

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

Long Term Transmission Rights in)	
Markets Operated by Regional)	
Transmission Organizations and)	Docket No. AD05-7-000
Independent System Operators)	

**COMMENTS OF THE ORGANIZATION OF MISO STATES
ON ESTABLISHING LONG TERM TRANSMISSION RIGHTS
IN MARKETS WITH LOCATIONAL PRICING**

I. Background

On May 11, 2005, the Federal Energy Regulatory Commission (FERC) issued a Notice Inviting Comments on Long-Term Transmission Rights. In its notice, the FERC characterized the concern as one that has been raised by some market participants regarding their inability to fully hedge market prices from resources that they may own or have under contract. In this context, a hedge is the ability for the load-serving entity to keep the price for serving load at the cost of operating resources owned or under long-term contracts (i.e., Designated Network Resources (DNRs)) and short-term contracts for economy transactions.

In regions of the United States where Regional Transmission Organizations (RTOs) or Independent System Operators (ISOs) either do not exist or do not use Financial Transmission Rights (FTRs),¹ the issue of hedging is dealt with via the deliverability of power from generation sources to native load using “physical” transmission rights – the right to inject power from a generation source to serve native load. In particular, Network Service is defined as transmission service from a load-serving entity’s DNRs to its native load.² Specifically, once the Transmission Provider approves a load-serving entity’s DNRs, it is the obligation of the Transmission Provider to make the upgrades necessary for the load-serving entity to continue to be able to deliver the power from those DNRs. - It is important to recognize that physical transmission rights never constituted an absolute ability to flow a particular transaction all hours of the year. Specifically, there are times when deliverability from the most economic resources

¹ For example, the Southwest Power Pool (SPP) is a FERC-approved RTO that does not plan to use FTRs to manage congestion in its proposed real-time energy imbalance market.

² For hedging the price of short-term bilateral contracts, the load-serving entities can also arrange delivery via requests for short-term, point-to-point service.

may be restricted because of transmission constraints and more expensive generation must be dispatched to meet those constraints; i.e., redispatch is required to maintain power system reliability. In addition, all physical transactions are subject to curtailment using Transmission Line Loading Relief (TLR) in the event that allowing schedule transmission flows would otherwise violate the security constraints and threaten the reliability of the power system. A TLR event can curtail firm service from DNRs when the curtailment of non-firm service does not alleviate the threat to the grid.

What is described above as a hedge through physical deliverability is not the case for RTOs and ISOs that have adopted the use of FTRs. While holding an FTR from a DNR will assure the load-serving entity that it can hedge its cost from that generation source, a load-serving entity is not assured that it will be allocated FTRs from its DNRs for its entire load. For example, in the FTR allocation process at the Midwest ISO, load-serving entities are assigned Candidate FTRs (CFTRs) from each of their DNRs and the Midwest ISO performs an annual allocation by which the load-serving entities are allowed to nominate FTRs from their CFTRs in a series of four tiers that add up to their forecasted summer peak demand. Not all CFTRs nominated will necessarily be allocated to the load-serving entities because of a requirement that all allocated FTRs be simultaneously feasible.³ In the Staff Discussion Paper on Long-Term Transmission Rights Assessment (May 11, 2005), the issue is described as follows:

“Some market participants have concerns that sufficient transmission rights may not be available each year to adequately cover their congestion cost exposure. They argue that the combination of potentially volatile congestion costs, variability in the annual allocation, and the inability to secure a known quantity of transmission rights for multiple years introduces an unacceptable degree of uncertainty into resource planning and investment. As a result, some participants want the ability to obtain long-term transmission rights or service at a price certain.”⁴

As a general matter, the OMS supports the desire by all market participants to develop approaches that will reduce market risks from congestion costs. However, this issue is somewhat more complex than it might first appear. Specifically, the more traditional view of resource planning involving building generation plants that will serve a specified load or service territory

³ This requirement is necessary in order to maintain expected revenue adequacy for the RTO/ISO; i.e., to ensure that the RTO/ISO expects to collect sufficient revenues in congestion cost payments to pay out to the FTR holders.

⁴ Long-Term Transmission Right Assessment, FERC Staff Discussion Paper, p.1.

for the life of the plant is different from the perspective where multiple load-serving entities use shorter-term contracts to serve retail load on a competitive basis. In competitive markets, market participants may determine that the risks associated with longer-term commitments are unacceptable because of the lack of certainty regarding the load that they will be serving. These two perspectives imply that purveyors of each of these different perspectives will have a desire to hedge power supplies for significantly different forward time periods. The Midwest ISO provides a footprint that encompasses the traditional perspective of state-regulated, vertical utilities, the restructured paradigm in which generation supply is a competitive resource and systems that have divested transmission assets. These comments of the Organization of MISO States (OMS) have attempted to address the issue of long-term financial transmission rights from all of these diverse perspectives.

