment of exports between the RTO systems, using a model similar to the approach proposed in the Commission's Option 1. Once seams reciprocity pricing arrangements between the RTOs are finalized and the transition period ends, export charges would be eliminated, creating a seamless Western market.

B. Uniform Cost Allocation

- *Whether there should be a uniform cost allocation of inter-regional costs among all zones within an ITP's system?* (SMD NOPR at P 188)

The Commission also seeks comment on whether there should be uniform cost allocation of inter-regional costs among all zones within an ITP's system.^{10/} The WestConnect Applicants believe that the ITP or RTO should retain the ability to decide this issue. Because ITPs will vary from region to region, the decision of how to allocate the inter-regional costs should not be

^{9/} WestConnect Order at P 129; *Arizona Pub. Serv. Co., et al.*, 101 FERC ¶ 61,350 at P 12 (2002) ("WestConnect Rehearing Order").

^{10/} SMD NOPR at P 188.

decided by the Commission at this time. Rather, the ITP or RTO should be allowed to make the choice of allocation best for its particular region.

C. Assignment of CRRs To Customers In Another Region

- *How should CRRs to the customers in one region that are paying a portion of the embedded costs of another region be assigned?* (SMD NOPR at P 189)

The Commission also seeks comment on how to assign CRRs to customers in one region that are paying a portion of the embedded costs of another region.^{11/} The WestConnect Applicants believe that long-term firm service should get the CRRs associated with their service. Under the WestConnect proposal, the transmission rights for existing contracts for long-term firm service over a congested path are grandfathered and excluded from the auction. Therefore, all nonconverted existing contracts receive the NCRs associated with their service regardless of their location. Further, transmission rights associated with converted existing contracts receive the FTRs associated with their service. The WestConnect Applicants believe this approach is an appropriate remedy for the concern raised by the Commission.

IV. INTERREGIONAL PRICING FOR PARALLEL PATH FLOWS

- *To the extent the Commission adopts a true-up methodology for recovering the costs of through-and-out services, should a similar pricing methodology be applied to parallel path flows? How should the cost impact of parallel path flows across regional borders be addressed?* (SMD NOPR at P 190)

The WestConnect Applicants provide no comments on the SMD proposal for parallel path flow issues as the Commission has approved the WestConnect solution on this issue.^{12/} Because the Commission has stated that it will not alter its decisions concerning settled RTO

^{11/} SMD NOPR at P 189.

^{12/} WestConnect Order at P 178.

issues,^{13/} the WestConnect region will not be affected by the outcome of this issue in the Final Rule.

V. PRICING OF NEW TRANSMISSION CAPACITY

- *Whether the pricing proposals are appropriate to meet FERC's goal of expediting needed infrastructure investment, or whether another method would be more effective?* (SMD NOPR at P 202)

The Commission states in the SMD NOPR that it is considering the adoption of “Participant Funding” for transmission upgrades as part of the adoption of SMD. The WestConnect Applicants support the principle of Participant Funding to the extent that it represents an effort to impose incremental transmission costs on those who cause them to be incurred and therefore benefit from the upgrades to the transmission system. The Commission’s existing policy, which simply assumes that all “network upgrades” should be rolled-in, sends incorrect price signals and creates disincentives to construct new transmission facilities.

Under the existing policy incremental transmission costs are often borne by customers that do not materially benefit from the upgrade, *i.e.*, when the upgrade is made to interconnect and deliver power from a new generator whose output will be used to serve a third party. Until the Commission gets the pricing right for transmission upgrades, new generation will be built in the wrong places, total congestion costs will increase unnecessarily, and ultimately electric consumers will be worse off.

However, the Commission has not defined Participant Funding with sufficient particularity to evaluate what the Commission intends. The WestConnect Applicants, therefore, request that the Commission put forth a specific proposal for implementation of Participant Funding, so that interested parties will have an opportunity to comment.

^{13/} WestConnect Order at P 4, WestConnect Rehearing Order at P 7.

VI. CONGESTION MANAGEMENT

A. The Western RTOs Are Resolving These Issues Through The SSG-WI Process.

The Commission's proposed congestion management remedies in the SMD NOPR should not apply to the Western Interconnection. The West has already developed a process, which the Commission has recognized, through which congestion management issues will be resolved and which will address the differing congestion management mechanisms in the three RTOs in the region. The SSG-WI process includes input from each of the Western RTOs and has established a working group (the Congestion Management Alignment Work Group) and a schedule to resolve congestion management specific issues.

The goal of this group, under the SSG-WI process, is to mitigate or eliminate seams related to congestion management in the Western Interconnection while accommodating, as much as possible, the basic attributes of each RTO's congestion management model. The Western RTOs will work through SSG-WI to create a seamless market through the entire Western Interconnection by creating solutions which maximize the benefits for all market participants. Because most of the congestion management issues will be resolved through the SSG-WI process, the Commission should allow the West to decide what congestion management systems work best for the region.

Although the WestConnect Applicants feel that the congestion management method proposed in the SMD NOPR should not be applied to the West, the WestConnect Applicants provide some guidance on how the Commission should resolve congestion management issues if the Commission ultimately requires the West to comply with the Final Rule on these issues.

