Audience publique relative à la détermination du prix unitaire moyen du transport et à la modification des tarifs de transport d'électricité
R-3401-98

Rate Design Analysis

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1 Overview

1.1. Objective

1.1.1 The overall objective of this testimony is to contribute to the regulatory process in defining TransÉnergie’s transmission rate structure and to assist the Régie in reaching a decision that would result in a long-term beneficial outcome for all stakeholders. This objective will be achieved by addressing the collective interests of the Coalition and sharing our experiences and observations gained in other jurisdictions.

1.1.2 The immediate objective of this testimony is to ensure that the level and design of TransÉnergie’s transmission rates do not directly or indirectly advantage Hydro-Québec (HQ) over other users of the transmission system and that, ultimately, the rates are reasonable and can contribute to the development of a healthy competitive environment in the future.

- I intend to accomplish this by emphasizing the need to develop a rate design that fosters and encourages competition and entry into the Québec market, and that is effective in meeting the needs of all transmission users, not only those of Hydro-Québec.
- Additionally, this testimony will elaborate on the importance of this hearing at this critical stage of the development of the competitive marketplace in North America. While Québec has been able to trade relatively freely in the US, taking advantage of its abundant hydroelectric resources and benefiting
greatly, many industry participants have been suffering considerably. Given the current heightened focus on investigating potential abuses of open access and deregulation, and the potential for corrective measures, it is also important to discuss the options and means by which the Régie can take a proactive stance in protecting and maintaining Québec’s electric industry interests and position.

1.2. Structure of the Testimony

1.2.1 The testimony is divided into sections that will address the following:

- Discussion regarding the distinction between TransÉnergie and Hydro-Québec as functionally separate entities.
- Description of the operating environment and the specific and unique challenges facing the Régie and intervenors in dealing with an important application that is likely to be precedent setting.
- Overview and discussion of the key elements of the application as submitted by TransÉnergie.
- Conclusion and overall evaluation of TransÉnergie’s proposal to meet its general rate setting objectives, uniqueness of TransÉnergie’s system, and recognition of current market realities.
- Recommendations to the Régie.
2 TransÉnergie’s Relation to Hydro-Québec

2.1. Functional Independence of TransÉnergie From Hydro-Québec

2.1.1 The Régie should address the transmission rates as they pertain to TransÉnergie independently of Hydro-Québec and its export subsidiary, regardless of the fact that Hydro-Québec and its export arm are the majority users of TransÉnergie’s transmission system.

2.1.2 It is important to emphasize that the two functionally separate entities need to be treated separately at the regulatory level in order to continue the Régie’s work in fostering a fair and competitive environment at the generation/wholesale level. The intent of a functional separation is to allow the function of each entity to be addressed and treated independently of the function and influence of other related entities.

2.1.3 This rate hearing needs to focus on the transmission function; that is, the needs of the transmission system, the needs of the transmission owning/controlling entity, the needs of all industry stakeholders including Hydro-Québec, but only as a transmission user. It is important that the Régie recognize that the overall interests of Hydro-Québec may not always be congruent with the needs of the transmission system operator or those of other transmission system users.
2.2. Commonality of Management and Ownership

2.2.1 All three entities (TransÉnergie, Hydro-Québec and the export arm of Hydro-Québec) are ultimately governed by the same senior management team and report to the same shareholder (the Québec Government). This shared management and ownership structure runs the risk of a conflict of interest between TransÉnergie, as an independent provider of transmission services, and Hydro-Québec, as the owner and primary user of TransÉnergie’s services, or, at the very least, a public perception thereof.

2.2.2 In addressing the potential for conflicts of interest arising between TransÉnergie and Hydro-Québec it is imperative that the Régie pay particular attention to recognizing and protecting the interests of the small and minority third party users of TransÉnergie’s transmission system. Although these third party users are potentially Hydro-Québec’s competitors, their incremental use of the system is the source of all additional revenue to TransÉnergie. Without such third party participation in the Québec market, there would effectively be no competition at the wholesale level, and, consequently a loss of all of the intended(desired) benefits from competition.
3 TransÉnergie’s Operational Environment

3.1. TransÉnergie as a Regulated Monopoly

3.1.1 The operational environment of TransÉnergie is, and will remain in the foreseeable future, a regulated natural monopoly. It is the sole supplier of transmission services in Québec, and is regulated by the Régie, earning a return on its assets on a full cost recovery basis.

3.1.2 The transmission business is evolving in the electrical power industry as a separate and independent business that is distinct and potentially separable from the generation and distribution sides of the business. The industry expectation is that the transmission businesses will remain regulated monopolies, earning a return on their assets on a full cost recovery basis.

3.1.3 FERC Orders 888 and 889 require the functional separation of transmission businesses from their generation counterparts. FERC Order 888 and 889 have managed to kick-start the industry into developing open access on a jurisdiction-by-jurisdiction basis. Continuing this work, FERC Order 2000 promotes further independence and separation of these transmission businesses; where the control, operation and even ownership of transmission systems would be delegated to an independent agency. It is expected that FERC will be moving to affirm the spirit, intent and objectives of open access, as opposed to enforcing or observing the rules strictly as written. Industry experience is that vertically integrated entities are able to appear to be strictly abiding by FERC Orders while managing to exploit...
these rules to the benefit of their subsidiaries. An example is where the entity or its subsidiary reserves all available long-term firm transmission then releasing it later to the short-term market thus denying competitors the ability to secure long-term access.

3.1.4 Irrespective of the manner in which the transmission system is controlled and operated or the rate structure put in place, the expectation is that the owners of the physical assets will always recover the full cost of operating the system including a fair return on their investment in the transmission assets.

3.1.5 It is expected that a competitive environment will tend to increase the virtual use of the transmission system (number and volume of transactions) by third parties, thus increasing the potential revenue collected by the transmission business.

3.2. **TransÉnergie is an Entity in a Unique Position**

3.2.1 TransÉnergie is a division of Hydro-Québec which is owned by the Québec Provincial Government. This is evidenced by the fact that the Provincial Government guarantees Hydro-Québec's debt which necessarily includes TransÉnergie's debt. In the past, Hydro-Québec has met all it's financial obligations through it's own cash flow without relying on the Provincial Government (HQT – 8, Document 3.1, p. 1). Naturally, the Government, as the shareholder, will ensure its interest in Hydro-Québec will be preserved using whatever means available to a Government.
3.2.2 Almost 99.6% of TransÉnergie’s system usage/revenue collection is received from Hydro-Québec. 88.8% of TransÉnergie’s revenue is generated directly by Hydro-Québec through the Network Integration Rate and a further 10.8% from Hydro-Québec through the long-term Point-to-Point rate. This leaves only a fraction of the approximately 0.4% of TransÉnergie’s revenues being generated through short-term Point-to-Point service, collected from third parties (HQT – 13, Document 13, p. 25)

- The result is that there is no material financial risk resulting from third party system usage as additional revenue from third party users is minimal, comprising less than 0.4% of TransÉnergie’s total revenues.

- This fraction of the roughly 0.4% of TransÉnergie’s system usage does, however, represent competition to Hydro-Québec in its exporting efforts.

- The third party users that make up this 0.4% are exposed to high rates that impair competition in the Québec market and are likely to discourage the entry of new participants.

- While some rate discounting is offered, it is only done so on an inconsistent and short-term basis. Such discounting practices create the artificial appearance that low rates are available, when in reality their inconsistent application and calculation prevent third party system users from long-term planning outside of the regularly posted long-term rates and non-discounted short-term rates.
3.3. Impact of an Evolving Transmission Business Environment

3.3.1 The directives in FERC Order 2000 have resulted in considerable activity by transmission owners over the past two years. If TransÉnergie were to adopt these directives, then TransÉnergie would evolve into one of three basic structures. None of these structures would reduce TransÉnergie’s ability to collect its revenue requirements and earn a reasonable rate of return on its assets.

- Become an Independent System Operator (ISO). This would entail more or less maintaining the same size and operating under a materially similar mandate with increased independence from Hydro-Québec. This would appear to be the minimum requirement necessary to satisfy the industry’s concerns regarding the independence of TransÉnergie.

