



August 24, 2016
LEG 2016-0557

**Before the Bonneville Power Administration in Rate Case BP-18
Supplemental Comments of the Sacramento Municipal Utility District
Proposed Rates for Hourly Firm and Nonfirm Service on the Southern Intertie
August 24, 2016**

The Sacramento Municipal Utility District (SMUD) appreciates the opportunity to provide these supplemental comments in advance of the Bonneville Power Administration's (BPA's) BP-18 rate case. On August 17, 2016, SMUD submitted initial comments (LEG 2016-0547) on BPA's proposal to redesign the Southern Intertie Hourly Nonfirm Transmission Rate (IS-HNF).¹ Based on BPA's most recent announcements, and further consideration of potential impacts on both hourly and subhourly markets, SMUD has re-examined the record of the BPA workshops that have taken place since the fall of 2015, considered the potential impacts of BPA's proposal, and has prepared supplemental comments. SMUD opposes BPA's proposal to more than triple² the IS-HNF and Hourly rates, which increase is projected to more than double BPA's revenues from short-term service on the Southern Intertie. These supplemental comments explain this opposition.

Major Conclusions

1. BPA proposes a dangerous shift away from cost-based rates to value-based rates.
2. BPA's proposal is neither cost-based nor fact-based.

¹ SMUD notes that, although BPA's workshop documents *appear* to address only "hourly nonfirm service", the proposed percent rate increase would apply to both Hourly Firm and HNF service.

² The current rate is \$3.25/MWh; the proposed rate is \$10.57/MWh. The proposed rate is more than three times the current rate.

3. BPA’s proposal is discriminatory, arbitrary and capricious in that (1) it prices hourly service on the Southern Intertie materially differently from the way that it prices the same service on the BPA regional network and (2) it prices hourly non-firm service on the Southern Intertie on the same basis as it prices reserved hourly long term firm service even though the former, by its terms, is inferior to the latter.
4. BPA’s proposal represents the exercise of market power, which is prohibited by federal policies.
5. BPA’s proposal will stifle liquidity in both hourly and sub-hourly markets for energy and ancillary services at the California-Oregon Border (COB).
6. BPA’s proposal will cause inefficiencies in Western energy markets, by increasing both the “toll” that must be paid to export power from the Northwest to California and the Southwest and the “toll” that must be paid to export power from California and the Southwest to the Northwest.
7. Any legitimate “seams” issues at COB should be addressed by collaboration between Northwest and California/Southwest parties, not by a unilateral BPA decision to triple the hourly non-firm and hourly firm rates on the Southern Intertie.

Discussion

- I. BPA does not have the responsibility or authority to maintain the “value” of long-term firm service

At its April 20, 2016 workshop, BPA explained that it had “developed a range of rate and non-rate alternatives designed to protect the value of LTF [long-term firm] transmission on the

Southern Intertie and encourage continued investment in the product.” Long-term transmission service is required and thus requested by multiple entities for multiple reasons. In some cases, load-serving entities require long-term service in order to ensure the delivery of energy from resources purchased under long-term contracts or owned outright. In other cases, non-load-serving entities (marketers and traders) purchase long-term transmission capacity as a “hedge”: a form of insurance that will ensure that they have access to certain markets over time. Different customers have different resource portfolios, of which transmission rights are only a part. As a result, the value of long-term transmission service varies from customer to customer and over time.³

On the Southern Intertie, customers holding contracts can be divided into these same two types: load-serving and marketers/traders. By folding marketers/traders into the group of customers for whom “value” should be maintained, BPA is stepping outside its traditional and statutory roles by attempting to ensure financial returns or “value” to non-load-serving entities. Marketers and traders exist in order to take risks and earn returns for their shareholders. BPA should not put itself in the position of protecting such interests. Furthermore, BPA does not have the information required to judge the value of LT firm service, which lies in a multitude of factors affecting the cost of service to load-serving entities and the speculative actions of marketers and traders. BPA can only judge the “value” of future LT firm service by looking at the queue of applicants. If such a queue exists, and it does, long-term firm service on the Southern Intertie by definition has value, both now and in the future. Indeed, the Administrator

³ This conclusion is reinforced by BPA’s workshop handout of September 29, 2015, Slide 23, which speculates about potential impacts on long-term transmission rights holders. Such speculation has no place in BPA rate-making.

said exactly this in his July 2015 Final Record of Decision, p. 111 (“The robust sales and long queue for Southern Intertie service demonstrate that the capacity has significant value.”).