B. CRR Allocation To Existing Long-Term Uses

- *Whether existing customers that are not LSEs, but are taking long-term Point-to-Point Transmission Service, should receive an initial allocation of CRRs if they also pay a share of transmission embedded costs? Or, whether the access charges for these customers should be eliminated, while also allocating no CRRs to them? Whether the Final Rule should select one option or, alternatively, allow customers to choose between them? (SMD NOPR at P 172)*

The Commission in the SMD NOPR requests comment on the treatment of existing customers taking long-term firm Point-to-Point Transmission Service that are not load-serving entities.^{14/} The Commission suggests two options: (1) customers continue to pay their embedded cost charges in exchange for CRRs that reflect their current levels of Point-to-Point Service, and (2) elimination of the access charges for these customers while also allocating no CRRs to them.^{15/} The WestConnect Applicants suggest that for Point-to-Point Transmission Service for non-load serving entities, the first option proposed by the Commission is the superior option, with the caveat that CRRs should be allocated to whomever pays the access charge.

The WestConnect Applicants also advocate that the Commission allow the option of premature termination of existing contracts if the affected parties reach mutually acceptable terms. Although the WestConnect Applicants firmly agree that all existing long-term agreements should be allowed to continue in their entirety, the parties to the existing agreements must also have the option to mutually agree to terminate the agreement, converting the agreement to conform with the standard form of Network Access Service under the SMD. This option would allow customers to enter the market sooner and reap the benefits of the Commission's standard market design.

^{14/} SMD NOPR at P 172.

^{15/} *Id.*

The Commission has held firm through Order No. 888, Order No. 2000, and subsequent RTO orders that it intends to balance the sometimes competing goals of honoring the rights of existing contracts with the need for a uniform approach to transmission service under an RTO tariff. This approach should continue under the SMD. However, in instances where contracting parties can mutually agree to early termination, the choice to remain under existing contracts or to take service under the newly proposed transmission service must be made available. Under the WestConnect proposal and the terms of Appendix E to the WestConnect Tariff, there are no additional WestConnect charges to customers taking service under existing contracts that are not converted to WestConnect transmission service and customers under such agreements will continue to receive the same service as they have enjoyed prior to commencement of WestConnect operations.

Existing contract customers continue to pay Participating TOs for service under these agreements in accordance with the terms of the agreements. However, upon conversion or termination of existing contracts, transmission service will be provided in accordance with the WestConnect Tariff. Under this voluntary conversion process, approved by the Commission, the transmission customer may best determine if the WestConnect Tariff service better suits its transmission requirements.^{16/} It is the position of the WestConnect Applicants that the choice to convert or terminate existing contracts, under mutually agreed termination terms, must be an option provided under the SMD to allow customers the full range of opportunities to obtain service under the new market design.

^{16/} WestConnect Order at P 108.

C. CRRs Must Follow the Retail Load if the Retail Load Leaves its Traditional Supplier

- *How LSEs in open access States that attract loads away from their traditional utility suppliers should receive an allocation of the customer's former LSE's CRRs in areas where there is no Available Transfer Capability for additional CRRs? (SMD NOPR at P 173)*

The Commission also seeks comment on how to allocate CRRs to new load-serving entities that attract load from other suppliers in retail open access States.^{17/} The Commission notes in the SMD NOPR that for States that have retail competition, provisions must be in place to ensure that CRRs stay with the load.^{18/} The Commission recommends that any new retail marketer serving load previously served by the local utility would receive a proportionate share of CRRs.^{19/} The WestConnect Applicants wholeheartedly agree with the Commission's position on this issue as a protection for customers from congestion charges.

The WestConnect Tariff proposes just such an approach. The WestConnect Tariff, at Appendix A.9.2, allows the FTR revenues to remain with the requirements loads. This section first states that WestConnect will credit FTR auction revenues consistent with State or local jurisdiction retail open access plans once such plans are in place. Where State and local plans do not define a methodology for the distribution of the FTR auction revenues, WestConnect will credit such revenues on a pro-rata basis to the Scheduling Coordinators representing the load. The load is the determining factor for the allocation of the FTRs. The WestConnect Tariff also commits WestConnect to work with market participants to develop an allocation methodology for the associated FTRs and payment obligations in the future.

^{17/} SMD NOPR at P 173.

^{18/} SMD NOPR at P 378, fn. 186.

^{19/} *Id.*

Further, one of the States in the WestConnect footprint, Arizona, has already placed a similar protection in place. The Arizona Independent Scheduling Administrator (“AZ ISA”), under Protocol V of the AZ ISA Protocols Manual, provides that network capacity previously used in serving retail load is made available for retail access. Under the initial apportionment, the two major transmission providers in the State of Arizona, APS and Tucson Electric (both now participants in the proposed WestConnect RTO), made available certain amounts of capacity on specified transmission paths presumed most likely to be used for retail access. The Commission found the allocations to be appropriate.^{20/} The Commission also stated that the proposal to allow existing retail load transmission capacity to follow the retail load as it is released to retail choice was consistent with the rollover rights afforded under Section 2.2 of the pro forma tariff.^{21/}

Moreover, the Commission found this provision a reasonable accommodation to spur competitive access to reduce the dependence of new competitive suppliers on internal generation resources that are owned by the transmission provider and its affiliates.^{22/} Although this allocation has been approved only as a temporary mechanism, the Commission has allowed the mechanism to stay in place until an RTO that serves the retail load is functional.^{23/} While the AZ ISA is not intended to create any precedent for the RTO ultimately formed in this region, it does provide an example of a method that has been successful in the region and has received approval

^{20/} *Arizona Indep. Scheduling Adm’r Ass’n*, 93 FERC ¶ 61,231 (2000).