- Join a larger ISO or Transco. While this option is unlikely, TransÉnergie’s involvement would of course be subject to its ability to earn its required rate of return.

- Become part of a larger Regional Transmission Organization (RTO). While this option may result in some loss of operating control, the structure of the RTO should not impact on the owner’s revenue requirements. This option would remove many of the concerns of the industry regarding TransÉnergie’s independence.

Any of the above options could enhance TransÉnergie’s ability to provide a true independence in the operation of
the system, better foster competition, and ultimately,
increase the utilization of the transmission system.

3.3.2 There is already a demand by industry participants that TransÉnergie recognize the directives in FERC Order 2000 and join or otherwise align itself with neighboring transmission operators. These sentiments are echoed in the submission to FERC by Enron Power Marketing Inc and Coral Power, (Docket No. ER97-851-012 attached as Appendix 1) in stating their preference for the means by which transmission and generation market power could be mitigated, as a condition to allowing Hydro-Québec continued participation in the U.S. deregulated marketplace:

- “HQ turns it’s facilities over to the operational control of either of the RTOs being formed in the NYISO or ISO-NE regions or at least a requirement that HQ implement a market structure that meets the open-access principles required by the Commission in the U.S. Only through RTO participation will HQES and HQ be subject to real open-access, market monitoring, and stakeholder review.” (p. 3)

3.3.3 The design of the rate structure for TransÉnergie should be proactive, reflecting the trend towards the formation of RTOs and the likely requirements (rate structures) for becoming, or aligning with, a FERC approved RTO.

3.3.4 In British Columbia, BC Hydro has recognized the importance of establishing rates and rate structures that support FERC Order 2000, and facilitate regional efforts to form RTOs. While RTO formation is flexible and innovation is
encouraged by FERC, filing transmission owners and their
Canadian counterparts need to work towards developing
natural transmission regions and address seams issues
between independent operators within those natural regions.
BC Hydro’s and West Kootenay Power’s efforts to align
themselves with RTO West are included in full as Appendix
2 (Attachment H To Supplemental Compliance Filing And
Request For Declaratory Order Pursuant To Order 2000 of
the RTO West Stage 1 Filing).

3.3.5 In the event that the Régie approves a rate structure that
would inhibit or otherwise confound the formation of an RTO
or alignment with neighboring RTOs, the rates and their
structure would need to be revisited in the future. As the
transmission side of the industry collectively moves toward
RTO formation, TransÉnergie must make an effort to
recognize and respond to the directives in FERC Order 2000
in order to strengthen transmission integration in the region
and to ensure that the benefits enjoyed by Hydro-Québec
and the Provincial Government continue. A narrow
interpretation of FERC’s intentions may be seen by potential
collaborating counter parties in the region as anti-competitive
and may result in TransÉnergie being in a less favourable
position in future negotiations. The Régie should be mindful
of this and should insist on a rate structure that would
facilitate the process and approval of RTO development.
4 The Challenges of TransÉnergie’s Rate Application

4.1.1 There are a number of key challenges that need to be emphasized in hearing this rate application. These issues and challenges present the backdrop and the drivers of the regulatory process. Bringing these issues to the forefront of the discussion is a necessary first step in addressing the full set of ramifications of TransÉnergie’s rate application. The issues have major implications for the electrical power industry in Québec and require creativity and innovation rather than the standard, historical treatment in order to produce long-term viable results.

4.2. Precedent Setting

4.2.1 The decisions of this hearing will have a major impact on the future of the electric industry in Québec. The final decision will set a precedent and drastically affect any future decisions made by the Régie. Mr. Priddle stressed this challenge in his report, stating that the “Régie’s decision(s) in the present case will have an enduring impact on Hydro-Québec's rate design. It would not be an exaggeration to assert that it will profoundly affect the development of Québec's electricity industry, its energy sector and, through that, the economy of the province at large.” (Evidence of Roland Priddle, p. 5, lines 19-25).

4.3. Encumberment by Previous Rules and Regulations

4.3.1 Hydro-Québec's assets have already been allocated between generation, transmission and distribution. Based on these allocations, there seems to be a large disparity
between the generation costs and transmission rates, and between TransÉnergie’s transmission rates and those in other jurisdictions. Hydro-Québec is blessed with one of the lowest generation costs in North America, while the transmission rates proposed rank among the highest in North America.

### 4.4. Interest in Export Markets

4.4.1 Protecting Hydro-Québec’s ability to sell at market based rates in the US may make it necessary that the Régie accepts/abides by certain FERC requirements. The challenge is to define those mandatory requirements, as most entities tend to follow the FERC-ordered pro forma tariff almost blindly, in order to avoid any issues with FERC, or else they use FERC as an excuse when it is in that entity’s interest to follow the pro forma tariff. The British Columbia Utilities Commission (BCUC) had to deal with similar boundaries in its dealing with BC Hydro’s Wholesale Transmission Services Application. The following correspondence is an excerpt from a letter sent by the BCUC to registered intervenors and interested parties dated July 18, 1997, and defines the extent of FERC’s interests in this area (a copy of the entire letter is attached as Appendix 3):

- FERC staff stressed that “they [FERC] have no interests in local transmission pricing issues – including incremental pricing. Instead, FERC seeks only to ensure that a local utility cannot control transmission pricing in a manner which would allow them to manipulate market prices into the United...
States.” and FERC’s staff also stressed that “it is Powerex’s decision to file a pro forma tariff, and that this is not a requirement of FERC … their [FERC] interest lie in the area of open access, comparability, and reciprocity, and do not extend to the issues of incremental rolled-in pricing, unless those pricing issues convey market power inappropriately to any party.” (p. 2)

4.4.2 Strict compliance with the wording of FERC Order 888 and 889 alone is no longer a guarantee that the Power Marketing Certificate is secure as exemplified in the submission to FERC (as stated above) by Enron Power Marketing Inc and Coral Power (Docket No. ER97-851-012 attached as Appendix 1).

4.4.3 While TransÉnergie’s rate application appears to meet the requirements of FERC Orders 888 and 889, specifically regarding the creation of a pro forma tariff, it is done in a way that appears to simply conform with the Orders as written, exploiting the flexibility of the Order to discourage use of the transmission and not reflecting the spirit of the order for open access. As mentioned before, FERC is becoming increasingly aware of these activities and is paying more attention to uncovering such abuses.

4.5. Market Perception of Canadian Utilities

4.5.1 Our own market intelligence indicates that Canadian entities (i.e., BC Hydro and Hydro-Québec) are sharply scrutinized by industry players with suspicion and negative regard. Their Government sponsorship and control and their
heavy-handed tactics of capitalizing on US export markets have raised concerns and perceptions that their practices are monopolizing and anti-competitive. Consequently, addressing industry perceptions of Hydro-Québec's performance and ensuring the Régie's commitment to the reality and the appearance of a level playing field in Québec becomes paramount.

- Complaints, like the one from Enron Power Marketing Inc and Coral Power, are a manifestation of the industry's sentiment and would result in focusing unwelcome attention on Hydro-Québec's and TransÉnergie's behaviour. This attention could ultimately jeopardize Hydro-Québec's ability to retain its authority to sell into the US at market-based prices.

- In the submission to FERC by Enron Power Marketing Inc and Coral Power (Docket No. ER97-851-012 attached as Appendix 1), they present the following arguments:

  - “[T]he Commission cannot find that HQES and its parent do not have or have mitigated generation and transmission market power.” (p. 3)

  - “If a liquid forward market does not develop in New York, there will be greater reliance on the spot market, which could lead to problems similar to those that occurred in California, in New York next summer.” (p. 4)

  - “Market participants are well aware of HQ’s manipulation power and are thus reluctant to
trade in the market when Hydro-Québec is an active participant.” (p. 7)

- “TransÉnergie, HQ’s transmission system, possesses unmitigated market power in transmission that should preclude its eligibility for market pricing authority. Consequently, open access to the TransÉnergie transmission system, for service within or into the HQ system is a meaningless concept” (p. 7)

- Since it appears that Hydro-Québec’s authority to sell power into the US at market based prices is already threatened by US marketers complaining to FERC about Hydro-Québec’s market conditions and performance, the Régie must take a clearly positive stance in creating a competitive environment in Québec. Hydro-Québec cannot be permitted to appear to enjoy a preference over access to transmission if the Régie is interested in preserving Hydro-Québec’s ability to trade in the US market.

