

**Comments of the Western Public Agencies Group
On the Bonneville Power Administration's
Network Open Season Reform Process**

The utilities that comprise the Western Public Agencies Group (WPAG) appreciate this opportunity to submit comments on the Network Open Season (NOS) reform initiative recently commenced by the Bonneville Power Administration (BPA).

I. Background.

In 2008, 2009 and 2010, BPA's NOS processes resulted in 263 executed Precedent Transmission Service Agreements (PTSA) for a total of 11,722 MW of transmission service requests (TSR). These past NOS processes resulted in six construction projects with a total estimated direct cost of \$974 million.¹

In exchange for BPA's commitment to build nearly \$1 billion of transmission infrastructure, the PTSAs required counterparties to provide a performance assurance in an amount equal to one year's worth of transmission service. When compared to the size of BPA's investment and outlay of resources, the amount of the performance assurance was completely inadequate to protect BPA from the risk that the parties to the PTSAs would subsequently default when the time came for them to take transmission service. This meant that BPA's post default remedies would largely be limited to the financial wherewithal of the defaulting entity, success in litigation and the performance assurance.

In the summer of 2011, BPA notified the region that a substantial portion of the parties that signed PTSAs had approached BPA and requested that BPA agree to terminate their PTSAs. This placed BPA in a considerable predicament. BPA had committed itself through NOS to building nearly \$1 billion of transmission infrastructure over the next several years, but a significant number of the customers for which it was to build those facilities no longer wanted the transmission service they originally requested. This seriously undermined the financial and economic reasons that had justified the NOS projects in the first instance, putting BPA and its remaining ratepayers at substantial financial risk.

A large portion of those parties that were requesting termination were non-investment grade limited liability companies (LLCs). The parties seeking termination argued that BPA should either agree to terminate PTSAs in exchange for forfeiture of each party's performance assurance (and no more), or a significant portion of the LLC parties seeking termination would simply file

¹ 2008-2009-2010 NOS Project Summary, as of September 1, 2011 available at http://transmission.bpa.gov/Customer_Forum/open_season_2009/2008_nos_Summary_Timeline_Map.pdf.

for bankruptcy. BPA would then be faced with protracted litigation and prospect of no or limited recovery from the defaulting parties.

To make matters worse, in addition to those seeking termination, there remained approximately 2,125 MW of PTSAs associated with non-investment grade LLCs that did not indicate a desire to terminate their PTSAs. While their desire to continue to move forward and perform their obligations is certainly good, their status as non-investment grade LLCs, as well as the limited performance assurance they provided to BPA under their PTSAs, continues to subject BPA and BPA's other customers to substantial risk in the event that these LLCs ultimately default by not taking and paying for the transmission service they requested.

It has now been a year since BPA first notified the region that parties desired to terminate their PTSAs, and BPA has finally commenced discussions with the region on how to reform the NOS process so that the next NOS does not create a similar financial risk to BPA and its customers. The WPAG utilities urge BPA to not repeat the mistakes of the earlier NOS. It can do so by ensuring that the NOS participants, and not BPA or its other customers, assume the risks they will possibly default under their PTSA obligations or terminate their participation in NOS before taking transmission service. To this end, the WPAG utilities offer the following preliminary recommendations and comments to assist in developing the new NOS framework.

II. Preliminary Recommendations.

1. Study Costs. The two main alternatives that BPA has identified for handling NOS related study costs are participants directly funding up to 100% of their pro rata share study costs or participants providing security for up to 100% of their pro rata share of study costs. These proposals are a step in the right direction for ensuring that BPA and its customers are protected from stranded study costs where participants fall out of NOS. However, not all NOS participants are the same. Instead, different classes of customers carry with them their own degree of associated risk that they will fall out of NOS and leave BPA and its remaining customers to pay study costs BPA incurred on their behalf.

On the one extreme are commercial resource developers. Commercial development of resources is a risky business. These projects can lose momentum and fall out of NOS for any number of reasons both within and without the control of their proponents. The level of direct funding or security for these types of parties needs to be high enough to mitigate the higher risks they bring to NOS.

On the other extreme are load serving entities that need transmission service from BPA in order to ensure that they can serve their loads. There is an inherent certainty as to BPA's cost recovery with these types of entities. That is to say, BPA can be certain that load serving entities will need, use and pay for the transmission service they are requesting because without it they will not be able to serve their loads. In addition, in the rare event that a load serving entity drops out of NOS or takes an off-ramp, there is a much higher certainty that they will continue to exist and remain a viable party from who BPA will be able to recover study costs or re-study costs incurred on their behalf. This higher certainty justifies a lower level of security.

Accordingly, BPA should explore the use of a tiered approach for the level of direct payment or security that a particular customer class is required to provide. Those classes associated with less certainty and higher risk of default or leaving NOS should be required to provide a higher level of direct payment or security, up to 100% of their pro rata share of costs. On the other hand, those customers that are more certain to take and pay for the service they requested (e.g., load serving entities) should either be required to provide a lower level of direct payment or security, or be exempt from the obligation altogether.