^{21/} *Id.* at 61,761.

^{22/} *Id.*

^{23/} *See, Arizona Indep. Scheduling Adm’r Ass’n*, 99 FERC ¶ 61,038 at 61,144 (2002).

from the Commission. The WestConnect Applicants, therefore, encourage the Commission to adopt the similar mechanism proposed in the SMD NOPR.

D. Multi-Year CRRs

- *Whether the Commission should require an ITP to offer multi-year CRRs when SMD is first implemented?* (SMD NOPR at P 249)

The Commission requests comment on whether multi-year CRRs must be offered on Day One operations under SMD.^{24/} The WestConnect Applicants respond that this proposal is not necessary for initial implementation of the SMD. The WestConnect Applicants have proposed a workable solution in its region for Day One operations. The WestConnect proposal envisions initially offering transmission rights of a maximum term of one year. The WestConnect proposal, however, offers variety in the transmission rights less than the one-year maximum, including month-long, multiple day and daily blocks of FTRs. The WestConnect Applicants believe that the availability of FTR which can be tailored to specific needs and grandfathering of capacity for existing contracts will ensure an adequate mechanism for Day One operations.

The WestConnect Applicants recognize the need to issue longer-term CRRs in the future. In fact, WestConnect is committed through its tariff to develop longer-term (multi-year) and/or seasonal (multi-month) blocks of FTRs.^{25/} The WestConnect Applicants believe that the first goal should be to get the markets in place and then to implement the widest variety of options possible to encourage further development. The Commission should allow the markets to develop through the initial phase of implementation with only the basic requirements in place.

^{24/} SMD NOPR at P 249.

^{25/} WestConnect Tariff, Appendix A.4.1.4(a).

E. Revenue Shortfalls

- *FERC proposes that any revenue shortfalls for funding CRRs would be made up by the transmission owners whose facility outage caused the shortfall. FERC is also proposing that transmission owners receive any surplus from CRRs as well but seeks comment on the potential of this policy to discourage transmission expansion and if alternative mechanisms should be considered. (SMD NOPR at P 251)*

Under the SMD NOPR, holders of CRRs will be entitled to receive congestion revenues associated with transmission congestion in each hour of the day-ahead market. When a significant amount of transmission facilities are out of service, the ITP may collect less in congestion charges from transmission users and loads than the amounts owed to CRR holders and generators. The Commission proposes to handle such revenue shortfalls by assigning them to the transmission owner whose transmission facilities are out of service, with an exception for outages due to *force majeure* events. The Commission also proposes to assign CRR surpluses to transmission owners, but is concerned that such a policy may also create an interest on the part of transmission owners in maintaining congestion and thus may discourage them from building needed transmission expansions.^{26/}

A physical rights model for congestion management, such as the one proposed by the WestConnect Applicants, would not encounter the problem of revenue shortfalls. Therefore, WestConnect is not affected by the outcome of this issue in its Day One operations. However, because other Western RTOs have adopted a financial rights model and the West is working toward compatible designs for congestion management, the WestConnect Applicants submit their thoughts on this issue to aid in the development of a workable model.

The WestConnect Applicants believe that the Commission is looking to the wrong party for incentives on CRR revenue adequacy and oppose the Commission's proposal. Penalizing

^{26/} SMD NOPR at P 250-251.

transmission owners for shortfalls would create further disincentives for them to turn over operation of their transmission facilities to an ITP. Further, under Order No. 2000, it is the RTO (not the transmission owner) that has the authority to coordinate and approve or deny transmission maintenance schedules. Additionally, under the SMD NOPR, the ITP will have ultimate responsibility for transmission outage coordination and will be responsible for determining the quantity of CRRs that can be issued, using a Simultaneous Feasibility Test.

The Simultaneous Feasibility Test should calculate transmission capacity with credible contingencies in accordance with NERC or regional reliability council criteria. If more than one transmission element is allowed out of service at a critical time, *e.g.* due to the ITP's decision to interconnect a generator or due to poor coordination of transmission maintenance, a revenue deficit may result, and an ITP could cause significant redispatch costs when the transmission system has less transmission capacity than was expected. Therefore, the ITP is the logical party to have a CRR revenue adequacy incentive, since it controls most of the key drivers of revenue adequacy. Such concerns have been acknowledged in previous orders where the Commission has found that it is inappropriate to send price signals to entities that cannot respond to those price signals.^{27/}

The WestConnect Applicants suggest that the development of incentives, including an incentive for CRR revenue adequacy, may be a way to address this issue. Such an incentive could be made symmetric, so that ITP benefits when its management of the system holds CRR revenue inadequacy below some benchmark level. It may also be appropriate to supplement

^{27/} See *Southern Co. Servs., Inc.*, 94 FERC ¶ 61,271 at 61,965 (2001).

such an ITP incentive with an incentive for transmission owners to minimize forced outages and outage durations.

However, any such incentive must be carefully crafted to focus only on events that are truly under transmission owner control. Transmission forced outages can occur for many reasons beyond a transmission owner's control, including ice storms, hurricanes, equipment failures and the like. Defining the "bright line" between force majeure events and the normal outages that can take place on a transmission system is a difficult, if not impossible, task. Yet if a transmission system experiences a period of transmission outages beyond what was expected in the CRR process, revenue deficits can significantly exceed revenue surpluses.