Even if it were appropriate for BPA to revise its non-firm and hourly firm transmission rates on the Southern Intertie based on a determination that the value of long-term firm service on this Intertie has deteriorated (or may deteriorate in the future), there is insufficient evidence to support such a determination. BPA points to withdrawn requests for long-term service between the fall of 2014 and the fall of 2015. (See BPA handout of 9/29/15, slide 15.) However, this is a tenuous point on which to propose a tripling in the SI HNF and Hourly Firm rates. A one-year comparison of the Southern Intertie request queue is simply insufficient to draw any conclusions about (a) the causes of withdrawn requests, (b) the likelihood and magnitude of future requests, or (c) likelihood and magnitude of non-renewal of existing long-term rights.⁴

Just as important, even with the withdrawal of several long-term firm service requests, there is still a queue. According to BPA’s workshop handout of September 29, 2015 (slide 15), there were over 2,000 MW of requests for long-term SI service in that queue last fall. It is difficult to see that this is a “problem” that requires a solution of any kind. Indeed, the Administrator reached that very conclusion just over a year ago. In his July 2015 Final Record of Decision, the Administrator expressly rejected arguments “that loss of long-term firm sales on the Southern Intertie may reduce utilization of the Intertie, as well as ‘simply make it impossible to recover the embedded costs of the Southern Intertie from the users of those facilities.’” BPA-16-A-02, p. 111. “[N]one of these events has occurred,” the Administrator concluded, “even though the same conditions have existed since 2009.” *Id.*

⁴ The same conclusion holds for all data presented on historical use of the AC lines. (See BPA handout of 9/29/15, Appendix.)

Similarly, BPA’s “Regional White Paper – Presentation and Analysis of Southern Intertie Hourly Non-Firm Alternatives” (February 16, 2016, Appendix B) speculates that a problem of “non-renewal” of long-term rights exists in 2019 and 2020. If these long-term contracts are in fact not renewed in advance at some point in 2017 or 2018, BPA has time to recalibrate its rates accordingly for those out-years. Again, that was precisely the remedy the Administrator suggested just last year, pointing out that if a problem *did* arise, BPA has the authority to initiate a mini-rate case:

I also believe collaboration is the best way to address concerns that policies in California may have devalued long-term firm transmission capacity on the Southern Intertie. I believe that seams issues exist and must be addressed. Before adopting a ratemaking solution, however, such as significantly increasing the Southern Intertie hourly non-firm rate, BPA will seek clarity on the extent of the issue, conduct a broader examination of seams issues with the involved parties, and evaluate both ratemaking and non-ratemaking solutions. *If the examination shows that a ratemaking solution is necessary to protect BPA’s ability to sell long-term transmission capacity, BPA may conduct an expedited 7(i) rate proceeding prior to the BP-18 rate case to address any changes needed.* I am determined to preserve the value of our assets, for both BPA’s financial stability and the benefit of all of our customers and the region.

Id. at 2 (emphasis added).

SMUD observes there was no such expedited 7(i) rate case initiated prior to the filing of the BP-18 rate case and even when the BP-18 rate case is concluded, BPA retains the right to initiate another 7(i) proceeding – *if* changed circumstances later warrant such a proceeding.

A rate adjustment clause could even be put into place now that would trigger an appropriate rate adjustment or adjustments *if* non-renewal of long-term rights in 2018 or 2019 threatened cost recovery on the Southern Intertie. There is simply no need to more than triple the rate on HNF and Hourly Firm service on October 1, 2017 in order to address a problem that may never materialize. Furthermore, if cost recovery on the Southern Intertie is a serious risk, all

mechanisms should be considered, not just those that target one or two forms of service in a way that creates, rather than resolves, seams issues at COB.

