



(Reclamation) and the Army Corps of Engineers (Corps). Project use loads, which are designated by Congress and carry out project purposes such as pumping of irrigation water, must be met first. Power in excess of the requirements of project use load is available for marketing by Western. Western has built high voltage transmission lines or entered into long-term transmission contracts for widespread distribution of this generation to preference customers (non-profit public bodies, such as rural electric cooperatives, municipal utilities and Indian tribes). Western's statutory obligation to market the Federal hydropower extends for the life of the Federal project.

The marketing of Federal hydropower to non-profit public bodies first is required by Federal law, e.g., 43 U.S.C. § 485h(c), and is a fundamental principle reflected in Western's project-specific marketing plans. Section 9(c) of the Reclamation Project Act of 1939, 43 U.S.C. § 485h(c), and § 5 of the Flood Control Act of 1944, 16 U.S.C. § 825s, reflect the congressional policy of not allowing profit to be made by private investors on Federal power resources constructed with taxpayer dollars.

By law, Western markets hydroelectric power pursuant to rate schedules that are cost-based. This requirement has been recognized in the Secretary of Energy's delegation order that makes Western's rates subject to review by the Commission. Department of Energy Delegation Order No. 00-037 (December 6, 2001) requires the Commission to review power and transmission rates for Western to determine "whether the rates are the lowest possible to customers consistent with sound business principles" and "whether the revenue levels generated by the rates are sufficient to recover the costs of producing and transmitting electric energy."

Many of the specifics of SMD are still evolving. Western is concerned that implementation of many aspects of the proposed SMD may result in costs that are not offset by benefits, which would result in rates that are not the lowest possible to customers. The specifics of how the Commission's initiatives will be implemented, particularly in the West, are still being defined by the RTOs and other stakeholders. Western cannot support implementation of a market design that would place Western at risk of not meeting its statutory obligation to market Federal hydropower at the lowest possible rates consistent with sound business principles. Western must retain the right to use the capacity in the Federal transmission system required to market the Federal hydropower, pursuant to bilateral agreements with our preference and project use customers.

With this statutory obligation in mind and the mandate to establish the lowest possible rates consistent with sound business principles, some of the potential high impact areas in the proposed SMD which could present issues or increase costs for Western are as follows:

#### Transmission Rights and Congestion Costs

- Under SMD, Congestion Revenue Rights (CRRs) would be auctioned to those that value it most. (§ 140) In fact, CRRs could be purchased by entities having no intention of delivering power (§ 162). There would be no assurance that Western could obtain the rights it needs to honor its existing obligations. Without these CRRs, Western's costs for delivering firm power would increase, and at times Western may not be able to fulfill its contractual obligations for power delivery. Allocation of CRR options for the life of the

Federally constructed projects are required for Western to meet its statutory obligations and reduce the risk of increased costs. The CRR options must also recognize Western's use of the diversity in its system to meet the load requirements of its existing customers.

- Western's use of its transmission system varies, depending on hydrological conditions during a period of time. Given the hydro variability of the West and Midwest, Western needs to use its transmission system to deliver the output of the Federal resources to load or to acquire and deliver firming resources sufficient to meet our firm power commitments. Over the years, both flood and drought conditions have necessitated access to Federal transmission in excess of firm contractual commitments and in excess of recent historical use. In the past, Western has addressed this variability in need by marketing transmission on a withdrawable basis. Therefore, in order to preserve our existing position, Western must be allocated CRRs consistent with existing transmission rights rather than "recent historical usage of transmission" to meet its obligations in the future.
- When SMD is implemented, the Commission states that all customers would receive the same quality and quantity of service they currently receive. *See* ¶¶ 370-375. However, other sections of the SMD NOPR raise concerns that Western's existing transmission rights could be degraded in the future because of the load growth of others. Western does not have a requirement to meet load growth. Western has rights on congested paths that also involve other jurisdictional and non-jurisdictional entities that do have load growth

requirements. If pro rata reductions in CRRs were implemented as suggested in the NOPR, Western's rights could be degraded over time due to the load growth of others.

- Western has concerns that SMD will negatively impact the hydropower systems from which Western markets power if the plants are subject to the “must offer” requirement for generators when such a requirement would conflict with meeting the non-power purposes or environmental constraints of Federal projects.
- The allocation of adequate CRRs would in theory allow Western to avoid congestion costs, but CRRs are not equivalent to an actual physical transmission right. In general, Western has adequate transmission capacity or redispatch capability to schedule for its present contractual obligations today. Western is concerned that unless some priority is given to those customers that hold CRRs, Western's schedules could be limited when all requests for service during the day-ahead scheduling process cannot be met. This might compromise service quality and could result in cost increases as well as a possible breach of contract. In addition, the fact that CRRs are not available in real time presents serious concerns regarding significant and unintended cost shifts.
- Western provides transmission service under bundled wholesale power contracts, pre-Order No. 888, and OATT transmission service agreements. Western cannot unilaterally convert these contracts. Western believes that if these contracts were converted, all parties to these agreements should be

involved and the conversion should protect important contract rights by providing the necessary CRRs.

#### Transmission Costs

- Under Phase II of the SMD proposed rate design, embedded costs would be recovered through a license-plate access charge to only load-serving entities based on their respective load-ratio share of the system's peak load. Western encourages the Commission to accept the negotiated embedded cost rate design proposals that are being submitted by the potential participants in the various RTOs to mitigate problematic cost shifts under license plate rate designs.
- Western supports the SMD proposal to allocate a portion of the "source" revenue requirement to the "sink" RTOs for exports. (See our response to ¶¶ 185-188 for details.)
- Western does not support the SMD proposed embedded cost rate design without mitigation measures to reduce cost shifting. Western's transmission system is used extensively by loads physically located on other transmission systems, even in other RTO footprints. If Western were to have to collect 100% of its transmission revenue requirement from only the load physically located on Western's transmission system, as described under Stage II in the SMD NOPR, the customers physically located on Western's transmission system would have to absorb additional costs of up to \$227 million or 64% of Western's annual transmission revenue requirement.