Although the WestConnect Applicants believe that it is appropriate for FERC to mandate full funding of CRRs to ensure consistency across regional markets, it is not necessary or appropriate to have uniform treatment of how the full funding will be accomplished. Mandating full funding by allocating the cost to transmission owners is, in effect, a zonal uplift. The WestConnect Applicants believe that a more appropriate approach would be to develop an appropriate set of incentives for the ITP.

VII. DAY-AHEAD AND REAL-TIME MARKET SERVICES

- *Whether transmission customers should be able to respond to price signals by submitting multi-hour block bids, requesting transmission service for a block of consecutive hours and indicating the maximum price for the entire multi-hour period? (SMD NOPR at P 259)*
- *Whether a customer should be allowed to provide a schedule for multiple days or have a standing scheduling request that would remain in effect until changed by the customer? (SMD NOPR at P 263)*

The WestConnect Applicants believe that an RTO should have flexibility in structuring its scheduling protocols, and thus the Commission should not hard-wire specific requirements into the SMD Final Rule. WestConnect has developed a detailed scheduling protocol, which can

be found in Appendix B to the WestConnect Tariff. A WestConnect transmission customer would be able to accomplish any of the stated bidding strategies in the WestConnect model, as long as the customer has secured sufficient transmission rights – either firm or recallable – sufficient to cover the requested service. Any transmission capacity that is secured by an FTR, but is not scheduled for use by the FTR holder, is released into the market. This fosters a secondary market and prevents the hoarding of rights by allowing others to use the capacity on a recallable basis. *See* WestConnect Tariff, Appendix A.4.1 (discussing release of FTRs).

VIII. TRANSMISSION LOSSES

- *Whether transmission losses should be recovered on the basis of the marginal cost of losses or if they should be recovered on the average cost of losses? (SMD NOPR at P 267). Whether transmission customers should have the choice of paying for losses in cash or in kind, or alternatively, whether all transmission customers should be required to pay for losses in cash? (SMD NOPR at P 268)*

The WestConnect Applicants believe that losses should be calculated on a forecast, marginal basis, and that there should be both seasonal and peak/off-peak differentiation. It is necessary to differentiate loss factors in this manner because the Southwest is dominated by seasonal load patterns, which can have a noticeable effect on the amount of losses incurred.

Seasonal and peak/non-peak differentiation are needed to account for the fact that the amount of losses on a line increases as the power flows on the line increase. Generally, electrical losses change as the amount of current flowing changes based on a squared factor, *i.e.*, if the current on a line doubles, the losses increase by a factor of 4. Thus, during peak hours (and high load seasons), when the line loadings can be significantly higher than the loadings during non-peak hours, the amount of losses incurred for a particular power flow can significantly exceed the amount of losses that would be attributable to the same power flowing during non-peak hours.

Allowing for some regional flexibility on this issue would reflect the unique characteristics of the transmission grid in the WestConnect region. The extreme heat conditions in the region, and the predominance of long high voltage transmission lines, contribute to the need for differentiation in loss factors over different time periods. Finally, the WestConnect Applicants believe that customers should account for all transmission losses when they schedule transmission service. If the customer does not schedule enough power to cover its losses, it will be assessed an energy imbalance charge for the shortfall.

IX. DAY-AHEAD ENERGY MARKET

- *Whether generators who provide real or reactive power should receive additional compensation (in addition to the locational market price for energy and the applicable compensation for reactive power) for the additional transfer capability that they create, to provide incentives to produce energy that increases transfer capability? Should such generators be given the CRRs with the additional transfer capability that they create? (SMD NOPR at P 283)*

For the WestConnect region, this aspect of the SMD NOPR is inapplicable because the WestConnect proposal does not include a centralized, day-ahead energy market. The underlying issue is addressed in WestConnect, however, through the local generation resource aspect of the RTO proposal. (*see, e.g., WestConnect Tariff, Appendix D.9*). In this regard, generators in the WestConnect region would be compensated for operating outside of the deadband pursuant to WestConnect Tariff, Appendix D.15.2, which provides the following:

D.15.2 PAYMENTS FOR VOLTAGE SUPPORT. A Generator or other entity representing a Generating Unit that provides an Ancillary Service Resource for Voltage Support pursuant to a competitive procurement process as described in Section D.10.4.c shall be paid pursuant to the terms of the agreement between the Generator or other entity representing a Generating Unit and WestConnect produced by that process. For dispatch of the Resource beyond the range specified in an Interconnection Agreement, [Generator Agreement] or [Existing Contract] or the requirements of Section D.12.c, the Generator or other entity, as applicable, shall be paid the amount of Resource capacity, in MW, made unavailable for Energy production due to the redispatch for Voltage Support multiplied by the higher of: (1) the Demonstrable Cost, in \$/MW, imposed

upon the Generator or other entity, as applicable, by the obligation to make the Resource available for Voltage Support, including the demonstrable impact on lost MWh production; or (2) the Market Clearing Price of Spinning Reserve for the Settlement Period; and (3) capped by any contractual or regulatory price cap that the Generator or other entity, as applicable, may charge for Voltage Support capacity from the Resource.

Thus, the WestConnect Tariff provides for full compensation of generators and, therefore, no further compensation is required.

The WestConnect Applicants do not believe that the RTO should be providing this compensation directly, however. That would impose a non-market solution on what is a market problem. Instead, if a party that is financially responsible for the cost of congestion can reduce its costs by paying a generator to increase or decrease its output, then the customer should have the incentive to do so. Socializing this cost would instead mask this incentive, and impose the cost on other customers.