4.6. Reasonableness of the Rates

4.6.1 TransÉnergie has the highest transmission rates but lowest generation costs in North America. One issue that must be dealt with is the “reasonableness” of the transmission rate. The high rate is primarily the result of the classification of generation assets. The Régie should ensure that the rates are not additionally higher than absolutely necessary and that the rate design does not further encumber users of the transmission system more than they are already encumbered by the current rate.
4.6.2 The Régie needs to be cognizant of the degree of unreasonableness of the transmission rates applied for by TransÉnergie. The argument made by Enron Power Marketing Inc and Coral Power (Docket No. ER97-851-012 attached as Appendix 1) only highlights the extent and fullness of the industry’s concern and frustration with the rates and their impact.

- “So long as HQ used this import capability to make long-term sales into New York and New England, its ability to exercise market power to influence prices in the U.S. markets was confined. Since 1997, however, HQ has substantially replaced its traditional pattern of making long-term sales in U.S. markets with an aggressive strategy of making shorter-term sales into the U.S. during period when prices are most easily influenced.” (p. 5)

- “Such through service is technically possible under TransÉnergie’s tariff, but it is economically infeasible because of TransÉnergie’s exorbitant charges for this service.” (p. 7)

- “Not only is there no economical access to TransÉnergie, the uneconomical service that TransÉnergie does offer is grounded in a highly discriminatory rate structure.” (p. 8)
5 Overview and Discussion of the Application

5.1 Rate Design Issues

5.1.1 TransÉnergie's proposed transmission rate and tariff structure will not promote the efficient use of the system, enhance economic efficiency, or advance competition and open access.

5.1.2 TransÉnergie's rates, as proposed, are exorbitantly high compared to other utilities, and several factors contribute to the rates being “unreasonable”.

5.1.3 TransÉnergie's rates can be brought down to reasonable levels if the transmission rate can be divided into components/parts (multi-part rates) to reflect the use of the system. Three components can be easily envisioned:

- A remote generation related component (similar to gathering rates in gas transmission)
- A network component; and
- An intertie component (for facilities connecting the network to neighboring jurisdictions). Again the intertie component could be included in the network component.

- As an alternative to multi-part rates, TransÉnergie's Point-to-Point rates could be restructured to reflect the degree of utilization of the system based on points of receipt and points of delivery.

- A third alternative would be to structure the Point-to-Point rate to be a function of the delivery voltage. Transmission rates would reflect the utilization level of
the system, meaning that the lower the delivery
voltage the higher the rate and the higher the system
losses.

- Irrespective of how the Point-to-Point rates are
  ultimately structured, the nature of the Network
  Integration Rate, which is used primarily to serve
  native loads, would allow the Régie, in future retail
  rate hearings, to ensure that Hydro-Québec
  consumers receive uniform tariffs as stipulated in the
  Act.

5.1.4 TransÉnergie's short-term Point-to-Point service should
be based on the same principles as the long-term Point-to-
Point rate. TransÉnergie should adopt the approach used by
most utilities of apportioning the short-term rates from the
equivalent long-term (annual) rates.

5.1.5 TransÉnergie's proposal to use discounting to enhance
the use of the system should be expanded to include long-
term transactions and should be structured and applied in a
predefined, transparent and consistent manner.
TransÉnergie should develop a discount policy and have it
approved by the Régie.

5.1.6 Irrespective of how the Point-to-Point rates are ultimately
structured, the nature of the Network Integration Rate, which
is used primarily to serve native loads, would allow the
Régie, in future retail rate hearings, to ensure that Hydro-
Québec consumers receive uniform tariffs as stipulated in
the Act.
5.2. **Issues In Perspective**

5.2.1 Given that the assets to be allocated to the transmission business have been mandated by the Government order in the Act, the typical industry process of the proper allocation of the assets is largely eliminated (as the rate structure could capture elements of fair allocation through their design).

5.2.2 The task left up to TransÉnergie is to design and gain approval from the Régie for a rate structure that will determine how the revenue requirements are collected.

5.2.3 There are three distinct rate classes for the Québec system:

- The Network Integration Rate used to serve native load customers – contributing approximately 88.8% of transmission system revenues (HQT-13, Document 8, Question 12a, page 18).

- Long-term Point-to-Point firm use by Hydro-Québec for its out of province exports – contributing approximately 10.8% of system revenues.

- Short-term Point-to-Point usage by third parties and Hydro-Québec – contributing approximately 0.4% of system revenues (Approximately $11 million) (HQT-13, Document 13, Question 3, page 25).

5.2.4 The three classes invariably need, and receive, a different quality of service, and impose different stresses on the system.

5.2.5 Québec has comparatively low generation costs and high transmission rates relative to other North American
jurisdictions, for example TransÉnergie’s Point-to-Point
service rates are roughly 150% to 250% of the
corresponding BC Hydro rates which are, themselves,
considered extreme by industry standards (HQ-10,
Document 1.1, P. 2).

5.2.6 One reason for the high transmission costs resulted from
a substantial contribution to the rate base through the
inclusion of high voltage transmission 750 kV lines that
would in all likelihood, in the absence of the Act, have been
declared generation related transmission assets. Third party
users of the system (mostly short term Point-to-Point use to
date) have not contributed (or benefited) from the radial high
voltage transmission system connecting remote generation
to the load centers.

5.2.7 Hydro-Québec is the primary, dominant user of a system
that was built to serve its needs and continues to benefit
from the use of this system not only in meeting its obligation
to serve native load but also in taking advantage of
financially lucrative export opportunities outside the province.

5.2.8 Irrespective of the allocation of the high voltage
transmission to the generation or transmission side of the
business, an effective rate design should not encumber the
other users with a cost that is attributable to a specific
function or single user.

5.2.9 Proper cost allocation is particularly important when
minority system users may be burdened with supporting
majority system users. Small, marginal system users (IPPs
and other generators) should not be expected to support or
otherwise subsidize the activities of the larger users (Hydro-Québec and its export subsidiary).

5.2.10 As demonstrated by TransÉnergie’s response to the Régie Information Request (HQT-10, Document 1.4, pp. 2-5), TransÉnergie discounted its short-term rate by between 61% and 92% on an average annual basis. Despite this considerable discount, third party use of the system was minimal. This is a direct reflection of the lack of reasonableness of the transmission rate and its impact on discouraging use by marginal users.

5.2.11 While the assets to be included in the rate base have already been defined by the Act, the allocation of the costs related to these assets to various classes of users or rate designs have not been finalized. For example, certain high voltage transmission lines that connect remote generating stations to load centers (gathering assets) could viably be allocated to the entity that uses those specific gathering assets or to transactions that rely directly on these assets.

5.3. Rate Setting Objectives

5.3.1 According to Hydro-Québec’s expert, Dr. Ren Orans’ testimony (HQT – 10, Document 4, p. 3, Lines 3 – 11), “Transmission tariff design should:

A) meet the goals of transmission rate design,
   1) to collect the transmission revenue requirement;
   2) to be simple to implement and use;
   3) to offer open and comparable access;
   4) to be equitable, and
5.3.2 Although Dr. Ren Orans identifies some of the typical rate design criteria, he did not, however, correctly identify the stakeholders, or users of the specific rate against which the objective of the rate design would be tested. The direct stakeholders of the transmission system include the incumbent utility (Hydro-Québec) and others who use the transmission services/system (i.e., Marketers, Hydro-Québec Energy Services, etc.). Dr. Orans classified the stakeholders as the native load customers; stating that, “...the tariff is equitable because it minimizes the rates of native load customers, for whom the system was primarily built to serve” (HQT-10, Document 4, p.15, lines 19-21). The transmission tariff is equitable if, and only if, it treats all the direct users of the tariff equitably.