The evidence provided by BPA in the Regional White Paper confirms that there is not in fact any problem to solve. Long-term firm service accounted for 91-97 percent of total Southern Intertie revenues during the period 2007-2014. HNF and Hourly Firm service accounted for one to four percent of total SI revenues during the same period. There is no clear trend up or down in this data. In 2014, long-term revenues accounted for 96 percent of total revenues. More than tripling the HNF and Hourly Firm rates allows the tail to wag the dog. Again, the Administrator addressed this very issue just a year ago.

Proponents of an increase to the Southern Intertie hourly non-firm rates in BP-16 had argued that non-firm customers were only using the service an average of 23 hours per week. But as the Administrator pointed out:

An hourly non-firm customer pays \$86 for service because it can use the Southern Intertie for only the 23 hours a week it has reserved, whereas a long-term firm customer has the right to schedule its Southern Intertie reservation for all 168 hours of the week. Linn *et al.*, BP-16-E-BPA-31, at 3. Long-term firm customers pay more because they can use the Southern Intertie more.

BP-16-A-02, p. 109. “[P]articipants that rely on hourly non-firm transmission,” the Administrator added, “often cannot obtain service on BPA’s system during times of high Intertie demand because the capacity is being scheduled by customers with long-term service. From FY 2012 to FY 2014 there were a significant number of hours where customers attempted to obtain hourly non-firm service on the Southern Intertie, but it was unavailable.” *Id.* at 111. “*The robust sales and long queue for Southern Intertie service demonstrate that the capacity has significant*

value.” *Id.* at 111-112 (emphasis added). There is no evidence that this circumstance has changed.

Finally, Transmission Service Requests (TSRs) southbound at COB may have been withdrawn, and Transmission Service Agreements (TSAs) terminated, but there are undoubtedly multiple reasons for this. (See BPA handout of 10-14-15, Slide 4.) Over the last five years, all participants in California energy markets have had to adjust to the new California carbon cap/trade system, increasing RPS obligations (including specified regulatory requirements for delivery of energy to a California Balancing Authority Area), the changing economics of solar/wind/storage, the entry and exit of trading entities (in some cases due to Dodd-Frank regulations), the resolution of disputes over transmission rights, and changing decisions by California buyers to rely on firming/shaping services from the Northwest. None of these changes appear to be jeopardizing recovery of the costs of the Southern Intertie.

II. Charging transmission rates - rates for what is essentially a monopoly service - based on value of service rather than cost is inherently unreasonable.

Setting rates based on perceived value is a bad precedent for other rates in future; BPA could set other transmission or ancillary rates based on perceived value. Moreover, value-based rate-setting is an exercise of market power, and not within BPA’s authority. (See BPA handout of 10-14-15, slides 12-13.) See also *Gainesville Utilities Dept. v. Florida Power Corp.*, 402 U.S. 515, 528 (1971) (“It is certainly true that the same service or commodity may be more valuable to some customers than to others, in terms of the price they are willing to pay for it. An airplane seat may bring greater profit to a passenger flying to California to close a million-dollar business

deal than to one flying west for a vacation; as a consequence, the former might be willing to pay more for his seat than the latter. But focus on the willingness or ability of the purchaser to pay for a service is the concern of the monopolist, not of a governmental agency charged both with assuring the industry a fair return and with assuring the public reliable and efficient service, at a reasonable price.”)

III. BPA does not have the responsibility to determine that “its” customers receive an “equitable share of the economic benefits provided by the Southern Intertie”

BPA began the discussion of potential changes to HNF service by asserting that “its” customers must receive an “equitable” share of the economic benefits of the Southern Intertie. (See BPA handout of 9/29/15, slide 3.) This raises two fundamental questions. First, who are “BPA’s customers” in this context? BPA’s actual customers on the Southern Intertie include entities in Canada, the Northwest, California, and the Southwest, as well as private parties not even based on the West Coast. BPA does not have the same statutory obligation to all of these customers, but instead has specific obligations to ensure open and non-discriminatory transmission access at cost-based rates to all eligible customers. If BPA has some group of customers in mind other than SI customers, this argument raises the specter of deliberate cross-subsidies between transmission segments on BPA’s system, or perhaps between power and transmission customers.