The RTO should be in the business of facilitating this transaction between the transmission customer and a generator, however. The RTO would do this by providing the necessary information to the marketplace that will enable generators and transmission customers to determine that economically beneficial transactions are available. By providing this information in a timely and usable manner, all market participants will benefit, and the RTO would not move over into the area of participating in market transactions. If the RTO does a good job of supplying the marketplace with information about the condition of the system, efficient transactions between generators and transmission customers will occur naturally.

- *Whether market participants should face additional charges for “uninstructed” deviations in real time from their schedules, (i.e., for producing or taking a different amount of energy in real time than was scheduled without permission or schedules may increase the amount of regulation service or other ancillary services that the ITP must procure, in order to reliably balance load and generation); is it appropriate to recover the costs of these services through a charge? (SMD NOPR at P 316)*

- *Whether the SMD Tariff should include penalty provisions for uninstructed deviations that threaten system reliability, and how such penalty provisions should be structured? (SMD NOPR at P 316)*

The WestConnect Applicants believe that penalty provisions for uninstructed deviations are necessary in order to ensure that the system runs efficiently and reliably. For a period of time, the lack of penalty provisions was one of the major problems with the California markets, and the questionable scheduling practices of some California market participants was one cause of the significant fluctuations in spot market prices in California during the 2000 and early 2001 time period. To avoid the potential replication of these problems, and to eliminate incentives for gaming the system through uninstructed schedule deviations, the RTO and/or ITP must be able to assess adequate penalty charges for any uninstructed deviation. The WestConnect RTO Tariff contains penalty provisions in Appendix D.19 (for over-scheduling or under-scheduling of demand), and D.20 (for balancing energy penalties).

- *What should be the scope of ITP's proposals filed with the Commission regarding the implications for market pricing of each reliability procedure? (SMD NOPR at P 327)*

Even with a perfectly designed market, there will be unavoidable circumstances that arise with the potential to affect system reliability. In these circumstances, the ITP must have sufficient authority and flexibility to manage the system in real-time in order to preserve reliability in accordance with the applicable industry standards and guidelines. As an example, Appendix C to the WestConnect Tariff allows WestConnect to declare either a System Insufficiency or a System Emergency, and to take the necessary action to rectify the situation. During a System Insufficiency, WestConnect may procure additional bids for Ancillary Services in order to rectify the insufficiency. During a System Emergency, WestConnect's primary objective is to preserve the reliability of the system. The costs for any services procured under a

System Insufficiency or System Emergency are allocated to all scheduling coordinators. *See* WestConnect Tariff, Appendix C.8.3(e), C.9.3(f).

- *Whether treating Scheduling, System Control and Dispatch Services as a basic cost of providing transmission service, instead of as an ancillary service, is appropriate?* (SMD NOPR at P 284, fn. 149)

As long as the appropriate cost is recovered, and the rate is appropriately designed, it should not matter whether this charge is encompassed in the transmission service charge or as a separate ancillary service rate. The WestConnect Applicants would prefer that the cost of Scheduling, System Control and Dispatch Service be recovered as a separate charge in order to avoid socialization of such costs. *See* WestConnect Tariff, Appendix D.2.9.

X. TRANSITION TO SINGLE TRANSMISSION TARIFF

- *Whether and under what circumstances load growth should be accommodated in the direct allocation of CRRs?* (SMD NOPR at P 376)

The SMD NOPR states:

In general, these customers would not be granted an initial allocation based on additions for future load growth, but would have to secure those rights. However, there are instances where the vertically integrated transmission provider has identified load growth and limited the term (and rollover rights) of point-to-point transmission contracts. We seek comment as to whether and under what circumstances load growth should be accommodated in the direct allocation of Congestion Revenue Rights.

SMD NOPR at P 376.

Allocation of CRRs for retail load growth should not mean that a retail load customer receives an initial allocation of CRRs for all expected future load growth. Rather, allocation of CRRs for retail load should mean an allocation of CRRs each year based on expected peak load for that year. Until the CRRs are needed for load growth, they would be available for other users of the transmission system.

If the Commission adopts a process that does not allocate CRRs for retail load growth, it will fail to recognize a key objective of energy markets, which should be designed to provide potential savings to retail customers. A failure to provide CRRs for load growth would leave retail customers unprotected from cost increases associated with the existing system. Moreover, such an approach ignores the fact that the vast majority of the existing transmission grid has been funded through the rates paid by retail load. Even under the proposed SMD Tariff, the retail load continues to pay the embedded revenue requirements through the Network Access Charge. Furthermore, a failure to allocate CRRs for future loads will compromise the ability of utilities who are POLRs to serve new loads in their certified service areas at rates that are comparable to those assessed their existing customers.

Retail load's payment of the embedded revenue requirements of the grid entitles them not only to the capacity associated with their load but also to the full capacity that the grid is capable of supporting in its embedded state. To the extent additional capacity exists relative to serving that load, such capacity should be used in a residual auction process. However, the amount that is auctioned should always be adjusted first by allocating the then-current expectation for retail load.

