NRU's comments on the PTSA Termination/Default Issue

November 2, 2011

BPA and its customers spent a considerable amount of time developing the Network Open Season (NOS) process in order to comprehensively address the issue of BPA's long queue of transmission service requests (TSRs) and the need for the orderly and systematic study of those requests. NOS offered the ability to study TSRs in clusters instead of individually. In order to do this, BPA needed to know which TSRs were seriously interested in obtaining transmission service, rather than speculatively holding a place for them in the transmission queue. Consequently, BPA developed Precedent Transmission Service Agreements (PTSAs) where customers would be able to express their legitimate interest in obtaining transmission service. PTSAs were offered to all customers with TSRs in the transmission queue. When the customer signed the PTSA, it committed to take service for the term requested and paid a performance assurance equal to one year's worth of transmission service. Alternatively, the customer could follow the pro forma path by funding its own system impact study, or simply exit the queue.

The purpose of the PTSAs was to protect BPA and its other transmission customers from assuming the risks and costs of entering into transmission builds for these TSRs and then having the transmission be undersubscribed. This would increase rate pressure on BPA's remaining transmission customers, primarily load serving entities such as NRU's members.

Ironically, despite the intended purpose of the PTSAs, BPA has wound up in the very spot the PTSAs were intended to prevent. A number of unsatisfactory results have arisen from the way the PTSAs were designed. For example, the PTSAs allow customers to receive a return of their performance assurance funds (equal to <u>one year</u> of service) after taking service for only <u>six months</u>. A number of the customers that signed PTSAs are limited liability corporations (LLCs) which are legally and financially separated from their parent company. As a result, the ramifications to the LLC of defaulting or terminating their agreements with BPA may be minimal because they are not concerned about their credit ratings and have few assets for BPA to pursue to seek compensation for damages. Of the nearly 12,000 MW of 2008-2010 signed PTSAs, 25% have indicated an interest in looking at termination (2,000 MW) or modification (1,000 MW). This is a significant issue and poses great risk and exposure to BPA's transmission customers who are load serving entities and will be left to face whatever costs remain. The structure of the PTSAs and NOS has considerable shortcomings and needs to be thoroughly revamped prior to NOS resuming.

The following comments reflect the position of NRU staff given the situation BPA's NT customers may be facing. Individual members of NRU may or may not agree, and to the extent there is disagreement, it is largely a result of the precedent that may be set by the Agency potentially allowing certain PTSA customers to terminate contracts. We honor our contracts and expect others to do the same. Given BPA's planning staff, its Risk Management office, and responsibility to follow sound business practices, it is extremely disappointing to have BPA's customers potentially inherit (through rates) the financial risks associated with the Agency's overly aggressive commitments to transmission expansion that in retrospect were not in sync with assurances of financial performance by those new entities signing PTSAs.

While we appreciate the opportunity to comment at this juncture, and encourage the Agency to set a course of action through a public process, we are not at all satisfied with how the PTSAs have been handled by the Agency. BPA's relationship with customers cannot be sustained over time if agreements can be breached simply due to the changing economic and regulatory environment.

NRU's members have signed many agreements, including PTSAs, with BPA and have stood by those agreements over the years. For example, members of NRU have gone through the PTSA process on their own to bring power to load. While it was a very challenging process, it did prevent these utilities from simply pretending that they had a deal with the power provider. They were required to provide a signed wholesale power contract number to BPA, and follow all procedures. Had BPA followed the same procedure, required the same documentation, and credit worthiness accounting, these stranded cost issues would not now be facing us. We doubt that business relationships can be sustained over time if agreements can be breached simply due to the changing economic and regulatory environment.

In addition to addressing the technical features of PTSAs, the senior management of BPA should engage in a broader discussion with customers as to how the Agency plans to approach any future NOS to help re-establish customer confidence that requests for transmission services and responsibility for payment for service are aligned.

