National Grid

White Paper on Wholesale Power Market Platform Planning and Expansion

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The FERC April 28, 2003 paper on Wholesale Power Market Platform contemplates a planning and expansion process in which the RTO or ISO must be responsible for planning, and for directing or arranging, necessary transmission expansions, additions, and upgrades that will enable it to reliably and economically serve the needs of customers in the region and coordinate such efforts with appropriate state authorities. The regional transmission plan must include all transmission facility expansions in the region. The RTO or ISO would include transmission upgrades in the regional plan that are necessary to maintain or improve reliability or to reduce congestion and improve access to lower cost supplies. The FERC paper also expands upon its view of the role of states in planning and expansion, including primary responsibility for how to allocate costs for transmission enhancements and for resource adequacy.

FERC's paper indicates that it would not require that the RTO or ISO use a Request for Proposal (RFP) process associated with transmission upgrades under the regional planning process. This represents a further clarification from the RFP discussion in the FERC SMD NOPR, as follows.

The SMD proposal discussed a regional planning process that may include:

(1) a requirement that the independent transmission provider (RTO or ISO) participate in an open regional planning process that will identify transmission investments that are expected to be needed during the planning period to maintain system reliability, reduce network congestion to reduce costs and increase generation supplies available to the region, and promote truly competitive regional wholesale electricity markets and publicize its assessment of those needs;

(2) the ongoing opportunity for developers of merchant projects -- including generation, demand side, and transmission – to develop projects consistent with the regional plan that would be financed entirely from anticipated market revenues obtained from generators, marketers and their customers;

(3) a requirement that certain transmission owners assume the obligation to build on a regulated basis transmission upgrades that are required for reliability, to reduce congestion, and to facilitate competition between generators within the region if merchant projects do not fill the needs identified by the RTO or ISO; and

(4) a requirement that before a regulated upgrade is built, the RTO or ISO conduct a formal request for proposals (RFP) seeking new projects to fill the needs identified by the planning process for which a viable merchant proposal has not already come forward. The winner of an RFP would presumably fund its investment partially through CRR (or FTR) sales and partially through regulated tariff.

National Grid supports the FERC's futher clarification in its Paper on Wholesale Market Platform in which it indicates that it would not require that the RTO or ISO use a RFP process for transmission upgrades. As elaborated below, National Grid believes that a mandatory formal RFP is both unnecessary and inimical to the Commission's objectives. Regulated transmission

investment should be encouraged now, not relegated to a last resort option following a process that the market participants that profit from congestion could game to delay grid upgrades and expansion.

The RFP Requirement Is Unnecessary and Duplicative

The FERC's proposal envisions an open regional planning process, in which the RTO or ISO will assess the needs of the regional transmission system for upgrades to preserve reliability and enhance the economic efficiency of regional electricity markets. The RTO's publication of its needs assessment will give developers of potential merchant generation, demand-side, and merchant transmission projects the information they need to identify favorable locations for their projects and potential beneficiaries who may be willing to provide financial support. Because of the inherent delays in constructing regulated transmission projects, the planning process would effectively contain an ongoing, self-executing RFP, in which developers make their proposals to prospective customers and the market selects winning projects by making commitments to developers. The RTO's role in that process is to provide the necessary information and to ensure that any proposed project does not have adverse effects on the regional network. As long as there are no such adverse effects, there is no need for the RTO to interfere with the operation of these market choices. As described below, the view that merchant developers should be given the opportunity to compete for regulated projects by proposing projects that presumably have lower net Tariff cost rather than lowest overall cost, would lead to inefficient planning.

Adding a mandatory RFP to this open regional planning process will only further delay the construction of regulated transmission infrastructure, and give merchant project developers an unnecessary second bite at the apple to obtain backing for projects that have not found favor in the market. It would require the RTO or other entity to "select winners," through a process in which it would override the choices made by prospective buyers. The mandatory RFP proposal would revert to the discredited notion that government-chartered non-market institutions know better than the market how to select winners. This is not only at odds with markets in general; it presumes that such institutions can always compare transmission, generation, and demand response alternatives as if they were substitutable commodities for long-term solutions to transmission needs. Each of these resources has distinct capabilities and characteristics that prevents them from being equivalent substitutes for one another and prohibits a fair and equitable quantification of their benefits. Characteristics such as availability, including emergency restoration time; market efficiency; operational performance and flexibility; and long term adaptability to changing system needs are examples of areas that were extremely difficult to equitably compare in the fully integrated industry of the past and thus are impractical and are nearly impossible in the generation and demand markets of the present.