5.3.3 From an independent transmission operator perspective the retail customers are not, at this stage, direct customers of the transmission rate. Rate design should reflect the fact that transmission rates are not designed for retail access by native load customers, rather they are designed for access by Hydro-Québec and other users at the wholesale level. The interests of the native load customers are addressed indirectly through the transmission rates charged to Hydro-Québec (Network Integration Rate). Hydro-Québec is ultimately responsible for ensuring that the
transmission/distribution needs of native load customers are met.

5.3.4 With respect to Dr. Orans’ tariff design objective A) 1) above, achieving the revenue requirements does not represent any challenge/risk because of the fact that the majority of revenue is generated from one client (Hydro-Québec) – as such virtually any rate design would be able to satisfy this requirement. Given that TransÉnergie will recover its costs under any rate design, the Régie should focus on the proper allocation of costs among other rate setting objectives.

5.3.5 With respect to the ease of implementation, objective A) 2) above, given the wholesale nature of the rate, ease of implementation should be of secondary concern and should not drive the rate design process. Users of the wholesale transmission system are sophisticated and are assisted by the conventions of OASIS.

5.3.6 With respect to open and comparable access, objective A) 3) above, although the rate design and the application is portrayed as offering open and comparable access, in practical terms the proposed rates will not encourage, and in fact will likely discourage, any new entrants into the Québec market at the wholesale level, resulting in open access by design, but not in reality.

5.3.7 With respect to the equity of the rate, objective A) 4) above, equity is difficult to define/measure and achieve – the system was built to serve Hydro-Québec, in particular to integrate remotely located generation with load centers, and
continues to serve Hydro-Québec in this capacity. The small, marginal use of the system by third parties has a limited impact on the actual generation of system costs — thus it is difficult to measure what is equitable given that third party users did not cause much of the system to be built (the part of the system responsible for most of the costs). Equity can only be achieved through a rate design that incorporates the proper allocation of costs to the appropriate classes of users, namely those that are responsible for causing the costs to be incurred (cost causation principal).

5.3.8 With respect to objective A) 5), the promotion of efficiency, Dr. Orans, in his answer to question 19 of his testimony, responded that the “The tariff promotes economic efficiency under Québec's market environment and system condition by encouraging efficient use of the transmission system. Because the grid is primarily used by an integrated utility, Hydro-Québec can operate the grid efficiently and reliably, without relying on a more complicated tariff that prices congestion by location. To improve capacity utilization, the tariff permits discounting to promote efficient use the capacity of the system.” (HQT-10, Document 4, p.16, lines 2-7). Dr. Orans’ justification is refuted. First, the discounting applies only to short-term Point-to-Point services, without the users being given any assurance of its availability in advance. Such discounting applies to only 0.4% of transmission revenues. Second, the short-term Point-to-Point rate itself has been inflated, as TransÉnergie indicated in its response to questions from Ontario Power Generation, to discourage the use of the rate. Specifically:
“De plus, en optant pour cette méthode (12-CP), il en résulte un tarif mensuel qui, multiplié par douze mois, donne un prix supérieur au tarif annuel. Cela a notamment pour effet d’inciter les clients à opter pour le tarif annuel, permettant ainsi aux planificateurs du réseau de mieux tenir compte de leur présence et de faire assumer par ces derniers une part raisonnable des coûts du transport.” [Also, opting for this method (12-CP), results in a monthly tariff, which when multiplied by 12 months results in a price higher than the yearly tariff. Therefore, clients will be enticed to opt for the yearly tariff. This allows network planners to better account for their clients’ presence and to make them pay a reasonable portion of the cost of transportation.] (HQT – 13, Document 13, p. 27)

Finally, the long-term Point-to-Point rate and the Network Integration Rate have nothing in their design that would change the use, by the primary user Hydro-Québec, or send a price signal to the industry. For example, the BCUC instructed BC Hydro to develop Point-to-Point rates based on marginal costs and to implement a long-term discounting policy that would promote the location of new generators. The BCUC stated:

“Nonetheless, the Commission believes that if the concerns discussed above can be resolved, discounting may provide benefits which would accrue to all customer classes. Accordingly, the Commission directs B.C.Hydro to consult with its customers, both those who may use the WTS rates directly and those
who will be affected by its use, in an effort to establish a discount policy, or some other policy, which will encourage the efficient present and future use of the transmission system and respond to the Commission's concerns as outlined above. This policy should distinguish between the benefits to be gained from discounts from those to be gained from site credits.” (BC Hydro and Power Authority WTS Decision, April 23, 1998, p 39 which is available at the following link: ftp://ftp.bcuc.com/Web%20Folder/PUB/Decisions/1998Dec/BCH_WTS.pdf

5.3.9 Additionally, in the “Commission Determinations in its previous WTS Decision, the Commission stated that there is a need to develop more efficient pricing signals than those which are contained in the proposed B.C. Hydro rates and explicitly rejected B.C. Hydro’s argument that locationally efficient price signals are not needed until such time as transmission constraints occur. Accordingly, the Commission directed B.C. Hydro to apply for new rates for wholesale transmission service which reflect long-run marginal costs and locational considerations.” (BC Hydro and Power Authority WTS Decision, April 23, 1998, p 37 which is available at the following link: ftp://ftp.bcuc.com/Web%20Folder/PUB/Decisions/1998Dec/BCH_WTS.pdf

TransÉnergie’s rate design includes nothing that could practically be considered to promote economic efficiency.
5.3.10 Additionally, a key test that all rate designs must meet, and one that is ignored by Hydro-Québec’s expert Dr. Ren Orans, is the “reasonableness test”. As discussed earlier in this testimony, TransÉnergie’s rates are unreasonably high and are much higher than the rates of other comparable Canadian utilities. The degree to which the rates were unreasonable is reflected in the level of utilization by third parties and the degree of discount offered. TransÉnergie’s response to the Régie’s IR #41.1 (HQT-10, Document 1.1, pages 2-5) indicates how unreasonable the proposed rates are. The transmission rates are between 150% and 250% higher than those of BC Hydro’s corresponding Point-to-Point rates and 2 to 3 times that of Manitoba Hydro’s corresponding Point-to-Point rates. BC Hydro’s rates are considered high by industry standards.

5.3.11 With respect to objective B), referring to consistency with industry standards, at this point in the evolution of the electrical power industry, defining an industry standard is very difficult. Different jurisdictions are at varying stages of market evolution and, by necessity, are in the process of implementing different approaches. TransÉnergie’s rates do not reflect the structures of, and are not consistent with, comparable Canadian transmission utilities. For example, the rates, as proposed, do not include marginal pricing, such as those implemented by BC Hydro, and do not include special provisions for exports and wheel through such as those developed by HydroOne Networks. The combined use of 1-CP and 12-CP for the determination of long and short-
term Point-to-Point rates is probably, in fact, an exception to common industry practices.

5.3.12 With respect to objective C), the appropriateness for the market environment in which the rate is applied, Dr. Orans limits his focus to the types of centralized and decentralized markets. When taking such a major step as unbundling the transmission rates and services, the Régie, TransÉnergie, Hydro-Québec and all of the stakeholders involved must look as far into the future as possible. The manner in which the electrical power industry in Québec, and surrounding jurisdictions, is evolving, requires that a clear effort be made to attract new entrants to the market. Otherwise, the whole exercise becomes a matter of accounting, rather than structuring the operations transmission system and encouraging a new way of doing business in the province. BC Hydro, which according to Dr. Orans’ classification is a centralized system, is already involved heavily in supporting RTO formation within its natural transmission region. BC Hydro may be required, and has demonstrated a willingness, to adopt many of the rate structures/designs that are typical of decentralized systems in order to form, align itself with, or otherwise join an RTO in its region. The Régie should not limit itself to focusing on the immediate transmission environment within Québec, but should expand the horizons of its focus to include those issues which may be required in the future, particularly those that may be necessary in order to maintain/preserve the position and benefits enjoyed by Hydro-Québec and the Province.
5.4. Uniformity of Rates

5.4.1 In the Régie Act, Section 49, subsection 11, the Régie is directed as follows;

- “When fixing or modifying rates for the transmission of electric power or for the transmission, delivery or storage of natural gas, the Régie shall, in particular ...(6) consider the cost of service, the varying risks according to classes of consumers and, as concerns natural gas rates, the competition between the various forms of energy and the maintenance of equity between rate classes; (7) ensure that the rates and other conditions for the provision of the service are fair and reasonable:.... (11) maintain, subject to any Government order to the contrary, uniform rates throughout the territory served by the electric power transmission system... The Regie may also also use any other method it considers appropriate” [emphasis added in all cases].”

