Transmission Pricing Work Group Issue Paper TXPR-02

Issue – Imputed Transfer Payments For Short Term Firm and Non-Firm Bundled Power Sales

Issue Description

Should there be Imputed Transfer Payments For Short Term Firm and Non-Firm Bundled Power

Background

When power is sold, and priced at the point of delivery to the recipient system, bundled into that price is, arguably, a contribution to the cost of the seller's transmission system. In fact, FERC requires that when a utility sells power at wholesale from within its system to another system, its transmission function should charge its merchant function for transmission service at its tariff rate to deliver the power from internal sources to the company boundary. This has been viewed (e.g. in the IndeGO model) as a transmission cost carried by the buyer of the power, because it was presumed that the seller recovered the cost in the bundled price. It has been proposed that to mitigate cost shifting this cost responsibility should continue to attach to the buyer of the power by imputing a transfer payment in the company rates reflecting the historical level of contribution.

The point at issue is whether it is appropriate to require transfer payments for internal transmission costs bundled into short-term firm and non-firm (STNF) power sales.

Alternatives

Chuck Durick developed for the WG the two positions on STNF sales are:

Alternative 1 - Yes, Impute a transfer payment that represents the transmission contribution related to a typical historical level of STNF bundled power sales. This should be done to the extent that the payment can be tracked through to the load ultimately consuming the power. Similar to non-firm wheeling transfer payments, this payment would be offset with non-exempt FTR auction revenue. There would be no transfer charge to marketers who are not PTOs or whose purchases cannot be tracked to load.

Alternative 2 - No, should not attempt to impute any transfer payment from STNF bundled power sales.

Alternative 1 - Arguments for Imputing Transfer Payment

Today, a contribution to the embedded cost of the transmitting system is collected even on short-term transactions. Regardless of economic efficiency, FERC requires it. This is a cost that the buyers of power have always been carrying in their bundled price payments. The parties selling power would not be doing so at a price that fails to recover their costs.

In the absence of an RTO this short-term collection of embedded costs would continue. However, the RTO model of recovering embedded cost through a load based access charge eliminates any transmission payment based on short-term transactions (in the absence of congestion). It therefore produces a cost shift to the sellers if that responsibility is totally removed from the buyers.

For some utilities a significant amount of money may be in play. There is no reason to expect the volume of power purchases to decline in future. In some cases present STNF levels may reflect long term situations of supply sufficiency or price differential that will certainly compel continuation of purchases in some form or another. If anything, the volume of these short-term transactions is more likely to rise than to fall. This represents a continuing reliance on the transmission systems of traditionally selling utilities. Equity says that a transfer payment should be imposed to compensate for this reliance.

<u>Alternative 2 - Arguments for Not Imputing Transfer Payment</u>

The notion that a short-term buyer of power is somehow paying the seller's transmission cost is an unsound economic premise. Transmission costs are essentially fixed. Short-term sellers of power are today selling at market prices, not cost based prices. They will sell whenever their short term incremental costs are covered, often at prices that fail to fully recover their fixed costs such as owned transmission.

For equity to be served by a transfer payment requires the assumption that the post RTO price of STNF power will drop by an amount approximating the payment. If the price of power does not drop, then cost will have shifted from buyer to seller. This is because the buyer is making a transfer payment to the seller based on historical usage, but is still paying the same price for the power. Since this power price was presumed to be making a payment for transmission, the buyer is now paying for transmission twice. There is no reason to expect future power prices to go down because of dropping today's requirement to make internal payments for short-term transmission use. This transmission hitch is trivial compared to the other forces that will be pushing future power prices around.

Short-term and non-firm transactions by their very essence lack a commitment to make long-term payments. The parties engaged in such transactions did so specifically to avoid a long-term commitment and it would be unreasonable to suddenly create such a commitment where none was intended.

Failing to charge power marketers whose purchases cannot be tracked to specific loads unduly discriminates against utilities and their affiliates. A utility merchant who has been buying power and reselling it at wholesale (just like any other marketer) would pay a transfer charge, but the unaffiliated marketer doing the same thing escapes. Two parties conducting essentially identical transactions are treated differently. The "leakage" effect of failing to charge unaffiliated marketers is very high and will create a substantial inequity. For example, over half of the Idaho Power sales for resale were to marketers or others who could not be tied to northwest loads.

The amount of power being resold at wholesale is extremely high. The volume and complexity of the STNF transactions would make it virtually impossible to determine how much power an integrated utility was buying on behalf of its native load needs versus what it was buying simply as a reselling merchant.
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WG Recommendation - WG is split on this issue

Rationale Behind Recommendation

Several of the PTOs do not have Merchant functions so this component of transfer payments are not supported by them. Including a Transfer Payment does not provide parity between PTO affiliated marketers and those marketers unaffiliated with a PTO.

Linkage to Other Major Issues

<u>Continuing Work if decision is to include a transfer payment</u>

> In case it is decided that a transfer payment should be imputed on the basis of historical STNF power sales, some parties are working on various ways to try to track sales to load and calculate payments. In one approach, power scheduling data is being looked at to see if the ultimate destination can be identified. In another approach, the net import/export energy balance of the PTO's is being looked at as an indicator of a consistent reliance on power from other systems regardless of how many intermediaries were in between

TXPR 01 – Constancy of the Transfer Payment

TXPR 03 – Imputed Transfer Payments For Long-Term Firm Bundled Power Sales

IPP Problem (also called the Montana Problem)
Handling of Transfer Payments in general (i.e., incentive to join the RTO Vs be a user of the RTO assets)