XI. STATE PARTICIPATION

- *Should there be a single Regional State Advisory Committee for all issues, or separate committees for siting and other issues? How should the state representatives be selected (e.g., by the governor, or through some other process)?* (SMD NOPR at P 553)

The WestConnect Applicants believe that there are jurisdictional issues that must be addressed before the Commission involves itself in issues regarding the participation of States in the oversight of wholesale electricity markets. The WestConnect Applicants do not believe that the FERC should dictate to States, and other applicable regulatory authorities, how they are to

participate in decisions that directly affect the cost and reliability of retail electric service and local siting decisions. Instead, the Commission should allow States and other applicable regulatory authorities within each RTO region to decide how they want to participate in this process.^{28/}

The only backstop that should apply in this area is that of RTO independence. The WestConnect Applicants agree that the Commission must ensure that no State interferes with independent decision-making by the management of an RTO if such State is a pervasive participant in the relevant electric markets, such as to make the State itself a market participant.

XII. OTHER ISSUES

A. REGIONAL PLANNING

1. Western entities are resolving this issue through SSG-WI

The Commission in the SMD NOPR cites regional planning as a way to improve efficiency in the market place and to develop regional competitive wholesale electric markets.^{29/} The WestConnect Applicants agree that regional planning is necessary for the development of truly competitive regional electric markets, but disagree that this issue must be determined, or mandated, through the SMD Final Rule, particularly in light of the rapid progress the West is making in developing its regional planning process.

^{28/} In this regard, the Western Governors' Association recently adopted a resolution calling for Congress to allow states to create regional mechanisms to address regional power issues, and asking that FERC defer to the states on such decisions. The resolution specifically identified reliability, transmission system planning and expansion, maintenance requirements, and market monitoring as areas where a cooperative input from the affected states would be the best approach. Policy Resolution 02-26, *Western States' Energy Policy Roadmap* (June 25, 2002) (available at www.westgov.org).

^{29/} SMD NOPR at P 329, 335-336.

The West is making substantial progress in the development of a seamless marketplace through the work of the Seams Steering Group – Western Interconnection (“SSG-WI”). The issue of regional planning is a primary focus of the SSG-WI process. In fact, the goal of the Planning Work Group under SSG-WI is to provide a forum to further the development of a planning process that will result in a robust West-wide interstate transmission system that is capable of supporting a competitive and seamless West-wide wholesale electricity market. This group, which includes members of all of the Western RTOs, is diligently pursuing the framework for a regional planning process for the entire West, not just for the smaller sub-regions that may be defined as regional markets. The Planning Work Group has proposed a schedule for the resolution of its highest priority issues which envisions the presentation of proposed resolutions to the Steering Group by the second quarter of 2003.

2. The Need for a Right of First Refusal for Transmission Owners

Although the Commission has not proposed such a right as a part of the SMD NOPR, the WestConnect Applicants stand firm that a right of first refusal for construction of new transmission facilities for TOs under an ITP or RTO is necessary in the new market design. Under the WestConnect Tariff, TOs whose systems must be modified or expanded to support a proposed project will have a right of first refusal for construction and ownership of projects and support facilities that are proposed by either WestConnect or other third parties. Such an approach recognizes the inherent difficulty in siting and building transmission and was designed to provide a framework for expansion that would allow for quick implementation. The right of first refusal was also included in the Applicants’ proposal as a way to ensure that none of the rights related to construction of facilities would be reduced before the time came for Applicants’

to transfer facilities to WestConnect. The proposal does not limit WestConnect's ability to build within its footprint.

Such an approach is necessary to maintain the support of public power, which is a significant factor in the WestConnect proposal. Many of the transmission facilities which will be under the control of WestConnect are jointly owned by private and public power entities. The expansion of these jointly owned facilities in many cases requires, by the terms of the contracts, that the joint owners construct and own any new upgrades to the line. Therefore, it is essential that the Participating TOs who are joint owners of these facilities have the right of first refusal over expansions to these lines to comply with the agreement of joint ownership.

The right of first refusal for integrated transmission facilities is also a requirement for Western to participate in WestConnect. Specifically, the right of first refusal is critical to enable Western to ensure that relevant laws will be complied with and its statutory responsibilities will be satisfied. For example, absent specific Congressional authorization, Western may not jointly own property with others. In addition, Federal law places many limits on the availability and use of funding for Western facilities. The right of first refusal under the WestConnect tariff allows Western to perform the work on its own facilities, or to achieve satisfactory alternative arrangements, thus avoiding potential joint ownership and financial issues. In short, in order to meet its legal obligations Western must retain ownership of its transmission facilities, and the ultimate management and control of those facilities. The right of first refusal for these facilities is a necessary component of such management and control.

Further, under the WestConnect Applicants' proposal, a TO whose system must be expanded or modified to support a project that is part of the Regional Transmission Expansion Plan ("RTEP"), known as a WestConnect Upgrade, shall have the first option to construct and/or

own such facilities under the Transmission Control Agreement (“TCA”). If it is a project outside of the RTEP, known as an Elective Upgrade, the TO shall have the right to build the Elective Upgrade. *See* TCA, § 6.2.5.

The Commission should not disturb this aspect of the WestConnect proposal in its Final Rule. The rights reserved on behalf of TOs, found in Section 6.2 of the TCA, were an important part of the negotiations in the Southwest and are necessary to maintain the significant non-jurisdictional support that the WestConnect proposal currently enjoys. Many of the non-jurisdictional entities in the Southwest, as well as the State commissions in the WestConnect region, would be unable to support any proposal that gave third parties unfettered rights to construct and own facilities on the transmission systems of those entities that choose to participate in WestConnect.