5.4.2 TransÉnergie has chosen to interpret this subsection of the Act in the narrowest sense exclusive of the other subsections of Section 49. Within Section 49 Subsection 6 indicates that rates can be different for different classes of users. Subsection 7 requires that the Regie ensure reasonableness and the final sentence of Section 49 allows the Regie to use any other method it considers appropriate. In order to strictly abide by subsection 11, it would be necessary to come into conflict with other subsections of Section 49 of the Act. The narrow interpretation of this subsection by TransÉnergie does not necessarily reflect the
overall intent of the Act or the desire to improve the efficiency of the system or achieve reasonable rates. The Act specifically allows the Regie to “use any other method it considers appropriate.” – presumably to give the Regie sufficient latitude to reconcile differences in objectives or interpretations.

5.4.3 Postage stamp (uniform) rates to retail customers is the common practice in the industry for regulated tariffs, however, postage stamp retail rates do not necessarily imply or require postage stamp wholesale rates. Wholesale rates, by their nature, apply to a smaller number of users and are structured to enhance and induce trade, thereby improving the efficiency of the system. Wholesale use of the system is normally elective, therefore, increased wholesale use of the system effectively reduces costs to all users. For example, BC Hydro offers uniform, postage stamp rates to all customers in a certain class over its entire integrated system. BC Hydro, however, also implemented Point-to-Point rates that do vary according to the point of receipt and point of delivery (See BC Hydro Rate Schedule 3001 which is available at the following link: [http://eww.bchydro.bc.ca/customerservice/rates/electric_tarif f.pdf](http://eww.bchydro.bc.ca/customerservice/rates/electric_tarif f.pdf) This was done as a result of the instruction by the BCUC to do so and after receiving a declaratory Order from FERC accepting the non-postage stamp Point-to-Point rates (refer to Appendix 4 for reference/details).

5.4.4 Mr. Priddle, in his testimony, attempted to demonstrate that uniform rates for gas transmission companies is the norm for the industry. He stated that the NEB rejected the
segregation of rates as the rule for the gas industry,
specifically that the “…the purpose and character of the
TransCanada system implies, and reasonably requires,
sharing by all customers of system costs as well as benefits.
The Board therefore rejects the Applicant’s separation of its
system into eastern and western segments for the purpose
of cost classification.” (HQT-10, Document 5, p. 6, lines 26-
30).

5.4.5 However, Mr. Priddle noted an important exception to the
practice of uniform rate application, based on “separate rate
bases for mainline transmission on the one hand and for
gathering and gas processing on the other.” (HQT – 13,
Document 5, p. 7, lines 15-17). The exception presented by
Mr. Priddle, in fact, very closely appears to resemble
TransÉnergie’s system and operational environment more
than the general rule does. It is important here to distinguish
between ‘gathering’ and other ‘transmission’ or ‘distribution’
assets. The Hydro-Québec/TransÉnergie system is
characterized by a large portion of high voltage transmission
lines that are used specifically to connect to several remote
northern hydroelectric facilities (gathering assets). The
electric industry deals with this issue typically by allocating
the part of a transmission system built to connect to the load
centers, a concept referred to as generation related
transmission assets (or GRTAs). For example, in British
Columbia, a jurisdiction that is very similar (in terms of
system characteristics and asset mix) to that of Québec, a
portion of the system used to connect remote generators to
the network are allocated to the generator as ‘gathering’
assets.
Mr. Priddle also states that, “The new rate design provides these tools by yielding rates for ‘short haul’ gas exports that will be sufficiently low to compete successfully against what was described as ‘inefficient bypass of the NGTL system’.” (HQT – 10, Document 5, p. 26, lines 17-20). Québec, and TransÉnergie need similar tools to allow potential independent producers and marketers, who would be using comparatively short hauls of the system and would not be able to compete/trade given the high TransÉnergie rates, an opportunity to economically use the system, evolve and develop. The same for neighboring utilities or transporters who offer reciprocal service at much lower rates who may, in the future challenge Hydro-Québec access to their wholesale or retail customers.

Mr. Priddle in describing the reasons for the “collapse of the NGTL comprehensive postage stamp rate design” indicated that NGTL submitted that, “in a new market reality of pipeline competition, it [the transmission provider] should have the tools needed to compete against new pipelines.” (HQT – 10, Document 5, p. 26, lines 25-26, 13-15). In the new market reality of electricity, a transmission only utility would be seeking the flexibility to allow it to enhance its revenues. Uniformity of rates would not help that cause. In the absence of reasonable rates, TransÉnergie would be losing business, although not directly, to competition in its region. High transmission cost in Canada makes the United States East-West paths cheaper than the Canadian path. A
loss in revenue is a loss irrespective of whether it is due to a competitor or lack of business. The Régie should be looking for innovative ways to open the system and enhance its utilization in advance of a competitive market in Québec.

5.4.8 In the case of Québec, although all generation related transmission assets have been assigned to the transmission entity by the Act, there is nothing to preclude the Régie from structuring the transmission rates to reflect the unique use of the system and to allocate costs accordingly, similar to how the NEB treats gas-gathering facilities.

5.4.9 The way in which Hydro-Québec will be charged its network rate by TransÉnergie would allow for the creation of uniform rates. This can be done when Hydro-Québec subsequently sets the rates for its customers, appropriately charging them for the transmission portion of their service. Virtually all network integration charges on the TransÉnergie system are attributable to Hydro-Québec, thus it would be able to set rates that reflect the costs and use of the system in a uniform manner.

5.4.10 If the Act is interpreted as strictly requiring uniform wholesale transmission rates throughout the system the TransÉnergie rate proposal, as submitted violates the Act in two ways.

5.4.11 The use of the 1CP for setting long-term Point-to-Point rates and 12CP to determine short-term Point-to-Point rates.

5.4.12 The discounting procedure which produces periodic and inconsistent short-term rate reductions that potentially could vary from Point-to-Point (HQT-10, Document 4, p. 13).
5.4.13 A rate design consisting of three components could be implemented to address the uniqueness of the TransÉnergie system. The rate components would include:

- Remote system (gathering) charge, including segments of the interties that connect remote generation to the network or export market – chargeable to those who use this part of the system.

- Common system or a networking component that is common and chargeable to all users of the system (equitably and uniformly).

- Export/Wheeling-across/intertie component chargeable to those who use these facilities for transit – many jurisdictions have similar intertie facility charges that are not part of the network and are only chargeable to those who use it (for example – BC/Alberta Tie, Hydro One, BPA/California DC and AC ties). The intertie component could viably be included in the network component as the interties provide essential system support services.

5.4.14 These components could be collected as either energy or capacity charges depending on the time frame and quality of service.

5.4.15 Another option is to develop a Point-to-Point rate that recognizes the characteristics of point-of-delivery and point-of-receipt (and corresponding losses) and factor that into the rate design in order to optimize the system. The charges for the various Point-to-Point rates, if allocated based on the
concepts above, would be consistent with traditional cost of service regulation.

5.4.16 A third alternative would be to structure the Point-to-Point rate to be a function of the delivery voltage. This alternative would require a typical cost-of-service study to differentiate and segregate the transmission system facilities required to serve different delivery voltage levels. The lower the delivery voltage the more the transformation/transmission facilities are utilized, hence the greater the cost. One attribute of this approach is that it will produce rates that are uniform for each voltage category. The rates would be reasonable because the third party users of the system (wholesalers) would not be paying for the lower voltage distribution system that is not used by them. This approach could be used by the Régie should it wish to interpret “uniformity of the rate” in its narrowest possible definition. Hydro-Québec’s current rates indirectly reflect this principle in its differentiation between industrial rates and commercial and residential rates. An extension of this approach would be to calculate the system losses based on delivery voltage level. This will help bring the overall TransÉnergie rate to a more reasonable level.