The RFP Requirement Would Impede Achievement of the SMD Objectives

Imposition of a mandatory RFP requirement in the Planning Process would impede achievement of the Commission's objectives in several critical ways:

- *The objective of large competitive regional markets.* Even if the mandatory RFP requirement has the desired effect of fostering the development of alternatives to

transmission upgrades, it will do so at the cost of *perpetuating* weaknesses in the transmission system. If a generation project is selected in the RFP to meet a need identified by the planning process, the transmission system will *not* be upgraded and will not give access to remote economic generation. Instead, the system will become dependent upon the output of that generator for reliability or market operations, requiring the RTO or other entity to constrain the new generator's bidding flexibility to avoid the exercise of market power. Moreover, incumbent generators in load pockets will have the incentive to propose projects in those load pockets in order to pre-empt real competition, requiring the RFP process to evaluate the competitive impacts of generation projects proposed by different owners. Even if a new generator proposes a project inside of a load pocket, moving from monopoly to duopoly reduces but does not eliminate market power problems. Transmission projects on the other hand can eliminate the load pocket problems once and for all and will generally be superior alternatives from a market power mitigation perspective. In addition, market participants can undoubtedly use the RFP process to further maintain market power by delaying construction of an already difficult to permit needed transmission project. The RFP requirement will thus lead to further and additional reliance on market power mitigation measures, rather than expanded access to competitive supplies, to assure customers of abundant and reasonably priced electricity.

- *The objective of encouraging transmission investment.* The mandatory RFP requirement would create additional hurdles before new transmission upgrades are built on a regulated basis. The RFP requirement is process-intensive: it will require the RTO to formulate RFPs, provide information to bidders, review responses, and select winning bids using what will necessarily be complex but imperfect evaluation criteria. At each step of the way, market participants will have the opportunity and incentive to intervene to shape the process to their benefit and to challenge the results if they are not successful. In fact, some market participants who benefit from current grid bottlenecks, will have the incentive to prolong the process even if they have no interest in being selected merely to slow down transmission investment to maintain their favorable economic positions. The mandatory RFP requirement will thus interfere with the development of a robust transmission infrastructure that can support competitive regional markets. The delays are especially unjustified should the RFP requirement be applied to forestall the installation of quick or inexpensive upgrades to existing transmission facilities that could significantly enhance their capability.

- *The objective of fostering competitive and non-discriminatory electricity markets.* If some merchant projects receive subsidies through regulated rates because they are selected as "winners" by the RTO in the mandated RFP, those projects will have an unfair advantage over their competitors in the wholesale electricity markets. Many developers will avoid proposing projects outside the RFP process so that they can pursue subsidies from the RTO or ISO. While this impact could be ameliorated if projects that are selected in the RFP receive no subsidies, there is no need for the RTO to select winning bids at all. It need only identify those projects that will not cause an unacceptable adverse impact if they proceed.

- *The objective of efficient expansion.* An RFP process in which different solutions bid in for partial solutions with subsidy and therefore requiring additional back stop

transmission solutions could lead to inefficient overall costs to customers. Furthermore, an RFP process will result in additional fragmentation of the grid and further reducing operational efficiencies.

Limit Application of the RFP Process to Interim Measures

National Grid supports reliance on the informal, "open RFP" that is embodied in the FERC planning process proposal, enhanced by explicit requirements to ensure that the RTO or ISO's assessment of the needs of the regional transmission system for upgrades is timely, complete, and widely distributed, and that the RTO or ISO's process to ensure that merchant projects do not have material adverse effects is not prolonged or burdensome. The RFP could, however, be applied in circumstances when generation reliability must run (RMR) type contracts or demand response can provide interim solutions to reliability and market power problems for one or two years while transmission projects addressing long term reliability and access issues are under construction.