The following is our response to the specific questions posed by BPA:

1. **Given the analysis BPA recently provided of base case, termination and default scenarios (see links above), what are your organization's current views regarding whether BPA should allow PTSA terminations?**

NRU staff encourages BPA to explore options for termination of PTSAs as long as such options do not result in a significant cost shift or material pressure on rates. Any such proposal would have to work in conjunction with an overall planning approach for future transmission service that will remain durable in varying regional economic conditions. The reason why NRU is open to such an exploration is due to the provisions of the PTSAs themselves and the nature of the counterparties with whom BPA has signed these agreements. Our concern is that not allowing termination could lead to an even worse situation. For example, under a "No Terminations Allowed" scenario, unneeded investments could be made which would draw down BPA's already strained available capital. Also, many of the PTSA holders that have indicated that they would like to terminate have signed up only for 5 years of transmission service. If the parties actually don't need the service, we could be in a situation where the lines are built and five years later the capacity is extremely undersubscribed. The revenue shortfall would need to be recovered from BPA's remaining customers, primarily the load serving entities. Finally, not allowing termination in an orderly fashion could lead to outright default with even potentially larger cost shifts to BPA's remaining transmission customers and regional turmoil that will come with the ensuing lawsuits.

In answer to this question, therefore, NRU responds largely from a financial perspective. If the result of not allowing terminations is worse than allowing termination, and these differences are deemed to be material, then a course of orderly termination should be explored.

2. One of BPA's principles in the PTSA termination discussions is that network transmission customers should not experience upward rate pressure as a result of any terminations; however, at a recent public meeting, some stakeholders suggested that BPA emphasize the risk of default and the ability to recover damages in deciding whether to terminate PTSAs and determining termination costs. **What level of rate pressure resulting from PTSA terminations would be acceptable, if any?**

NRU recognizes that if the orderly termination scenario is pursued, then there may be rate pressures due to the reduced transmission revenues that will arise as a result of the conditions associated with letting these potential transmission customers out of their agreements. Given the lack of better information at this time, we cannot reasonably forecast either the expected volume of terminations, or the financial consequence of such terminations on transmission rates. Our preferred approach is clearly no rate impact. However, it is reasonable to expect that terminations will impact rates. We would want to know the other factors that will be weighed against this potential result. For example, if termination avoids unnecessary capital investments and forestalls uncompensated defaults that could occur if termination is not allowed, then slight upward rate pressure may be worthy of consideration. Also, in BPA's own analysis of the default and termination scenarios, it has taken a conservative approach to looking at rate impacts. For example, in its analyses BPA assumes that if termination occurs there will be no purchaser of the now-excess capacity. Our expectation is that BPA will design an approach such that the rate pressures that may come as a result of allowing termination will be minimal. Given the interrelated variables involved here, we believe it would be premature and inappropriate in this correspondence to specifically address the question of rate levels resulting from PTSA terminations.

3. In the event of a default, BPA will assert the right to draw on the performance assurance provided to secure the obligations in the agreement and to pursue other remedies to enforce the PTSA obligations through litigation, and to the US Treasury for collections if applicable. **Should BPA attempt to address default risk (based on default scenarios presented on October 12, 2011 – see link above) through PTSA terminations or wait for any defaults to occur and exercise its legal rights?**

As discussed above, we would suggest that the Agency find a way to resolve this issue prior to the event of default. BPA can attempt to address default risk by permitting orderly terminations of PTSAs as part of a publicly developed proposal that the Agency would generally offer. The termination provisions should include a cost (in addition to forgoing their performance assurances) to those who elect to take this path. A balance must be found that will allow for orderly termination and also provide for the highest achievable compensation for BPA and its remaining transmission customers. The exercise of formal legal rights through litigation or other adversarial administrative procedures is time consuming, sometimes fraught with political peril, and creates uncertainly that may impede orderly planning for the region's transmission assets and the related rates that are charged to transmission customers.

4. Do you have any other comments or feedback at this time?

The termination or modification of PTSAs would result in an increase in available transfer capacity (ATC). BPA should evaluate whether some portion of that ATC would be utilized by its NT customers and therefore held out in a margin to help address planning needs identified in the ongoing process BPA is having with its customers to modify its NT planning policies. Also, as noted above, the structure of the PTSAs and NOS has considerable shortcomings and needs to be thoroughly revamped prior to NOS resuming.

We also request that BPA maintain a detailed accounting of the costs that are being imposed on its remaining NT and PTP customers as a result of allowing termination and/or facing default by these entities.

Thank you for the opportunity to comment. If you have any questions regarding either our response to the questions or other views expressed herein, please let us know.