- Although the main purpose of the license plate rate design is to minimize cost shifts among affected transmission owners, the design does not result in equitable treatment to all customers on the same independent transmission provider (ITP) or RTO grid. Mitigation measures are often difficult and complex to implement and may be difficult to maintain as all loads take service under Network Access Service in the future. Therefore, Western encourages the Commission to require a transition to a postage stamp rate, or a variation such as the highway-zonal model being considered by WestConnect and others. The postage stamp model is an equitable one under which all customers pay the same transmission rate for access to the bulk power transmission system. The appropriate transition period should be determined by the individual RTO.

#### Administration Costs

- Western is concerned that the complexity of the proposed SMD will result in significant start-up expense and annual operating costs. The current overhead cost of the California Independent System Operator (ISO), which is in excess of \$2.00/MWh for each transaction, is prohibitive. SMD will not succeed in lowering costs to consumers if similar expenses are incurred as a result of implementation. SMD costs are passed on to the users of the grid, and consumers have no recourse except to pay the increased costs, even if the envisioned benefits do not materialize. Western supports an incremental approach using existing infrastructure to reduce costs.

## Reliability

- The SMD NOPR makes proposals with regard to reliability issues in a number of places. Reliability issues are better left to the organizations that have been historically responsible for their development and implementation, such as the North American Electric Reliability Council (NERC) and the Western Electricity Coordinating Council.

Western urges the Commission to preserve the flexibility needed to accomplish its goals, and to refrain from adopting a rigid national standard that is insensitive to both institutional and regional needs. Western encourages the Commission to address undue discrimination issues in each region, and allow regions to develop practical solutions, focused on factual evidence. Regional solutions should avoid possible adverse economic impacts to consumers associated with a comprehensive approach. Competitive markets are more likely to be successful if a sufficient number of wholesale power market competitors exist, coupled with adequate supplies of both generation and transmission. The Commission should consider lower risk regulatory alternatives to SMD that promise to be more effective at enhancing the economic efficiency of the electric utility industry in an incremental and measured manner.

Although the Commission's desire to adopt SMD in a speedy manner is understandable, Western believes the primary objective must be to assure that the rules are workable for all parts of the country. The physical rights model that exists in the Midwest and the West has evolved over many years, and serves the region well. Any movement from a proven and well functioning system to one based on financial flow-

based rights should take place incrementally, to provide certainty to consumers, investors and marketplace participants.

Federal statutes both define Western's purpose and limit Western's ability to embrace fully all aspects of the SMD NOPR. Notwithstanding the unique nature of its Federal mission, Western is proactively engaged with others to explore RTO participation avenues that do not compromise its ability to meet its statutory obligations. Western has successfully negotiated provisions that would allow participation in RTOs, if the costs of participation, whether direct or indirect, are offset by commensurate benefits. Western's comments on the features of SMD similarly focus on an examination of the costs and benefits.

## **II. BACKGROUND**

Western is a Federal power marketing administration. It markets Federal power in fifteen central and western states, and owns and operates almost 17,000 miles of high voltage transmission facilities. Western sells power generated principally by hydroelectric plants constructed and operated by Reclamation and the Corps. Power is a secondary feature for these multi-purpose water projects, which were constructed primarily for irrigation, flood control and navigation purposes. Most of the Federal generation is sold under long-term contracts and delivered over the Federal transmission system or pursuant to contractual rights Western possesses over non-Federal transmission in the region. Western's transmission facilities were constructed to allow for the marketing and transmittal of Federal power, to acquire firming resources to meet Western's firm power commitments and to carry out other purposes related to our power

marketing mission. Transmission that is excess to these needs is made available pursuant to Western's open access transmission tariff (OATT).

### **III. COMMENTS**

#### **1. Non-Federal Control Over Federal Resources**

Western's authority to market power and transmission is derived from and limited by Federal law, including many unique statutes. Western cannot agree to be bound to SMD features that conflict with those legal responsibilities. Moreover, managing the high voltage grid for the sole or primary purpose of optimizing the economic efficiency of energy markets may be to the detriment of public values associated with rivers that generate Federal hydroelectricity in the western United States.

Western must retain the ownership of its transmission facilities, and the ultimate management and control of those facilities. Western cannot carry out its mission by converting the character of its transmission from Federal to non-Federal. Western may delegate the operation of its facilities to an Independent Transmission Provider (ITP), only if Western retains adequate oversight and ultimate control over the operation of its facilities. An agreement between Western and an ITP permitting the ITP to operate Federal facilities would have to specify the applicable conditions and parameters of such operations that would be consistent with Western's mission and sufficiently preserve Western's oversight role. Similar to the position Western has taken with RTOs, Western would have to retain the ability to terminate its relationship with an ITP if there is any breach of applicable conditions and provisions of the delegation agreement.

The Commission has proposed to refrain from granting native load preferential treatment under the SMD NOPR. Unlike the transmission used by jurisdictional utilities

to serve native load, Western's transmission and transmission rights carry out a Federal program, authorized by Congress and serving the purpose of stimulating vibrant regional wholesale power markets through yardstick competition. The Commission should not equate native load with the reservation of Federal transmission to carry out a congressionally mandated power marketing program, and attempt to implement SMD in a manner that violates Western's statutory obligations.

## **2. Reciprocity**

Western notes the inconsistency between the NOPR Preamble's discussion of reciprocity and the discussion in the proposed SMD Tariff. In particular, Section 4 of Part I.A. of the proposed Tariff appears to require the adoption of SMD by all entities who would take service under the Tariff on any system other than their own. Conversely, the Preamble proposes to continue Order No. 888's approach to reciprocity and to grandfather all reciprocity tariffs that the Commission previously found met the comparability standards of the aforementioned Order. Section 35.35(d) (3) of the proposed REGULATORY TEXT reinforces the Preamble's approach. Western supports the Preamble's proposal as being consistent with an incremental approach to enhancement of competition in wholesale power markets, while recognizing the Commission's jurisdictional limitations under law.