II. Summary of Comments

The need to decrease the risk associated with congestion costs appears to be a general concern that is cognizant of credit ratings, and the costs to market participants and ultimate consumers. With the needs for more capital intensive investments by utilities to perform environmental upgrades to existing facilities, the demands for replacing older capacity, the demands for additional base-load capacity, and the need for transmission system enhancements, initiating a discussion at the federal level addressing these needs and concerns through long-term transmission rights or other means is timely and welcomed.

In response to the notice inviting comments regarding long-term transmission rights, the OMS is submitting detailed comments. The following highlights the primary points of the more detailed discussion.

- To guarantee long-term transmission rights absent grid expansion is likely to mean shifting the congestion costs among market participants without lowering the overall level, and therefore risks, of these congestion costs. This does not mean that the FERC or RTOs should abandon consideration, further discussion, and potential implementation of long-term transmission rights.
- Longer-term transmission rights that are not subject to prorating require a higher risk premium (potentially much higher) than shorter-term transmission rights that are subject to prorating. This is because the longer the term for which risks are to be mitigated, the greater the amount of uncertainty and the higher the cost of mitigating that risk. Given that the OMS is not aware of any proposals or practical ways to set a

- higher risk premium on long-term transmission rights or exemption from pro-ration, further stakeholder input and discussion of this issue is needed at the RTO level.
- If some form of reverting to physical rights is used to address the establishment of long-term transmission rights, it should not occur at the expense of reduced efficiency to the RTO day-ahead and real-time energy markets
 - A properly executed regional transmission planning process, including siting with appropriate cost allocation for reliability and regionally beneficial upgrades to the transmission system, is likely the most important factor in reducing congestion costs in the long term.

III. Detailed Comments on Long-Term Transmission Rights Assessment

A. The Interest in Long-Term Transmission Rights

The FERC Staff's well-written Discussion Paper refers to some market participants' perception of greater price risk because of volatility of the congestion cost component of locational marginal pricing (LMP) or "congestion cost risk" as well as the desire to diminish this risk when financing new generation and transmission investment.⁵ FERC Staff notes that, while not all market participants agree with the need, it would like comments on several questions:

- **What are the needs of market participants for long-term transmission rights in RTO markets?**
- **What has been the experience with congestion pricing and transmission rights of market participants in RTO markets?**
- **Have financial right allocations been sufficient to meet participants' needs for congestion hedging and long-term resource planning and acquisition?**

Because the Midwest ISO has operated for such a short period of time, it is impossible for the OMS to answer any of the above questions with hard factual data. However, the OMS points out that the FERC Staff has made an assumption at the outset that, at first added some confusion regarding answering its third question related to long-term resource planning and acquisition:

"Most RTOs do provide long-term transmission rights (i.e., rights with terms greater than one year) for transmission upgrades or expansion that increase transmission capability. These long-term transmission expansion rights merit extensive discussion in themselves, but the paper will focus on long-term rights to existing transmission capacity."⁶

⁵ FERC Staff Report at 4.

⁶ Ibid, p.4.

With respect to long-term financial rights associated with new infrastructure, the concern of some market participants is that, without such rights, it is difficult to finance new generation projects that are located remote from the load. Later in its discussion paper, the FERC Staff notes that the real issue may be not on a specific project, but rather on the “overall risk profile of the utility,” and this may impair the utility’s “overall financial flexibility and ability to make the strategic decision to invest in new generation (instead of, for example, to purchase power through a contract).”⁷ The point here is that just having long-term financial rights for new generation options may not be sufficient to mitigate the perceived poor risk profile that a utility may have because of its congestion cost risk on existing generation resources. In part, this explains the emphasis that the FERC Staff has placed on long-term financial rights for existing transmission capacity as opposed to similar rights for transmission upgrades.

1. To guarantee long-term transmission rights absent grid expansion means shifting the congestion costs among market participants without lowering that overall risk.

Functional energy markets can encourage market participants to develop many risk management instruments, such as demand resource options. While there may be other methods for reducing the risk of congestion costs in the long-term, expanding transmission capacity appears to be the most direct means of decreasing that risk. Without increasing the capacity of the electrical system, moving to long-term transmission rights cannot in and of itself decrease the overall risk of congestion cost, and may only prove to move that risk from one set of market participants to another.

For new generation resources, implications for the ability to hedge congestion cost risk are directly related to the deliverability standards for DNRs that must be met in order for the RTO to grant a long-term FTR. Assuming a greater amount of transmission capacity is built to meet deliverability standards, the greater will be the assurance for market participants that they will be able to hedge their overall congestion costs over a longer period of time. Any realistic consideration of long-term transmission rights must take into consideration the relationship between resource deliverability standards and the ability to hedge congestion costs on a long-term basis.

2. Implications for revenue adequacy of long-term financial transmission rights

⁷ Ibid, p. 16.

The FERC Staff discussion paper relates the uncertainty with respect to revenue adequacy to fund FTRs to changes in the topology of the network along with unexpected loop flow; i.e., “events that were not in the model used to identify the feasible set of rights” that “can reduce congestion revenues collected below the level needed to pay existing FTR holders.”⁸ In this regard, the FERC Staff believes that “the probability of revenue insufficiency is likely to be greater with long-term financial rights”⁹ and raised the following questions.