2. Construction Costs. The major risk imposed on BPA by the past NOS processes was BPA making facility investments for commercial developers to provide service that those customers ultimately did not take. To avoid a repeat of this situation, commercial participants in NOS should be required to provide security sufficient to mitigate the risk of cost shifts to regional ratepayers in the event they fail to take transmission service. This can be achieved through a letter of credit, deposit of funds in escrow or other security for up to 100% of each commercial participant's pro-rata share of construction costs. For the reasons stated in section II(1) of these comments, those customers that are more certain to take and pay for the service they requested (e.g., load serving entities) should either be required to provide a lower level of security, or be exempt from the obligation altogether.²

BPA should continue to consider whether advance funding by NOS participants of 100% of their pro rata share of project construction costs is a workable alternative to having those participants provide security. The rate implications of transmission credits under the advanced funding approach, however, need to be further explored and possibly incorporated in the CIFA analysis. Currently, transmission credits are given for advances made for network upgrades under the Large Generator Interconnection Agreements (LGIA). These LGIA credits have resulted in substantial upward rate pressure on all transmission rates. It is assumed that advance customer funding of the next \$1 billion in NOS projects would have a similar, yet shockingly higher, long term rate impact for transmission customers who pay their transmission bills with cash rather than credits. But to be certain, BPA needs to perform and provide some analysis so that the rate impacts of advance payment are truly understood.

3. Term of Transmission Service Agreements. In the NOS processes conducted in 2008, 2009 and 2010, it was common for NOS participants to commit to five years worth of transmission service with opportunity to renew the term of the service before the initial term expired. The problem with this approach is that in order for BPA to fully recover the costs of the associated transmission builds it needed these customers to take transmission service for periods longer than five years. In the next iteration of NOS, BPA should ensure that NOS participants commit to an initial term of service that is at least long enough for BPA to recover each participant's pro-rata share of the costs associated with the project.

² Providing no or a smaller amount of security does not mean that load serving customers would avoid paying costs that BPA incurs when they fall out of NOS or decide to take an off-ramp.

4. Capital Prioritization. In the Capital Investment Forum, BPA discussed with customers an ongoing effort to develop a method for prioritizing capital projects across all of BPA’s business programs. Under the proposed framework for capital project prioritization, expansion projects would be initially divided into two categories, i.e., mandatory projects and discretionary projects. Mandatory projects are to be assigned the highest priority followed by top-ranked discretionary. Mandatory projects are tentatively defined as “investments that a law, appropriations act, regulation, tariff, or contract requires be made. Mandatory projects are limited to investments that, if not made, will result in non-compliance.” Only projects that do not meet the mandatory test would be subject to priority ranking at the agency level.

It is unclear from the NOS reform materials provided to date when a particular NOS project or build stops being a discretionary project and becomes a mandatory project. An argument could be made that a NOS project should be discretionary up until the point when the Administrator makes a build or not build determination under section 6(d) of the current form PTSA, or its successor. This would mean that NOS projects remain discretionary for at least some time after PTSAs are executed. However, BPA staff has indicated in several meetings that NOS projects become mandatory at the time the PTSAs are executed.

This begs the question of what is the purpose of a build decision under section 6(d) of the PTSA if a NOS project is already mandatory because the PTSA has been signed. Nevertheless, the central point is that BPA must synch-up the capital project prioritization program for the agency with the decision point when NOS projects shift from being discretionary to mandatory (whenever that is in the NOS process).

This is important because BPA is running out of its limited borrowing authority. Further, while the WPAG utilities encourage BPA to explore using alternative funding options for transmission projects (such as lease financing), they believe that BPA must retain and exercise the right to say no to NOS projects even when those projects could be funded using third party financing or even upfront financing from the project proponents.³ Such discipline is critical if BPA is ever going to gain control of the persistent upward trajectory of its capital expenditures. Accordingly, BPA should only move forward with NOS projects, or any other capital improvement projects, after the projects have been (i) reviewed and prioritized by BPA’s internal agency-wide prioritization committee and (ii) given a “go”, versus a “no go”, determination by the committee and Administrator.

³ BPA should not borrow every third party dollar that is made available to it in order to fund NOS projects. Third party financing creates an obligation on BPA, and ultimately its other ratepayers, to service the debt regardless as to whether the associated transmission facilities are subscribed to or are generating revenue for BPA (e.g., a project may not generate revenue for BPA due to defaults, deferrals, etc.). In addition, in the event of a roll-in determination, the higher borrowing costs associated with alternative financing ultimately result in higher rates for all of BPA’s transmission customers. On the other hand, if project proponents were to fund construction costs in advance, the use of transmission credits to pay them back over time would have rate impacts on BPA’s remaining customers.

III. Conclusion.

BPA has identified and presented for comment some very important issues that will have long-term impacts on both transmission access and transmission rates. To date, it appears that BPA has listened to its customers and is attempting to modify the NOS framework to reduce the risks to BPA and its customers. We encourage BPA to continue to do so, however, BPA must make certain that those efforts take into account the varying degrees of risks associated with different types of customers.

We further recommend that BPA recognize that bringing discipline to the NOS program is an important component of BPA's and its customers' ongoing efforts, currently taking place in the Strategic Capital and Capital Investment Review processes, to bring its capital programs under control. We also urge BPA to incorporate the capital expenditure prioritization process that is currently ongoing into its NOS build decisions such that other important agency capital expenditures are not forced to compete with unessential transmission expansion projects.

We appreciate the opportunity to provide these preliminary comments and will continue to provide comments as the NOS reform process moves forward.