Western also notes that Section 4 of the proposed Tariff includes the ambiguous term "comparable transmission service". In light of Western's status as a Federal power marketing agency, Western believes that its provision of transmission service under its Commission-approved open access tariff<sup>1</sup> is inherently nondiscriminatory and thus

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<sup>1</sup> See United States Department of Energy-Western Area Power Administration, et al., 99 FERC ¶ 61,062 (2002).

reflects the spirit and intent of SMD. Therefore, with respect to Western and like public power entities, Western envisions that the term “comparable transmission service” would mean the provision of service under our existing OATT rather than the mandatory adoption of SMD.

### **3. Load Shedding and Curtailments**

In ¶ 159, the Commission is proposing that to the extent practicable, when system conditions require curtailments (in real time) that cannot be resolved through the congestion management system, the ITP should curtail the customers whose transactions contribute to the constraint on a pro rata basis. The Commission further proposes that to the extent the ITP is unable to schedule all requests for service made through the day-ahead scheduling process, those customers with CRRs for their requested receipt point-delivery point combinations should be scheduled first.

Western supports the Commission’s proposal to give those customers with CRRs a superior scheduling right during the day-ahead scheduling process and also during times of curtailment and load shedding. We do not believe that it would undermine the benefits of having a single transmission service for all customers if the Commission were to provide this additional certainty of delivery for holders of CRRs. Entities have entered into long-term contracts on the assumption that transmission would be available to accompany these contracts. If these entities receive CRRs for their existing transmission encumbrances, they would have an added assurance during the day-ahead scheduling process and during a curtailment or load shedding situation that their schedules have some protection from either being cut or not scheduled, similar to the existing rights under the contract. In addition to this, the Commission should also take into account the

scheduling priorities under existing contracts. When there is a need for curtailments, they should be consistent first with the existing priorities contained in existing contracts.

A new customer under the SMD Tariff could purchase CRRs if they wanted to achieve some certainty with respect to price and avoid congestion costs associated with a particular receipt point-delivery point combination. Since all customers under the SMD Tariff could potentially have an opportunity to purchase CRRs, which would provide this additional protection in the event of a curtailment or load shedding situation, providing the additional protection that the Commission is proposing should not undermine the benefits of having a single transmission service.

#### **4. Trading (Reassigning) Congestion Revenue Rights**

In ¶ 163, the Commission seeks comment as to whether all CRRs must be traded through the OASIS, or whether some bilateral sales may be made and only reported through OASIS after the sale.

Western believes that to promote an open market, it is important that CRRs be traded on the various OASIS sites. Western supports and encourages trading CRRs on the OASIS. This will enhance the perception of a fair and open trading electricity market. Since the Commission desires that CRRs be traded as transmission rights are currently traded under Order No. 888, then similarly, CRR trading should be conducted openly on the OASIS.

#### **5. Recovery of Embedded Costs**

##### **a. Treatment of non-LSE Customers**

In ¶¶ 171-2, the Commission proposes two options for the treatment of existing customers taking long-term firm Point-to-Point Transmission Service that are not load-

serving entities. One option is for these customers to continue paying their embedded cost charges in exchange for receiving CRRs that reflect their current levels of Point-to-Point Transmission Service. This option would help minimize cost shifts, while maintaining the transmission rights currently held by these customers. On the other hand, this option would recover a portion of embedded transmission costs from customers that are not loads. The second option is to eliminate the access charges for these customers while also allocating no CRRs to them. This option avoids recovering embedded costs from entities that are not loads. However, it would result in some shifting of the responsibility for recovering embedded costs, and it would fail to maintain the transmission rights currently held by these customers. The Commission seeks comment on the merits of the above two options, as well as whether the Final Rule should select one option or, alternatively, allow customers to choose between them.

Western recommends that the Commission give existing customers taking long-term firm Point-to-Point Transmission Service the option to continue paying their embedded cost charges in exchange for receiving CRRs that reflect their current transmission rights. As the Commission cogently observes, this option would serve to minimize cost shifts, a result that Western is committed to ensuring for our preference power customers if and whenever possible.

**b. Postage Stamp v. License Plate Rates and Intra-Regional Transfers**

In ¶ 174 of the proposed rule, the Commission proposes that transmission owners recover embedded costs through an access charge assessed mainly to load-serving entities, based on their respective shares of the system's peak load, i.e., their load-ratio shares. Second, the Commission proposes to eliminate all "rate pancaking" which

involves charging separate embedded cost charges for moving power within and between separate ITP service areas. The Commission proposed the use of license plate rates such as those that are currently in effect within certain ISOs. The Commission seeks comment, however, on whether the Commission should retain license plate ratemaking only for a transitional period and, at some later date, should require that all regions have postage stamp rates.

Western supports the Commission's proposal to require that all regions must have postage stamp rates following a transition period. Without mitigation measures, the license plate rate design causes problematic cost shifts for those entities, such as Western, whose transmission systems could provide the backbone of an RTO. These backbone systems are used extensively to move power from source to sink, and moving power from generators that are not always close to the load. It is these backbone systems that are used for through-and-out transactions and imports to load from generators outside the immediate area. Without these systems, there would not be adequate capacity for a competitive market from a wide range of generators.

However, under the license plate rate design, transmission owners whose systems are used extensively for moving power long distances to loads on other transmission systems, no longer receive revenue from these transactions, and therefore the customers physically located on their systems must absorb the shortfall.<sup>2</sup> The customers physically located on these transmission owners' systems are forced to pay significantly higher

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<sup>2</sup> Without mitigation measures under a license plate rate in Phase II, the customers on Western's transmission systems would have to absorb \$227 million or 64% of Western's annual transmission revenue requirement.

transmission rates, unless mitigation measures are incorporated.<sup>3</sup> Although necessary to reduce cost shifts, these mitigation measures are often difficult and complex to implement and are difficult to maintain as all loads take service under Network Access Service. For example, the Commission's option of allocating a portion of the source transmission owner's revenue requirement to the revenue requirement of the "sink" transmission owners requires significant negotiations and provision for true up in an attempt to keep cost shifts to a minimum (¶¶ 185-188). Similar mitigation measures would be required for both intra- and inter-ITP transactions. Another example is the complex arrangements for continued revenue streams between participating transmission owners, generators, and other holders of existing contracts in lieu of contract payments (Appendix F). Even the allocation of the revenue requirement for transmission system enhancements under the license plate rate model becomes a complex matter.