Second, how should BPA determine what is equitable among these diverse customers? What is equitable in this context? How can equity be measured? Does the principle of equity

apply to load-serving entities and marketers/traders in equal measure, despite BPA's differing obligations to these types of customers?

Quite simply, all customers that pay cost-based rates are contributing to cost recovery and effectively "funding" transmission capacity; this includes both Northwest and California/Southwest customers, load-serving entities as well as marketers and traders. Some of BPA's "Northwest" customers are actually U.S. subsidiaries of foreign corporations. BPA has no statutory obligation to protect any foreign interests. BPA's only obligation in this context is to ensure open and non-discriminatory access at cost-based rates.

IV. BPA's proposal for SI hourly rates is discriminatory – it is contradicted by BPA's own proposal for Scheduling, System Control and Dispatch service

In contrast to the proposal for a significant increase in the SI HNF and Hourly Firm rates, BPA has proposed no change in the methodology for calculating the rate for Scheduling, System Control and Dispatch (SCD) service, even though such a change was considered. (See BPA handout of 4-20-16, slide 14 and BPA handout of July 27, 2016, slide 27.)

More specifically, SMUD notes the observation in BPA's April 20, 2016 Southern Intertie Workshop slides that it currently charges the same SCD service rate for its Southern Intertie and Network customers (p. 12) and explains that if the SCD rate to non-firm Southern Intertie customers were to be designed to use "the same divisor used to calculate the IS HNF transmission rate" (rather than the 16 hour divisor it now uses), "this would result in an SCD rate for IS HNF service that is significantly higher than for other services." *Id.* at 13. And, for precisely that reason, BPA staff indicated that it was "leaning" to charging "the same SCD rates

for IS HNF service as for other hourly Point-to-Point services.” *Id.* at 13, 14. But charging IS-HNF service customers a transmission rate “significantly higher than for other services”, just by changing the divisor, is precisely what the staff found problematic with respect to establishing a separate IS-HNF SCD rate.

BPA proposes no separately calculated rate for SCD service on the SI, and no value-based rate for SCD on the SI or any other segment. Indeed, SMUD is unaware of any other value-based rates charged by BPA.

V. BPA’s proposal will create seams issues with the CAISO, not resolve them

SMUD agrees that some legitimate seams issues exist at COB (e.g., conflicting timelines and deadlines for tagging, different product definitions, and different curtailment protocols). These seams issues probably differ between CAISO and non-CAISO entities south of COB. However, price increases for non-firm transmission on the Southern Intertie are not the way to resolve non-price and non-cost issues. On the contrary, by BPA’s own account, Hourly *Firm* service on the Southern Intertie “is a *superior* product.” April 20, 2016 Presentation, slide 11 (emphasis added). Yet, BPA incongruously “proposes to change the IS HNF rate so a customer reserving *HNF transmission* in the evening peak *would pay the same* as a customer reserving long-term transmission.” *Id.*, slide 5 (emphasis added).

Even more, an increase in the HNF and Hourly Firm rates will impose a “toll” on exports from the Northwest. Price differences between trading hubs should not face artificial barriers to convergence, but such a barrier is exactly what BPA is proposing. A substantial increase in the HNF and Hourly Firm rates will either push some transactions out of the money, when they

would otherwise contribute to lower overall energy costs on the West Coast, or will push customers to engage in contracts that are not the most economical. If long-term reservations increase as a result, for example, and short-term energy and ancillary service markets dry up, BPA could be forced to build additional SI capacity that is not required for overall economic efficiency.