B. MERCHANT TRANSMISSION

In response to the request for comments on whether a merchant transmission provider should have an obligation to expand its merchant transmission facilities, issued by the Commission on November 26, 2002, the WestConnect Applicants feel that no such obligation should be required of merchant transmission providers. Although the Commission initially needs to clearly define merchant transmission, the WestConnect Applicants believe that merchants should not be forced to upgrade their facilities if it would discourage their entry into the market. Merchant transmission providers should not, however, be allowed to hoard rights-of-way to corridors if upgrades are necessary and other are willing to invest in expanding the system.

The SMD NOPR endorses the concept of "merchant" transmission facilities as an alternative for meeting regional needs for new transmission infrastructure. The WestConnect

Applicants believe that such merchant facilities (*i.e.*, projects that are promoted and funded by third parties who retain certain property rights in the newly created capacity) are realistic development options for only a very small portion of transmission system needs. Merchant transmission facilities have valid application such as direct current (DC) facilities, linking low cost generation sources (*e.g.*, hydropower or lignite sources) to major load centers, and selected radial lines that serve point-to-point customers. Merchant transmission projects are especially problematic for network additions.

Experience thus far tends to confirm the view that merchant transmission project development is unlikely to result in a significant expansion in the number of new lines being added to the system. Such merchant projects make sense where (i) they can be planned and developed somewhat independently of the interconnected regional transmission system and, (ii) the benefits of such projects (measured in terms of enhanced transfer capability and lower nodal price spreads between defined points on the network) can be forecast with reasonable accuracy over a reasonable time horizon.

For example, the unidirectional power flows on portions of the western transmission system may lend themselves to merchant DC projects. In this case, it may be possible to isolate and measure the incremental transfer capacity added by the project, thereby facilitating the award and resale of definitive property rights.

The incremental capacity associated with most new AC facilities cannot be isolated from the overall transfer capacity of the existing interconnected system; as a result, such projects do not lend themselves to merchant development based on vested property rights. In addition, allowing segments of a network to be removed from service or restricted for strictly economic reasons would impose costs and risks on other users/owners of the network. Further, the

RTO/ITP has limited ability to curtail the development of new generation and demand-side management options, which could materially alter system dynamics and transfer capacity almost immediately after the award of property rights in a new merchant transmission project. The system dynamics would again be impacted for the large percentage of projects whose primary focus is enhanced reliability rather than increased transfer capability.

The WestConnect Applicants also believe that allowing any market participant to bid for the rights to develop and construct new transmission projects as proposed in the SMD NOPR, undermines the financial viability of stand alone transmission companies. Most new transmission projects will have to be integrated with the existing interconnected system. Allowing unlimited rights for third parties with no service obligation to develop new transmission projects in an area already served by an incumbent transmission utility effectively reduces the role of that utility to that of “transmission provider of last resort.” With this responsibility to serve the transmission needs of its customers, the utility could be exposed to significant financial risk if the third-party transmission developer decides to “back out” of a project if the short-term market conditions change.

Financial markets are likely to view such a default provider role as allowing limited growth opportunities by excluding them from the most attractive expansion opportunities, while imposing on them the burden and associated risks of those projects that are not attractive to the marketplace. If a bidding process is to be implemented as part of the market design effort, it should not restrict the ability of existing transmission utilities to develop needed reliability improvements in their service areas and effectively serve their customers.

Allowing merchant facilities to be built within an existing network will also introduce growing inefficiencies in the system. Today, a TO looks at multiple needs for new transmission

facilities and develops projects, which solve multiple problems or meet multiple needs. Merchant facilities will, by definition, mainly be focused on single needs. The benefits of planning and building for a multitude of needs is lost, causing either more facilities to be built to meet the unmet needs or causing some legitimate needs to not be met.

In brief, the WestConnect Applicants believe that the public good characteristics of most transmission services and the difficulty of isolating the benefits of a single component of an integrated AC network will limit the role of merchant facilities in meeting the nation's critical needs for new transmission infrastructure. Excessive reliance on market-based approaches for building new transmission facilities is likely to result in under building. Since merchant transmission facilities have relatively limited financial and physical application, the regional planning process contemplated by the SMD NOPR should include the development of such facilities but should not endow them with any preferences or special advantages in comparison with development by incumbent TOs.

C. THE COMMISSION SHOULD REAFFIRM CONTROLLING “INTEGRATION” STANDARD APPLICABLE TO CREDITS FOR CUSTOMER-OWNED AND CUSTOMER-FINANCED FACILITIES.

Under the heading “Transmission Facilities That Must be Under the Control of an Independent Transmission Provider,” the SMD NOPR describes confusion relating to two separate questions. Specifically, P 361 seeks comment concerning (i) which facilities belong under the control of the RTO and (ii) which customer-owned transmission facilities are entitled to a credit. The Commission notes that disputes arising from these questions historically turn on whether facilities are integrated and some involve the voltage level at which a facility is determined to be transmission. The NOPR proposes that the question of eligibility for credits be subsumed under the question of which transmission facilities must be under the control of an

ITP. However, this proposal conflicts with other language in the NOPR and, further, it conflicts with certain aspects of the WestConnect Order and WestConnect Rehearing Order. The result is more confusion.

WestConnect Applicants believe that which facilities must be under the operational control of an ITP and which customer-owned facilities are entitled to a credit are separate questions. The question of credits for customer-owned facilities should not be resolved by the proposed seven-factor test or any other test for classifying facilities as “transmission” or determining which facilities are under the operational control of the RTO. WestConnect Applicants believe that the determinative question for credits for customer-owned facilities has been and should remain whether facilities are integrated into the transmission provider’s transmission system and thus provide a benefit for all users.