Although the main purpose of the license plate rate design is to minimize cost shifts among affected transmission owners, the design does not result in equitable treatment to all customers on the same ITP/RTO grid. For example, under the license plate rate design, customers of the same RTO pay different Network Access Service embedded cost transmission rates. All customers should pay the same embedded cost transmission rate for access to the bulk transmission system. Variations in payment should only result from the amount of congestion the load is willing to pay to move power across a congested path.

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<sup>3</sup> For example, in the WestConnect filing, the Transmission Adjustment Charge was included to collect the revenues which transmission owners such as Western would not recover from long-term, short-term and non-firm transactions, including revenues from through-and-out transactions, under the license plate rate. The WestConnect filing also includes provisions similar to those spelled out in Appendix F for payments of the access area rate by holders of converted long-term contracts in return for rights to transmission right auction revenue.

Therefore, Western encourages the Commission to accept negotiated proposals that have been submitted by the potential participants of RTOs to minimize cost shift among the participants for the interim period for internal transactions. In addition, we encourage the Commission to require a transition to a postage stamp rate, or a variation such as the highway-zonal model being considered by WestConnect and others, to provide equitable access for all customers. The appropriate transition period should be determined by the individual RTO. If some customers do not convert existing contracts prior to the end of the transition period, any double payments should be resolved between the transmission customer and the transmission owners, as specified in Order No. 888.

#### **6. Inter-Regional Transfers - Recognition of Import/Export Quantities in the Revenue Requirement**

In ¶¶ 185-188, the Commission proposes to create a mechanism that recognizes the import/export quantities in establishing the revenue requirement to be recovered through the access charge. The Commission seeks comment on two approaches that could be used.

Western receives a large percentage of its transmission revenue requirement from firm, short-term firm, and non-firm transactions to loads physically located on other transmission systems. Without some recognition of these transactions, the revenues from these exports would be forgone, and the loads physically located on Western's system would have to absorb these forgone revenues, under a license plate method.

Western supports the collection of access charges from all customers that use its transmission system. With regard to recognizing imports/exports between ITPs, loads benefiting from use of the transmission system should pay for the use of the "source"

transmission system. Western supports the first method presented by the Commission that the “source” ITP allocate a portion of its revenue requirement to the “sink” ITP’s transmission customers for transactions involving converted long-term firm point-to-point not paying the access charge of the “source” ITP, short-term firm and non-firm. This approach allows for immediate recognition of these transactions as a reduction in the “source” ITP’s revenues, and minimizes cost shifts. Western suggests that a true-up method be implemented to reflect differences from projections. Western suggests that the cost allocation under this method be between export zone to import zone to more accurately allocate the costs and revenues between the load and source<sup>4</sup>. This will prevent customers in zones that did not import from having to pay for benefits they did not receive. As part of this, Western suggests that the revenues be returned to the export zone. Western has concerns about the cost shifts that could occur if the cost allocation were done on an ITP to ITP basis, which may result in zones which did not supply exports receiving revenues, therefore creating cost shifts to customers within the zones of the ITP. Furthermore, the export zone to import zone cost allocation may provide the additional benefit of encouraging construction of new facilities in an export zone.

## **7. Treatment of Inter-Regional Transactions vs. Intra-Regional Transactions**

In ¶ 189, the proposed rule advocates treating inter- and intra-regional transmission pricing the same. As explained elsewhere, customers within the region who pay the access charge will be entitled to CRRs or the revenues from the auction of those rights. The Commission proposes a similar result for inter-regional transactions when customers in one region are paying a portion of the embedded costs of another region.

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<sup>4</sup> To limit cost shifts under a license plate rate model, a zone to zone cost allocation is required. However, under a postage stamp model, the cost allocation could be between ITPs revenue requirements and hence

The Commission is asking for comments on how to assign such CRRs to customers of the importing region.

The definition of “Access Charge” is a “charge designed to recover the embedded costs of the Transmission System.” By paying an Access Charge, a customer receives CRRs, which entitle the customer to receive (or obligate the customer to pay) specified congestion revenues. The Commission has stated that the purpose of its SMD Tariff is to create “seamless” wholesale power markets that allow sellers to transact easily across transmission grid boundaries and allow customers to receive the benefits of lower-cost and more reliable electric supply.

With those conditions in mind, Western supports the position that the ITP should be required to assign CRRs to customers outside of its region using the same procedures it uses to assign CRRs to customers within its region, and there should be no distinction in the allocation process of CRRs between these classes of customers. To allow the ITP to use two different methods to assign CRRs could be considered unduly discriminatory to customers outside of the ITP’s region. Appendix F includes several specific examples of how Access Charges will be assessed and how CRR will be allocated during Phase I. Western agrees with the specific examples in Appendix F, which treat customers within an ITP’s region the same as customers outside an ITP’s region.

The Commission suggests (in footnote 106 in ¶ 172) that non-firm and short-term firm customers within the ITP’s region would not receive CRRs. Given that scenario, Western would support the position that non-firm and short-term firm customers outside of the exporting ITP’s region, which pay a portion of the exporting ITP’s revenue requirement through a cost allocation, should not receive CRRs.

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collected or distributed to all customers taking service from the ITP.

The Commission further allows that customers in an importing ITP region pay the applicable access charge in order to receive CRRs. If the customers determine that CRRs are not of sufficient value and elect not to continue to pay the exporting ITP's Access Charge, the Commission is proposing that a portion of the exporting ITP's revenue requirement would be allocated to the importing ITP region (see Western's response to ¶¶ 185-188). This allocation of the exporting ITP region's revenue requirement is necessary to minimize cost shifts as a result of customers in the importing ITP region no longer paying the exporting ITP's Access Charge. Because these customers would have made the decision that CRR are not of sufficient value to warrant paying the exporting ITP's Access Charge, Western would support the position that no allocation of CRRs is needed from the exporting ITP.