5.4.17 In BC, West Kootenay Power’s wholesale transmission rates are differentiated by delivered voltage level while BC Hydro differentiates its wholesale Point-to-Point rates by the location of the point of receipt and the point of delivery. This indicates that even in the same regulatory jurisdiction different approaches can be used to accommodate different system requirements. Both approaches are considered to be
in compliance with the FERC order 888 and 889 pro forma tariff.

5.4.18 Mr. Priddle stated, “The postage stamp toll design has been replaced since April 2000 by Receipt Point Specific Rates. This means that there is a separate rate for gas from every one of the hundreds of receipt points on the NGTL system. The rate design is such that, on average, the charge for intra-Alberta deliveries is about half that for export deliveries. The EUB approved this rate design because it ‘best meets accepted rate making principles and is in the public interest’.” (HQT – 13, Document 5, p. 25, lines 1-10). This demonstrates that a Point-to-Point rate design that is Point-of-Receipt specific is compatible with recent trends in the natural gas transportation industry.

5.4.19 More recently the BCUC has instructed BC Hydro to develop a Point-to-Point transmission service locational specific rate (BCUC Decision WTS Decision, April 23, 1998) in a non-discriminatory manner, to serve a user located close to the BC/US border that would be using a short portion of the BC Hydro system. As mentioned earlier, the transmission rates BC Hydro has already adopted are based on Point-to-Point rates that are a function of the Point-of-Receipt and Point-of-Delivery. This resulted from a directive from the BCUC and with clear and explicit approval from FERC. To reiterate, BC Hydro offers domestic users “uniform” postage stamp rates, while the wholesale point-to-point rates are differentiated, not postage stamps or uniform.
5.5. **Network Integration Rates versus Point-To-Point Rates**

5.5.1 Hydro-Québec has generated two classes of rates – Network Integration Rates and Point-to-Point rates. The Network Integration Rates mostly represent and collect the cost of serving native load customers. Its structure, as a single payment by Hydro Québec, allows Hydro Québec, with the approval of the Régie, to subsequently apply this cost to the distributors in a manner that produces “uniform” rates.

5.5.2 The Point-to-Point rates are intended to apply to transactions that have a defined path and a specific purpose, for example exporting from a facility to an out of province market. Point-to-Point rates should optimally reflect the cost/impact/value to the system and should be structured to enhance the efficiencies of the system, now and in the future. For example, Point-to-Point rates could be:

- Designed to reflect the marginal costs of the system
- Discounted to encourage preferential resource or load locations
- Discounted to increase the utilization of the system
- Adjusted to reflect the true costs of transmission usage over short distances in order to avoid system by-pass or to encourage beneficial resource development.

A uniform and inflexible application of Point-to-Point rates would deny the benefits that would likely accrue to the system, or even
deny the innovation that would likely result if the flexibility were available.

5.5.3 Hydro-Québec applies a 1CP approach to developing the long-term Point-to-Point rates while applying a 12CP approach to setting the short-term rate. Using a 12CP approach for short-term results in a 28% increase over the long-term Point-to-Point rate. This approach, while positioned by TransÉnergie as reflecting the costs of the system, will not in any way result in increased efficiencies; because the rates are uniform from month to month, so the rates do not reflect system conditions or loading on the system on a truly short-term basis.

5.5.4 The short-term Point-to-Point rate will likely further discourage competition in the short term as acknowledged by Hydro-Québec as one of the their objectives (HQT – 13, Document 13, p. 27). It’s not typical in the industry for rate design to use the 12CP/1CP selectively. Utilities typically use one approach or the other, and, in this manner, produce consistent long-term and short-term rates. Even though FERC allows either method to be used, the intent is to use the appropriate approach for the particular system, not both of them selectively. The use of a rate design approach that has the intention of discouraging the use of the rate is not a proper rate design objective. Ironically, TransÉnergie is proposing a higher, inflated, short-term, Point-to-Point rate that past experience indicated had to be discounted to attract use (see the collective responses to OPG from Hydro-Québec (HQT – 13, Document 13)). This is the same
type of activity as when retailers inflate their prices prior to
discounting them for sales, in order to create the illusion of
higher discounts and lower prices.

If Hydro-Québec truly wants to reflect the seasonality of use
of the system, they should produce a rate that varies from
month to month, rather than a flat rate for all months that is
higher than the corresponding long-term rates.

5.6. Discounting

5.6.1 Discounting is a mechanism that allows the utility to
change the pricing occasionally without changing the basic
pricing level or structure. It is useful whenever the “normal”
price is considered reasonable/appropriate to generate
enough use of the system (sales) some of the time but may
require discounting to optimize system usage (generate
additional sales) at times when the normal price is not
effective. TransÉnergie’s response to the Régie, Question
#60.1 (HQT – 10, Document 1.4, pp. 2-5) indicates that deep
discounting has been required to attract short-term Point-to-
Point use. The level and frequency of discounting is a
reflection of the unreasonableness of the rate.

5.6.2 Although there is no reported use of the long-term Point-
to-Point rate other than by Hydro-Québec, TransÉnergie is
not proposing to discount the long-term Point-to-Point rate
(HQT-13, Document 13, p.20). If discounting is to be used
effectively, it has to be applied to both long and short-term
rates in order to be effective in attracting additional use of
the system (sales), and to improve system efficiencies.

Given that the additional use of the system, and the
corresponding additional revenue, reduces the allocation to the Network Integration Rate, discounting would have a favorable impact on third party users of the system, Hydro-Québec, and ultimately, through Hydro-Québec’s reduced cost burden, all retail customers.

5.6.3 As it stands right now, discounting provides limited benefits to the system, namely some additional sales. Discounting is applied so late that it is unlikely to benefit, and attract, any of the intended users besides those relying upon short-term spot transactions. As stated by Hydro-Québec, “Dans tous les cas où des rabais étaient applicables, la décision a été prise dans les jours précédant le début du mois où ils s’appliquaient.” [In all cases where discounts were applicable, the decision as to the applicability of the discount was taken in the days preceding the beginning of the month] (HQT-13, Document 14, p. 115). This process impedes long-term planning and places third party users at a disadvantage compared to Hydro-Québec.

5.6.4 Since discounting is not offered in a consistent or structured manner, it is impossible for third party users to count on, or plan, their system usage based upon the expectations of discounted rates. There is also no way to gauge the success of discounting in attracting additional system utilization, as its calculation methodologies and application are not consistent.

5.6.5 In its response to Régie IR #60.1, Hydro Québec indicated that discounting would be based on market conditions, “Les rabais offerts sur les services de court terme sont établis en tenant compte des conditions de marché.”
Dans les périodes de prix élevés sur les marchés voisins, il n’est pas nécessaire d’offrir de tels rabais et les prix maxima prévus aux Tarifs et Conditions s’appliquent.” [Discounts offered on short-term services were established by taking into account market conditions. In periods of high prices in neighbouring markets it is not necessary to offer such discounts, and the given maximum prices provided by the Tariffs and Conditions apply.] (HQT-13, Document 1, Question 60.1, p. 100). Discounting should not be based on market condition/prices, rather discounting should be based on the potential for system utilization. The regulated transmission business earns a guaranteed rate of return based on cost, not on market conditions. Discounting should be based on the degree to which the system is utilized, which itself may be a function of market prices. This is particularly true given that the transmission system of Hydro Québec does not suffer from congestion, and marginal system usage represents a minimal portion of operational costs (HQT–13, Document 13, p. 30).

5.6.6 One thing that is certain is that discounting, as proposed, will not encourage anyone to build long term in Québec because the discounting cannot be counted on.