The confusion arises in part from paragraphs 361 through 369 of the SMD NOPR and in part from rulings in the WestConnect Order and the WestConnect Rehearing Order. Paragraph 361 of the SMD NOPR initiates the confusion by positing that under the new rule, the only question is which facilities are under the control of the ITP. Paragraph 368 reiterates this proposition, concluding that once a facility is determined to be transmission, there would be no need for review under the previous integrated facilities test. However, that same paragraph concludes that the determination of facilities under the operational control of an ITP (i.e., which facilities are “transmission”) does not dictate transmission pricing. See also n. 173 appended to P 368 and NAS tariff, section 3.9, which both stand for the proposition that credits are a separate question.

Yet, credits are an element of transmission pricing. If the inquiry ends once it is determined that a facility should be under the operational control of the ITP because it is a

transmission facility, and if therefore there is no need for review under the previous integrated facilities test, how is the question of credits for customer-owned facilities to be decided?

The confusion is compounded by the WestConnect Order and the WestConnect Rehearing Order. The WestConnect Order did not discuss Appendix N of the WestConnect tariff, which specifies the facilities that would be under WestConnect's operating control. Thus, that provision is approved and will not be modified by the SMD rule. However, the WestConnect Order directed WestConnect Applicants to modify their tariff with respect to credits for customer-owned facilities, citing the SMD NOPR discussion of facilities under the operational control of the RTO or ITP, and concluding in a footnote (as the NOPR also concludes) that once a determination is made that a facility is transmission, there is no need for further review under the previous integrated facilities test. P128. The WestConnect Rehearing Order denied, however, that the WestConnect Order had prescribed a particular standard for determining transmission credits, stating that this provision is subject to the outcome of the SMD NOPR. P 43 and n. 53.

Notwithstanding the various conflicting proposals and directives noted above, WestConnect Applicants submit that socializing costs of customer-owned facilities that are not shown to provide benefits to the RTO grid would be error. It is inconsistent with controlling authority in case law, inconsistent with Order Nos. 888 and 888-A and *TAPS*,^{30/} and is bad policy. The Commission should clarify that the integrated facilities test applies.

^{30/} *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 at 726 (D.C. Cir. 2000) (“TAPS”).

The Commission adopted the integration test for credits for customer-owned facilities in *Florida Municipal Power Agency*,^{31/} then prescribed it as the industry-wide standard in Order No. 888, and codified it in section 30.9 of the Commission-prescribed OATT. The integration test was the subject of numerous requests for rehearing and more analysis on rehearing in Order No. 888-A. The standard also was affirmed on review in the United States Court of Appeals for the D.C. Circuit.

In Order No. 888-A, the Commission noted that:

The intent of section 30.9 of the pro forma tariff is that, for a customer to be eligible for a credit, its facilities must not only be integrated with the transmission provider's system, but must also provide additional benefits to the transmission grid in terms of capability and reliability, and be relied upon for the coordinated operation of the grid. Indeed, in the Final Rule we explicitly stated that the fact that a transmission customer's facilities may be interconnected with a transmission provider's system does not prove that the two systems comprise an integrated whole such that the transmission provider is able to provide transmission service to itself or other transmission customers over these facilities.^{32/}

Under an interconnected-but-not-integrated standard, owners of low voltage or limited and discrete "transmission" facilities^{33/} would be entitled to credits, shifting costs of their systems to the other customers of the transmission provider. Further, without integration and joint planning, the usefulness of the facilities to the grid and the costs for which credits may be provided are not subject to control by the jurisdictional transmission provider nor, in the case of

^{31/} *Florida Municipal Power Agency v. Florida Power & Light Co.*, 74 FERC ¶ 61,006 (1996) ("FMPA").

^{32/} Order No. 888-A, *supra* at 30,271.

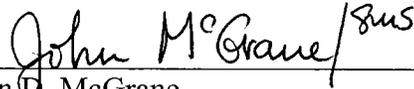
^{33/} Owners of limited and discrete transmission facilities routinely are granted waivers of the requirements of Order Nos. 888 and 889 to provides service under an OATT, maintain an OASIS, and observe standards of conduct (for public utilities) and of the reciprocity requirement (for non-public utilities).

facilities owned by non-jurisdictional entities that are not participants in an RTO, by the Commission. All grid users should not be burdened by paying costs for facilities owned by customers, where those facilities are not useful as a part of the transmission grid, providing service and value to all users. The result of compressing two separate questions and determining pricing (i.e. credits) based upon a determination that a facility should be classified as transmission simply will be cost shifting, duplication, or unnecessary construction with no public benefit.

XIII. CONCLUSION

The WestConnect Applicants respectfully submit these comments and urge the Commission to consider the arguments raised herein. The WestConnect Applicants further urge the Commission to continue its path towards regional variation and not adopt a “one-size-fits-all” approach in this SMD NOPR. The central purpose of the SMD NOPR should be to create wholesale power markets that support robust competition and innovation without impairing service to retail customers under existing service obligations or rights under existing contracts. These new markets must reflect the regional nature of bulk power commerce and permit the electric industry to evolve efficiently and reliably as new technologies emerge. The Commission has taken positive steps through its recognition of SSG-WI as the primary vehicle for implementing a western market design and should continue on this path towards the creation of seamless energy markets in the West.

Respectfully submitted,



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