#### **8. Locational Marginal Pricing - Opportunity Costs for Hydropower**

In ¶ 216, the Commission notes that bids of hydroelectric energy into spot markets should not be bound by the same marginal running cost limitation that applies to thermal generation. Instead, the Commission would allow suppliers of hydroelectric energy to reflect opportunity costs in their bids. Western agrees that the cost of replacing water in a reservoir-determined by purchasing energy in the spot market to meet delivery obligations, rather than releasing water to generate that energy-is the appropriate measure in the pricing of hydroelectric generation.

#### **9. Conversion to and Initial Allocation of Congestion Revenue Rights**

In ¶¶ 236, 245, 248, 249, 378 and 380, the Commission makes proposals regarding CRRs and requests comments on how existing transmission rights should be converted to CRRs and allocated.

Western cannot state too strongly its position that existing and historic rights as well as both explicit and implicit contracts must be fully recognized in the transition to SMD. The Commission must provide for sufficient CRRs or CRR auction revenues to fully meet existing obligations and to ensure that customers under existing wholesale contracts receive the value of their contracts.

Western must retain sufficient transmission rights over its transmission facilities to meet its statutory duty to market Federal power for the life of the Federal project. Further, Western has existing contracts including exchange arrangements that allow the delivery of Federal power over the transmission systems of others. These contracts contain terms that provide for their extension beyond the initial contract term. The Commission has no authority to abrogate those contracts.

Western must retain its current transmission rights, or their equivalent, in order to meet its statutory obligations. The term for retention of CRRs should coincide with the term of the firm transmission contracts over the systems of others, and to the extent that those contracts can be renewed or are evergreen, the CRRs should follow. In light of these statutory and contractual obligations, Western recommends that the Commission's rule allocate CRRs for the life of the Federal generating project when Federal transmission is involved, rather than requiring the auction of those rights.

In the allocation process, given that CRR Options (i.e. where rights cannot go negative) are more similar to existing firm point-to-point transmission contracts under the Order 888 OATT, holders of existing transmission rights (both implicit and explicit) that would be entitled to CRRs should be allocated CRR Options rather than CRR Obligations. *See* the discussion in ¶ 245.

If holders of existing transmission rights (both implicit and explicit) are not directly allocated CRRs consistent with the terms and conditions of the existing transmission rights, but instead must participate in a CRR auction, they should then be entitled to the CRR auction revenues consistent with the terms and conditions of their existing transmission rights. Knowing that they are entitled to the CRR auction revenues, existing transmission rights holders could bid a very high price to ensure they receive the CRRs at no risk. A mechanism must also be put in place that would allow the existing rights holder to hold a priority status, a “price taker”, that could be used as a tie-breaker in the event another party bid an equally high price for the CRRs. If this or a similar method is not adopted by the Commission, a dilution of existing holder’s rights could occur, exposing them to financial risks or reductions of service that they would otherwise not have experienced had the CRRs been directly assigned.

However, even direct assignment of CRRs consistent with the terms and conditions of the existing transmission rights and priority status may be insufficient to make existing customers whole in a SMD context. Western now takes full advantage of diversity in its system to meet the load requirements of its existing customers. Moving to SMD and pooling all transmission resources may ultimately result in the reduction of the level of available transmission below that for which it was built and which is necessary to meet Western’s obligations.

Western’s use of its system varies as a result of the hydrological conditions during a period. In low water years, a rights holder may use its full transmission allocation to pump water. In high water years, that same customer may use water from the river, reducing its energy usage while other customers may take increased usage on another

path. Given the hydro variability in the West and Western's need to utilize varying combinations of its existing transmission rights (both implicit and explicit) to deliver the output of the Federal resources to load, Western must be allocated CRRs consistent with these existing transmission rights rather than "recent historical usage of transmission" to meet its obligations in the future.

Western is also concerned that existing transmission rights not be degraded in the future because of an accommodation for load growth. That is, in regions where several transmission providers are serving retail and/or wholesale loads, the existing transmission rights (both implicit and explicit) of one transmission owner cannot be taken by a second transmission owner to serve its growing load and should therefore not be entitled to the CRRs made available by the first transmission owner's existing transmission rights.

Unless netting of bids and revenues is allowed, Western's participation in an auction for CRRs may be problematic given our principal funding through congressional appropriations. In an atmosphere of ever-tighter budgets for Federal agencies, successful requests for additional appropriations to participate in CRR auctions are far from assured. In addition, Western cannot use revenues to purchase CRRs because all revenues received by Western must be deposited to the Treasury.

#### **10. Funding for Congestion Revenue Rights - Revenue Shortfalls**

In ¶ 251, the Commission asks how congestion revenue shortfalls, caused by a significant amount of transmission facilities being out of service, should be handled.

Western believes that the transmission owner should not be held responsible for shortfalls in congestion revenues. Maintenance of the system is required for reliability of the system. Planned and approved maintenance should be reflected in the

allocation/auction of CRRs. Any shortfalls should be absorbed by the users of the system, such as netting against times when congestion revenues are greater than estimated or distributing the shortfalls pro rata among the holders of the CRRs. If the Commission's intent is to minimize the number and duration of forced outages, then the transmission owners should be rewarded for proactively maintaining their transmission facilities. Monetary incentives should be offered to the transmission line owners who have approved scheduled outages and are willing to reschedule these outages with a short notice (less than 48 hours). Short notice rescheduling of outages usually involves increased costs (e.g. lack of efficiency of long range planning, delay in completing new facilities, etc.) and increased risk of facility outages/damage caused by a facility failure which could have been avoided by performing the originally scheduled work.

The Western Electricity Coordinating Council has sanctions in place or is developing them to help insure reliability of the transmission facilities. Penalizing the transmission owner for taking facilities out of service is counter productive to those initiatives and places the transmission line maintenance organizations in the middle of two organizations assessing monetary penalties (e.g. sanctions and/or tariffs) for both not performing the maintenance and performing the maintenance.