BPA's proposal will interfere with the efficient operation of hourly, intra-hour and hour-ahead markets in California. BPA's proposed rate will make the Southern Intertie hurdle rate for exports approximately equal to the CAISO hurdle rate for exports, which seems certain to cause a real-time liquidity issue at COB, negatively impacting transactions involving renewable and carbon-free resources. This will impede progress toward greater integration of western power markets, which relies on inter-regional resource diversity to help integrate renewable and carbon-free resources.

Legitimate seams issues should be addressed collaboratively, not by a monopolistic attempt to reallocate economic rents from some customers to others. The CAISO policy that awards bids without firm transmission appears to be a problem that the CAISO should solve, not BPA; any practice that awards bids without firm transmission could potentially pose a risk to system reliability. More than tripling the HNF and Hourly Firm rates could shrink the HNF and hourly markets; if this happens, the hourly and intra-hourly markets in California (both inside and outside the CAISO) will be affected negatively. Also, BPA has not taken into account the potential impacts of its proposal on obligations to carry reserves. Finally, BPA appears to be intent on influencing levels of congestion and the distribution of "benefits" of congestion at COB; as a dominant transmission owner at COB, BPA may not engage in such activity. Instead

of increasing the SI HNF and Hourly Firm rates, non-rate alternatives should be the focus of BPA's efforts. (See BPA handout of 10-14-15, Slides 15-18.)

In addition, the CAISO is not the only buyer at COB. Non-Northwest customers rely on long-term firm SI service to integrate renewable resources under long-term contracts or ownership rights that help meet California's RPS obligations. Some California entities actually hold long-term firm SI rights themselves. Allegations that "some customers" have expressed concerns about the division of benefits of trading on the SI is not sufficient grounds for BPA to change rate design, especially in so drastic a manner.

VI. The impact of the proposed increase in the SI HNF and Hourly Firm rates is not fully understood

BPA's stated purposes for the increase in the SI HNF and Hourly Firm rates include "sharing the benefits" of transactions on the Southern Intertie. Notwithstanding the dubious nature of this argument, SMUD is unaware of any analysis of the impact on power rates of BPA's exports of secondary energy to California. If BPA-Power faces a higher toll on its exports of secondary energy, BPA-Power's net revenues from such exports will fall, at least by the unit increase in the SI HNF and Hourly Firm rates. An increase in payments for HNF and Hourly Firm service by BPA-Power to BPA-Transmission should reduce revenue credits from the export of secondary energy and thus increase BPA-Power's energy rates, *ceteris paribus*.

VII. The proposed rate solution is based on an unfounded perception of a shrinkage in “high-value” hours in the CAISO

BPA has attempted to justify the proposed change in methodology for calculating the SI HNF and Hourly Firm rates based on a forecast that “super-peak” hours in California will shrink or have shrunk, especially as more solar generation is integrated in California. SMUD’s evaluation of California markets leads to the conclusion that super-peak hours (defined by price) are shifting and moving around as more renewables are integrated, not necessarily shrinking. In the future, more solar means that super-peak prices could easily be defined by ramping requirements both in the early morning and during the hours from mid-afternoon (high temperatures) well into the evening (solar ramp-down combined with continued cooling loads). The result may well be the same number of what are *called* super-peak hours, but distributed differently across the day.

More fundamentally, it is not clear what justification BPA could have for setting cost-based rates on the Southern Intertie based on super-peak pricing conditions in California and the Southwest. (See the arguments above on value-based pricing.) “High value” is a relative, not an absolute, term. What ratio of super-peak prices to average peak period prices constitutes “high value”? How will super-peak prices change in the future? Will BPA switch its methodology back if the number of super-peak hours, however defined, changes? If so, how long will the “incorrect” value-based prices endure before BPA can change its methodology? By what standard will the methodology change? BPA’s proposed rate design for the Southern Intertie is simply not cost-based, and the connection between super-peak energy price hours in California and transmission rate design in the Northwest is arbitrary and capricious.

Conclusion

Thank you for the opportunity to provide these comments. SMUD looks forward to further discussion of these issues. Please direct any questions to Andrew Meditz at andrew.meditz@smud.org or 916-732-6124.