5.6.7 BC Hydro’s discounting of Point-to-Point rates envisages discounting of long-term firm Point-to-Point rates. BC Hydro’s discounting is specified in a policy submitted to the British Columbia Utilities Commission as part of the Wholesale Transmission Services. “Specifically, B.C. Hydro proposed that long-term discounts be considered whenever a discount is necessary to encourage new generation or load
to locate in a manner that would increase the overall efficiency of the system. Accordingly, B.C. Hydro stated that siting generation in areas which yield cost effective reductions of losses, or permit deferral of transmission investment, would be considered for discount.” (BC Hydro WTS Decision from BCUC, p. 33).


BC Hydro’s discounting of short-term Point-to-Point rates sets a clear minimal level of the discount, namely $2/MWh for firm rates and $1/MWh for non-firm rates. (BC Hydro Electric Tariff Rate, 3001 and 3002)

http://eww.bchydro.bc.ca/customerservice/rates/electric_tariff.pdf
6 Conclusion

6.1.1 TransÉnergie, Hydro-Québec and other Canadian utilities’ activities will be scrutinized by the industry and FERC due to the perception of abuse of market power and excessive charges for energy and services. The Régie needs to be seen to be trying to create a truly fair, open and viable competitive environment in order to protect Hydro-Québec’s interest and its ability to trade in the US from potential retaliatory actions by US regulators.

6.1.2 Public perceptions of the Québec market are an important consideration in setting policy and determining rates. This is evidenced in the Enron Power Marketing Inc. and Coral Power submission to FERC. This action is important, and could potentially impact Hydro-Québec, TransÉnergie and the Régie in the following ways:

- A complaint to FERC brings an issue to the forefront of the industry’s focus, legitimizing it as an issue that warrants attention and investigation

- FERC is obligated to recognize and investigate the complaint. The concerns raised are no longer moot, once the wheels are set in motion. The issues must be addressed in a diligent and prudent manner.

- It focuses attention on the Québec market in particular, making the outcome of this hearing an important signal of the market’s long-term viability and competitiveness.
6.1.3 The rate design proposed by TransÉnergie does not meet the objectives of rate setting when seen from the perspective of all direct users of the transmission system rates.

6.1.4 Rate design does primarily meet the Transmission Revenue Requirement, however, any rate design will satisfy this requirement with ease since Hydro-Québec is the primary user of the system. The majority of costs are captured in the Network Integration Rate that is directly assignable to Hydro-Québec.

6.1.5 Hydro-Québec elected, unnecessarily, to adopt a very narrow interpretation of uniformity in the rate requirements. Besides, if a narrow definition of the Act is imposed, the rates as proposed, are not uniform, or interpretable as uniform.

6.1.6 Rate design seems to address Hydro-Québec’s and its subsidiary’s interests but does not meet the requirements of other third party users. Nor do the rates, as designed and proposed by TransÉnergie, positively enhance the efficiency of the system or encourage competition or entry into the Québec market.

6.1.7 It appears that the transmission rates are designed to discourage other users from using the transmission system, and are effective in this. For example, short-term rates are supplemented by a discount policy that has questionable value given the degree of discretionary power that TransÉnergie has in setting the discount rate, and the short time frame when the discounts can be applied.
6.1.8 Ultimately, the rate design will not promote competition in Québec. It is difficult to perceive any other energy developers, marketers, or other third party users, being able to afford these exorbitant transmission rates.

6.1.9 The proposed rate design could contribute to a negative perception of the Québec market, where Hydro-Québec will be seen as wanting to participate in out-of-province open markets while exercising its influence to limit participation in its primary market. Such perceptions can have a damaging affect on Hydro-Québec's long-term interests. The proposed rate structure will increase the industry’s criticism of Canadian utilities and the Québec market at a time when the industry, FERC, and Public Utility Commissions across the US are actively searching for the causes of the ills of the US market.

6.1.10 Hydro-Québec's usage of the transmission system is unique in that it is in a class by itself. Its size, level, and the nature of its use of the system, are unlike those of other third party users. Consequently, having a comparable rate with third parties is not a fair measure of rate equity. The focus of the Régie should be on the reasonableness of the rates.

6.1.11 There are no practical reasons to focus on the impact of competition on Hydro-Québec as it has such a low cost of generation that its resources should be dispatched ahead of almost all other resources, particularly those of new gas-fired plants and other market entrants. A viable rate design and level may allow other independent users to benefit and contribute to the enhanced use of the Hydro-Québec
system. Hydro-Québec's storage system and transmission capacity (which is under utilized because it is rarely congested) has room to be optimized and serve a wider base than Hydro-Québec alone. In the end, Hydro-Québec, Québec and the market at large will benefit from a reasonable rate.

6.1.12 TransÉnergie's proposal to apply discounting to its Point-to-Point rate is the only attempt made to enhance the utilization of its transmission system. Almost all other aspects of the application would discourage third parties from using the services of the system. The discounting is, however, offered in a manner that severely limits its usefulness. The discount is only applicable to the short-term Point-to-Point rate. Additionally, the short-term Point-to-Point rate is inflated, in part to discourage its use, and the manner in which it is calculated and applied is inconsistent, unpredictable and unreliable.

6.1.13 The current discount policy/practice restricts the ability/power of the Régie to manage and oversee the discounting process properly. Although, as is clear from the evidence provided, the discount is required to affect any third party use, accepting the discounting as proposed, denies the Regie the ability to determine and judge the appropriateness of the rate. It will be hard to define how TransÉnergie will be setting the rate or to measure the effectiveness of the discount activities as proposed (HQT-13, Document 13, p. 22).
7 Recommendations to the Régie

7.1.1 The Regie is respectfully advised when making its decision with respect to this case to:

- Clearly demonstrate to the industry and its participants that the design and structure of the Québec market will be pursued in a manner that promotes competition, encourages fair and open access, and enhances the overall efficiency of the system

- Meet both the spirit and the letter of FERC orders 888 and 889

- Enhance Québec’s ability to join or align itself with an RTO in the future

7.1.2 To achieve the objective above the Regie should insist on a rate structure that emphasizes the functional separation of Hydro-Québec and TransÉnergie, and reflects allocation of costs based on the use of the system. The Régie still has an opportunity to allocate the costs resulting from the use of the generation related transmission assets (and/or distribution related transmission assets), and it should make an innovative effort to ensure that the cost burden is attributable to the actual users of those specific assets.

7.1.3 The Régie is advised to interpret the intent and the definition of uniformity in rate design as being non-preferential (all rates available to all system users equally) rather than as a requirement that there be only a single rate which necessarily must apply to all users. Such
interpretation would allow a lot of flexibility to achieve efficient rates.

7.1.4 Non-preferential rates require that the Régie should direct TransÉnergie to set the short-term Point-to-Point rates on the same basis they set the long-term Point-to-Point rates. This would entail the monthly rates being equal to one twelfth of the annual rates, the weekly rates being 1/52 of the annual rates, and the daily rates being one fifth of the weekly rates.

7.1.5 It is recommended that the Régie direct TransÉnergie to develop right away non-discriminatory Point-to-Point long-term rates that represent the true impact/cost to the system, including losses in order to produce more reasonable rates that will encourage the utilization of the system. These rates could be made to reflect the true utilization of the system either by developing:

- Multi-tiered rates, that separate the transmission system by its functional use
- Specific Point-to-Point rates, based on point of receipt and point of delivery
- Or rates based on delivery voltage level

7.1.6 The Régie should require TransÉnergie to develop a clear, transparent guideline for its discounting policy, which could be produced through industry consultation. Generally the discount should be applied to both short and long-term service. For long-term service it should reflect the impact of the siting of new resources on system performance and cost.
It should have a minimum target discount level for both firm and non-firm.

7.1.7 The Régie should order TransÉnergie to implement a system for monitoring the use of the discounting process in order to facilitate optimized use of the system in the future.

7.1.8 Should the Regie decide that a revision of the Hydro Québec submission is required then as an interim measure the Regie should at least ensure that:

7.1.9 The short-term rate is pro rata based on the long term rate as discussed above

7.1.10 An interim discount is applied to the long-term rate as well as the corresponding short-term rate. A conservative level for this would be around 25%

7.1.11 TransÉnergie discounts the short-term rates sufficiently to ensure substantial use by third parties. A floor rate of $2/MWh for firm services and $1/MWh for non-firm services could be used as a guide.
UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

H.Q. Energy Services (U.S.) Inc.