#### **11. Transmission Losses - Compensation for Losses**

In ¶ 268, the Commission seeks comment on 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.

Western suggests that the Commission allow transmission customers the choice of paying for losses both financially and in kind. Western may not have sufficient

appropriations to pay for losses with cash, so the flexibility to pay in kind is critical. It may be financially burdensome for the transmission customer to be forced to pay for losses on a financial basis when a self supply source for in-kind losses is less expensive. Western has implemented a process to allow the customer the choice. Based on this experience, Western recommends the Commission require transmission customers to commit to a loss payback methodology based on a certain timeframe (e.g. monthly or yearly). Allowing changes in payback methodologies within transactions would create accounting difficulties.

## **12. Day-Ahead Energy Market - Bidding and Scheduling Rules**

### **a. Hydroelectric Generation**

In ¶ 274, the Commission recognizes the need for a special scheduling option for hydroelectric resources. Western supports the option of allowing the ITP to schedule hydroelectric energy flexibly. The Commission has also asked for comment on whether other options or regional variations should be allowed for hydropower in the SMD tariff.

Western is encouraged by the Commission's sensitivity to regional differences and needs. Business practices that meet the needs of a centrally managed tight power pool such as that in PJM may not translate well to the Western's service territory, which features bilateral arrangements. The West has a very different resource mix, a large reliance on hydropower and a different transmission configuration featuring extensive ownership and operation by power marketing administrations and not-for-profit entities such as public power utilities and rural electric cooperatives. In the SMD NOPR and the WestConnect and RTO West Stage 2 ruling issued in the fall of 2002, the Commission

has recognized the need to proceed with awareness of different regional characteristics and needs.

The multipurpose projects from which Western markets Federal power are located on different river systems. Power generation in Western's region is integrated and coordinated among numerous Federal power plants, the operation of which is largely dictated by non-power priorities and constraints. Examples of non-power purposes are irrigation, navigation, flood control and the environment. The LMP in the SMD NOPR, which was premised on a system of thermal generators that operate independently and compete with each other, needs to recognize and accommodate coordinated hydro-system operations.

Also, the day-to-day and hour-to-hour operation of the hydro-system changes depending on non-power constraints and the availability of water at specific hydro-projects. These changes are not always predictable and Western needs flexible transmission rights to account for these changes. The SMD NOPR describes an initial allocation of CRRs based on a single generation dispatch. Western is concerned that CRRs allocated in this fashion would not account for the flexibility of the hydro-system and consequently Western would be exposed to significant congestion costs.

The hydro-system can encounter substantial changes within a day, requiring changes in the transmission schedule. Existing transmission contracts allow for changes between day-ahead scheduling and real-time to account for these changes. Under the SMD NOPR, transmission customers making changes after the day-ahead schedule will be exposed to the volatility of the real-time market and will not have CRRs to protect

against congestion costs. Western believes this would result in significant and unintended cost shifts.

### **b. Scheduling of Intermittent Resources**

In ¶ 275, the Commission proposes to include the California ISO's scheduling option for intermittent resources as part of SMD. The Commission also seeks comment on whether there is a better way to schedule intermittent resources.

Western agrees that scheduling intermittent resources on a day-ahead basis is not a reasonable approach. However, scheduling intermittent resources can be accomplished in the hour-ahead time frame. This type of scheduling allows sufficient accuracy and mitigates the uncertainty inherent in day-ahead scheduling of intermittent resources.

Western does not believe that intermittent generators should be exempt from paying the cost of providing balancing of improper schedules. Instead, the shift in the scheduling parameter to next-hour for intermittent resources equalizes the ability to accurately schedule intermittent resources with more traditional generation resources.

Western also feels that intermittent resources should incur charges for significant uninstructed deviations. Any deviation from schedule by generating resources results in a requirement for more regulation service, and a real cost for providing that regulation. The cost of the regulating reserve requirement should be properly assigned to the cause of the regulation. Western is willing to purchase, on a pass-through cost basis, the regulation and energy required to mitigate the fluctuations inherent in intermittent resources.

The Commission should strive for equity in charging for regulation independent of the type of generation causing the requirement. Variations should be allowed during

the scheduling process for intermittent resources. However, once in the real-time environment, the source of regulation requirement and energy deviation support should bear the resultant cost.

### **13. Other Charges for Uninstructed Deviations From Schedules**

In ¶ 316, the Commission seeks comment on 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 direction from the ITP.

Uninstructed deviations cause a real-time imbalance for the ITP. The result of that imbalance is that resources are not utilized as planned because of the real-time deviation. Some deviation is caused by the difficulty in running a generating unit to a precise schedule. However, good operating practice minimizes this deviation. The per-unit deviation of actual from schedule should be maintained within a specified bandwidth to be considered “normal” deviation. Any deviation outside of the specified bandwidth should be assessed a penalty, as well as the incremental power cost and administrative fee to cover the required shortfall or surplus.

Generation deviations resulting from under-generation should result in a pass-through of the costs of mitigating the generation shortfall. Deviations outside an accepted bandwidth should be assessed an additional charge. Deviations resulting from relatively small amounts of over-generation should not incur a charge, but the price paid for the over-generation outside of a defined bandwidth should be less than the current market value for power. This concept is contained in Western’s Colorado Missouri Control Area Energy Imbalance Service rate order, placed into effect on a provisional

basis by the Secretary of Energy earlier this year, published at 67 Fed.Reg. 39970, on June 11, 2002. Over-generation can have an adverse impact, causing a regulating generator to drop its generation level.

If the amount of over-generation, and resultant deviation, is high enough, it will hamper regulation capability. Under conditions where over-generation negatively impacts the control area, over-generation should not receive any compensation. If over-generation is great enough to require a generator outside the regulation mix to lower its generation to accommodate the situation, the generator causing the deviation should be required to provide lost revenue minus saved fuel costs.

Load serving entities have a responsibility to correctly schedule for their use. Load forecasts should meet the schedule requirements.