- **Should long-term financial rights be fully funded or subject to revenue shortfalls due to transmission network changes?**
- **How should potential revenue shortfalls be allocated?**
- **If long-term financial rights are awarded based on forecast grid conditions, but maintenance of the grid declines, resulting in future infeasibility, which parties should be responsible for maintaining the revenue adequacy of the rights?**

The primary concern here is, if the hedging value of long-term FTRs is decreased because of revenue inadequacy, does the RTO need to protect these particular FTRs from having to pay for a share of the revenue inadequacy or should they be equally subject to prorated FTR payments like everyone else? In this regard, it is important to point out that if longer-term transmission rights are not subject to prorating, then these rights should require a higher risk premium than shorter-term transmission rights that are subject to prorating. This is because the longer the term for which risks are to be mitigated, the greater the amount of uncertainty and the higher the cost of mitigating that risk. Providing some market participants with long-term transmission rights that failed to incorporate a risk premium that accurately reflected the potential long-term congestion costs or subjected some customers to greater likelihood of pro-ration for otherwise equivalent service could be unduly preferential and discriminatory. The OMS is not aware of any proposals or practical ways to set a higher risk premium on long-term transmission rights or exemption from pro-ration. Therefore, the OMS recommends further stakeholder input and discussion of these issues at the RTO level.

As a practical matter, this is clearly a distributional question. When the RTO is short of revenues, someone must make up the shortfall (e.g., an uplift charge to all customers). If all load-serving entities are allowed the same opportunity to obtain long-term FTRs, then an

⁸ Ibid, p. 15.

⁹ Ibid, p. 15.

expectation might be that each load-serving entity would have approximately the same pro rata share of long-term FTRs in their FTR portfolios. If RTO revenue shortfalls are allocated on the basis of a pro rata share of megawatts of FTRs held, then it should make no difference whether or not long-term FTRs were protected from an allocated share of a revenue shortfall because the amount of the shortfall taken from a load-serving entity would be approximately the same with or without long-term FTRs being protected. However, in practice the actual allocation of FTRs is likely to result in some load-serving entities having a higher mix of long-term FTRs than others.

B. Physical Rights as an Alternative for Providing Long-Term Transmission Rights

Reverting to OATT service is not equivalent to hedging congestion costs to a level equal to the cost of meeting load from owned generation. Specifically, in an OATT service context, load-serving entities will enter into short-term bilateral purchases and sales of power. This can occur on either a firm or non-firm basis. Short-term purchased power substitutes energy at a lower price than from owned generation, and short-term sales result in profits that are subtracted from the cost of meeting load from owned generation. These transactions require the load-serving entity to request physical transmission service, and, if available, the Transmission Provider grants such service, subject to possible curtailment through Transmission Line Loading Relief (TLR). The FERC Staff discussion paper correctly recognizes the fact that this first come - first served approach with possible TLRs is less efficient than having a bid system where the RTO uses security constrained economic dispatch to determine which generators will meet overall load at the least cost. If some form of reverting to physical rights is used, it should not be allowed to reduce the efficiency of the RTO centralized dispatch.

IV. Conclusion

The OMS is not unalterably opposed to longer-term transmission rights, if they can be designed in such a manner as to fairly apportion the risks so as to avoid undue discrimination and not disrupt the real-time market dispatch. However, the OMS is concerned that, if they are pursued, long-term transmission rights be designed in a way that avoids providing some market participants with unduly preferential services. Without adequate expansion of grid capacity,

long-term transmission rights are likely to only redistribute congestion costs among market participants.

The OMS recognizes that long-term financial transmission rights could provide added incentive to build infrastructure to expand the electrical system so as to reduce congestion costs in the long term. However, a properly executed regional transmission planning process, including siting with appropriate cost allocation for reliability and regionally beneficial upgrades to the transmission system, is likely to be a more important factor in reducing congestion costs in the long term.

The OMS submits these comments because a majority of the members have agreed to generally support them. The following members generally support these comments, with the exceptions noted herein. Individual OMS members reserve the right to file separate comments regarding the issues discussed in these comments:

- Illinois Commerce Commission
- Indiana Utility Regulatory Commission
- Iowa Utilities Board
- Michigan Public Service Commission
- Minnesota Public Utilities Commission
- Missouri Public Service Commission
- Montana Public Service Commission
- North Dakota Public Service Commission
- Public Utilities Commission of Ohio
- Pennsylvania Public Utility Commission
- Wisconsin Public Service Commission

The Kentucky Public Service Commission, the Nebraska Power Review Board, and the South Dakota Public Utilities Commission abstain from this comment for procedural reasons. The Manitoba Public Utilities Board did not participate in this comment.

The Minnesota Department of Commerce and the Iowa Consumer Advocate, as associate members of the OMS, participated in these comments and generally support these comments.

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