#### **14. Market Rules for Emergency Situations**

In ¶ 327, the Commission seeks comments on what changes are needed to market rules to recognize reliability requirements when emergencies arise.

Western suggests the Commission defer to the North American Electric Reliability Council and its regional members on this subject. The few emergency conditions that will occur should be regarded as minimal. The Commission should not attempt to force pre-defined and probably incorrect effects on the market price during those instances, or encourage additional requirements.

#### **15. Test for Transmission Facilities Subject to ITP Control**

In ¶ 367, the Commission proposes to utilize Order No. 888's seven factor test as the starting point for determining which facilities belong under the control of an ITP.

The Commission requests comments about whether, either in addition to or in lieu of the seven factor test, a bright line voltage test (e.g., 69 kV) should be used to determine which facilities are placed under the control of the ITP. If so, the Commission seeks comment on the bright line, whether it should allow regional variation, and how transmission facilities that are not placed under the control of the ITP's tariff should be treated with respect to open access and rates.

Western recommends that the Commission continue to apply a functional test, such as the seven-factor test. This functional test could start with a bright line voltage test. However, the use of a bright-line voltage test alone would impose an artificial – and, in many cases, inaccurate – determination of a facility's character. Of particular relevance to Western, a bright-line test would improperly classify certain of our lower-voltage transmission facilities. Such a test would also result in an improper finding for certain load-serving entities' higher-voltage distribution facilities.

The Commission itself has indicated a strong preference for the seven-factor test. Notably, in Order No. 888, the Commission observed that “case law and practical realities of a changing industry support an analysis of local distribution facilities based on the facilities' functional as well as technical characteristics. . . . While it would be preferable to draw an absolutely ‘bright’ line (e.g., based on technical characteristics such as voltage), this does not appear to be required by the case law and, importantly, would not be a workable approach in all cases because of the variety of circumstances that may arise and because utilities themselves classify facilities differently (e.g., one utility may classify a 69 kV facility as transmission; another may classify it as distribution).” Order

No. 888, FERC Stats. & Regs. ¶ 31,036, at 31,981<sup>5</sup>. The plain fact is that a bright-line test is not reasonable.

#### **16. Transition to Single SMD Transmission Tariff -**

##### **Meeting Pre-existing Obligations under the SMD Tariff**

Under ¶¶ 370, 374 and 375, when SMD is implemented, wholesale customers with pre-Order No. 888 contracts would be given the opportunity to convert to the new transmission service under a revised OATT.

Western supports the Commission's proposal to honor the terms, conditions, rights and provisions of both implicit and explicit existing transmission contracts. The detail associated with implementation needs to be consistent with the policy proposal. The Commission needs to avoid a scenario where rights may be less secure, less valuable and shorter term.

Western provides transmission service under bundled wholesale power contracts, pre-Order No. 888 and OATT transmission service agreements. Western cannot unilaterally convert existing contracts. Western believes that all parties to these bundled and pre-Order No. 888 transmission service agreements should be involved regarding the decision to convert to Network Access Service under the SMD Tariff and that no party should be empowered to unilaterally convert these existing agreements. Further, Western believes that these contracts if converted should be done so consistent with any and all

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<sup>5</sup>Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (March 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part, remanded in part on other grounds sub nom.* Transmission Access Policy Study Group, *et al.* v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom.* New York v. FERC, 122 S. Ct. 1012 (2002).

contract limitations, including the contract term, by providing the transmission customer with the rights to CRRs and/or CRR auction revenues.

### **17. Allocation of Congestion Revenue Rights - Transition Period**

In ¶ 382, the Commission seeks comment on whether to allow a transition period before the start of CRR auction allocations and, if so, what the length of such a transition should be.

Western recommends that the transition to auction of all CRRs should be on a case-by-case basis in each RTO and should only be implemented when consumers, investors and marketplace participants believe the market rules are workable for a particular market. The Commission should allow the transition period to vary by region, allow allocations of CRRs to LSEs and limit auctions to residual CRRs that are available after the initial allocation.

### **18. Force Majeure and Indemnification Provisions - Liability**

The Commission asks in ¶¶ 385-389 whether liability language is needed in the SMD OATT, and if so, what liability protection is needed. In particular, the Commission seeks guidance on whether liability language should be generic or region-specific, whether it should reflect state law, and how it should be addressed in the multi-state context of an RTO or an ISO.

Liability provisions are needed that set forth reasonable limitations on the liability responsibility of ITPs/RTOs/ISOs. As these entities may have no significant assets which could be used to pay judgments rendered against them, costs would have to be passed through to their customers. Without liability limitations, SMD costs may rise to unreasonable levels. State law may be helpful in drafting such provisions, but Federal

law should be taken into account as well. The liability provisions need not be generic; it may be best to reserve the flexibility to address this issue on a regional basis.

Presently, there are differences among such provisions proposed and/or implemented for each of the existing and nascent RTOs and ISOs. One difference that will be more important in the West is the existence of many municipal utilities and of power marketing administrations, which are subject to different types of liabilities than public utilities. Public utilities, for example, tend to disclaim liability for anything but gross negligence or willful misconduct on the part of their officers and employees, and tend to require that they be indemnified by their customers. On the other hand, Western, as a Federal power marketing agency, is subject to liability only for negligence on the part of its officers and employees, in accordance with the terms of the Federal Tort Claims Act. Another important distinction is that Federal agencies, including Western, cannot under Federal law indemnify and hold harmless some other entity, such as an ITP/RTO/ISO. Federal agencies can, however, pay their fair share of the insurance costs of another entity, as part of doing business with the entity.

In summary, Western agrees that language limiting the potential liability of the ITP is needed in the SMD Tariff. It would be beneficial to limit the liability to that which is coverable by insurance, with caps on the potential liability for all claims arising out on any one occurrence. Western also recommends limiting recovery to direct damages, excluding recovery for indirect, incidental, consequential, punitive, special, or exemplary damages. An ITP should not be liable for acts of Force Majeure, nor should judgments be allowed on the basis of strict liability. The ITP should not be liable unless an act or

omission of an employee or officer, or someone acting at the direction of the ITP, directly caused the harm.

### **19. Establishing Bid Caps or Competitive Reference Bids - Western's Environmental Responsibilities**

As a federal agency, Western has environmental responsibilities pursuant to statute that jurisdictional utilities do not always have. The Commission needs to consider how a non-jurisdictional Federal agency involved in hydro-system operations, such as Western, the Bureau and the Corps, could meet its responsibilities under the proposed SMD. In ¶ 423, the Commission envisions that hydro-system operators could satisfy environmental conditions through scheduling practices. While Western appreciates the sensitivity of the Commission to this issue, the suggested scheduling practices may not allow sufficient flexibility to operate the multi-purpose facilities from which Western markets power.

Federal agencies such as Western must not be financially penalized or operationally constrained if hydroelectric powerplant system operations necessary to comply with environmental responsibilities contribute to transmission congestion. Second, to ensure that Federal agencies possess full operational flexibility to meet their environmental mandates, Western requests that the Commission clarify that ITPs can not require Federal agencies to ensure that hydrosystem outages would occur only “when they are least disruptive to markets” as suggested in ¶ 423. The Federal power program in Western's service territory at times must be carried out in ways that may be disruptive to the market to accommodate environmental considerations; the Federal generating

agencies, and not an ITP, must retain discretion to make decisions regarding when it is appropriate to schedule outages for environmental reasons.

Western further requests that the Commission clarify that the hydropower systems from which it markets power are not subject to the “must offer” requirement for generators when such a requirement would conflict with environmental constraints. Section 9(c) of the Reclamation Project Act of 1939, 43 U.S.C. § 485(c), specifically prohibits contracts relating to electric power which impair the efficiency of the project for irrigation purposes. Impairment of environmental constraints should likewise be avoided. Finally, Western asks that the Commission clarify that Western’s transmission of power generated to comply with environmental requirements would be treated as an historic use eligible to receive CRRs. Without the grant of CRRs, acquiring sufficient CRRs may be cost prohibitive or even unavailable when needed to transmit this power.

## **20. Enforcement of the Tariff Rules - Penalty Mitigation**

Western supports the idea in ¶ 456 of mitigating penalties for violation of the SMD tariff standards. Although Section 10 of the SMD tariff provides for dispute resolution procedures, the ability of the ITP to mitigate penalties would provide for resolution outside of the formal dispute resolution process. If the violation does not adversely impact the operation of the grid or economically disadvantage others, or if the violation occurred despite good faith efforts to avoid it, then some mechanism should be available to the RTO/ITP to mitigate the penalties. Conditions not anticipated in the tariff may arise that are beyond the control of the parties. For example, failure of communication, mechanical equipment or computers could result in the failure to perform ITP instructions in real-time (SMD Tariff Section 7.6.2), subjecting the supplier

to penalties. Without some form of mitigation, the only remedy for this type of situation would be the dispute resolution procedures outlined in Section 10 of the Tariff or a filing with the Commission. If the violation were unintentional or the activity had no impact on the operation of the grid, these penalties would be punitive. If the violator could demonstrate that it made a good faith effort to maintain compliance, the Tariff should have a mechanism to mitigate penalties.

The Federal hydro system has legal and regulatory requirements that place certain considerations before the generation of power. In satisfying these laws and regulations Western may be impacted and could, under the Tariff, incur penalties. Western would encourage the Commission to ensure that no penalties are assessed when actions are taken to meet legal and regulatory requirements. The peculiarities of operating a hydro system might otherwise result in the assessment of penalties. Examples of such situations include:

- Real time changes in available generation to satisfy emergency water temperature restrictions, environmental or water quality concerns.
- Uninstructed deviations resulting from load swings attributable to environmental, temperature or water quality requirements.
- Failure to provide bid amount of ancillary services due to powerplant operations needed to satisfy emergency water temperature restrictions, environmental or water quality concerns.

## **21. Level of Resource Adequacy**

### **a. Planning Reserves**

In ¶ 489, the Commission seeks comment on and encourages regional discussion of appropriate planning targets in energy-limited areas, specifically on how to incorporate volatility of annual hydropower supply.

Western encourages the Commission to defer to NERC and its reliability councils in this area, and to allow regional diversity in addressing this issue.

### **b. Resource Adequacy**

In ¶ 492, the Commission asks for comment on what fallback provision should be employed if the Regional State Advisory Committee does not reach agreement on the appropriate level of resource adequacy.

As with the issue of planning reserves, Western encourages the Commission to defer to NERC and its reliability councils in this area, and to allow regional diversity in addressing this issue.

## **22. System Security**

In response to ¶¶ 575-579 of the NOPR, Western agrees that system security is critical to the reliable operation of the high voltage transmission grid. Western believes that NERC should further develop cyber-focused security standards, and that such standards should be subject to NERC's standards setting process before they are implemented. Cyber security standards should consider relevant laws, statutes and recommendations issued from the Federal government, such as those from the Office of Management and Budget and the General Accounting Office; the National Institute of

Science and Technology's (NIST) Special Publication 800 Series guidelines on computer security; and other applicable sources.

The NERC process for developing industry reliability standards has served the electric utility industry well for many years. Western recommends that the Commission allow the development and implementation of these security standards in a similar fashion with due regard for the NIST guidelines noted above. The Commission should allow the NERC standards and development process to move forward.

#### **IV. CONCLUSION**

Western supports the goal of lowering costs to consumers, and to that end urges the Commission to adopt rules that feature regional flexibility and allow participation by a wide variety of electric utility industry participants. Existing levels of service quality must be maintained or enhanced. The proposed time frames for SMD implementation are very ambitious. Western urges the Commission to develop tailored and responsive policies, in an incremental manner that provides certainty to the electric utility industry.

Respectfully submitted,

/s/  
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**CERTIFICATE OF SERVICE**

I hereby certify that I have served the foregoing United States Department of Energy, Western Area Power Administration Comment upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated this 10<sup>th</sup> day of January, 2003.

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