Docket No. ER97-851-012

PROTEST
OF ENRON POWER MARKETING, INC.
AND CORAL POWER, L.L.C.

Pursuant to 18 C.F.R. § 385.211 (2000), the Commission’s November 17, 2000, Notice of Filing, and the Commission’s November 30, 2000, Notice of Extension of Time, Enron Power Marketing, Inc. ("EPMI"), an intervenor in this proceeding, and Coral Power, L.L.C. ("Coral"), hereby protest H.Q. Energy Services (U.S.) Inc.’s ("HQES") market power analysis and request for authority to sell power at market prices in the above-captioned docket. HQES has failed to show that it and its affiliate lack or have mitigated market power in generation and transmission; therefore, HQES’s continued authority to sell power in the U.S. at market prices should be conditioned on HQES and its affiliate taking steps to mitigate that market power, including full participation in a regional transmission organization ("RTO"). In the alternative and at a minimum, HQES’s market pricing authority should be suspended pending an evidentiary hearing on the issues raised in this protest. In support of its protest, EPMI and Coral state:

1 Concurrently with the instant filing, Coral is filing a motion to intervene in this proceeding.
I. PROTEST

HQES is the wholly-owned power-marketing affiliate of Hydro-Quebec ("HQ"), the state-owned electric monopoly in the Province of Quebec. In 1997, the Commission accepted HQES's market-based rate schedule based on a finding that despite HQ's high market shares in the two directly interconnected U.S. markets — the New York ISO ("NYISO") and ISO New England ("ISO-NE") — HQES lacked generation market power. HQES now argues that it deserves a three-year extension of its market-based rate authority because nothing has changed since 1997 that warrants disturbing the Commission's earlier conclusion of no market power.

HQES's argument must be rejected. Experience since 1997 indicates a potential increase in market power by HQES, in combination with its parent HQ, by strategically exercising generation market power in New York and New England, particularly in forward markets.\(^2\) This is coupled with an HQ transmission system that offers only nominal, reciprocal open-access. Furthermore, because of the nature of HQ's hydro-electric generation facilities and the fact that they are not within

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\(^2\) The Commission's 1997 order found that HQ had a market share in 13 U.S. markets ranging from 27.8% to 35% of installed capability and 31.8% to 38% of uncommitted capability. H. Q. Energy Services (U.S.) Inc., 81 F.E.R.C. ¶ 61,184 at 61,809-10 (1997), rel'd denied 82 F.E.R.C. ¶ 61,234 at 61,897 (1998). HQ is projected to enjoy market share in 2001 as high as 25.8% in ISO-NE and 17% in the NYISO. Transm. Ltr. of H. Q. Energy Services (U.S.) Inc., Exhibits WHH-3 and WHH-4 (filed Nov. 9, 2000).

\(^3\) A forward market involves contracts to buy and sell products at a fixed date at a price agreed to in the contract. All real-time commodities markets are volatile and rely on forward markets to hedge against the risk of price volatility and to provide a level of price certainty in real-time. This is particularly true for electricity markets since the lack of storage capability means that all energy must be consumed as it is produced. For most commodities, the largest volume of trading occurs in the forward markets, with real-time markets being used only for incremental or marginal supply and demand balancing. An efficient and active forward market for delivered energy, and one free from market power abuses, should be the fundamental component of any competitive wholesale energy market. Unfortunately, forward markets for delivered energy have developed slowly in the U.S., which has significantly impeded the development of all forms of regional electricity markets.
the NYISO system, the NYISO Market Monitor cannot generate market power abuses by HQ. For these reasons, the Commission cannot find that HQES and its parent do not have or have mitigated generation and transmission market power. Absent those findings, HQES's market power analysis must be rejected and its requested extension of market pricing authority conditioned on mitigation of HQES's and HQ's market power, including HQ's full participation, i.e., HQ turns its facilities over to the operational control of either of the RTOs being formed in the NYISO or ISO-NE regions; or at least a requirement that HQ implement a market structure that meets the open-access principles required by the Commission in the U.S. Only through RTO participation will HQES and HQ be subject to real open-access, market monitoring, and stakeholder review.

A. **HQES and Its Parent Coordinate to Exercise Generation Market Power in U.S. Markets**

The Commission must go beyond a simplistic hub-and-spoke analysis and investigate the unique ability of HQES and its parent to exercise generation market power in the New York and

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4. At a very minimum, HQ must be required to implement a market structure that meets the non-discriminatory open-access principles required by the Commission in the U.S., and their activities in the U.S. market must be subject to meaningful oversight by the NYISO or ISO-NE market monitor unit.
New England markets under certain recurring conditions.\textsuperscript{5} HQB3 and its parent appear to be exercising generation market power during periods of peak usage\textsuperscript{6} in both regional markets when the supply curve slopes steeply vertical and small changes in supply can cause significant price swings. Figures 1 and 2 (attached hereto as Exhibit A) show the supply curves for New England and New York with the peak demand graphed as a vertical line. HQ's ability to control between 1500 megawatts ("MW") and 2000 MW of highly responsive hydro-electric capacity in these regions gives it the ability to influence the price in these markets. As explained below, their ability to exercise generation market power is particularly damaging to forward markets. In New York, the forward markets trade as a financial swap against the NYISO day-ahead market average price. HQ's ability to arbitrarily change from importing 1500 MW to exporting 1000 MW has a significant impact on the settlement prices for these forward swaps, which in turn discourages market participants from relying on the forward market. If a liquid forward market does not develop in New York, there will be greater reliance on the spot market, which could lead to problems similar to those that occurred in California, in New York next summer.

\textsuperscript{5} The "Hub & Spokes" analysis is an appropriate method for determining the ability of a transmission owning market participant to exercise market power in transmission. Market-based rate applications for transmission-owning utilities merit the same level of scrutiny as that given to merger applications, i.e., a competitive screening analysis followed by a more detailed behavioral analysis whenever the screen reveals potential market power. Modernizing this type of market power analysis required with market-based rate applications is of equal importance to that of improving the analysis for merger applications, as recognized by the Commission in its recent Filing Requirements Rulemaking, Order No. 642, Revised Filing Requirements Under Part 33 of the Commission's Regulations, 93 P.B.R.C. ¶ 61,164, 66 Fed. Reg. 70,953 (Nov. 28, 2000); see also Siebel Edgar L.L.C., 93 P.B.R.C. ¶ 61,193 (2000) (Masey, Comm'r, concurring).

\textsuperscript{6} HQ has significant excess generating capability during both peak and non-peak seasons. Northeast Power Coordinating Council Load, Capacity, Energy, Fuels and Transmission Report, EIA Form 411. Because HQ is a winter peaking system, the NYISO and ISO-NE are summer peaking systems, its ability to export during the U.S. summer is particularly great, as is its ability to influence peak prices.
HQ's generation capability is overwhelmingly hydroelectric—approximately 93 percent—and it enjoys significant excess generating capability. Hydroelectric systems possess unique storage capability unknown to other mediums of electric power generation. These systems can decide when to run and when not to run without losing the ability to sell the energy at a future time because the opportunity to generate is stored in the water reservoirs. Hydroelectric systems are also uniquely flexible in their dispatchability, permitting them to turn on and off almost instantaneously. These characteristics allow HQ to operate, in effect, as a giant peaking unit on the U.S. border capable of delivering approximately 1,500 MW of power into New York and 2000 MW into New England.7

So long as HQ used this import capability to make long-term sales into New York and New England, its ability to exercise market power to influence prices in U.S. markets was confined. Since 1997, however, HQ has substantially replaced its traditional pattern of making long-term sales into U.S. markets with an aggressive strategy of making shorter term sales into the U.S. during periods when prices are most easily influenced.6 HQES, in turn, appears to have taken over its parent's former role of forward contracting in New York and New England. This creates a situation in which the market, HQES, can make forward commitments and then arbitrages against the short-term prices that its parent sets in NYISO and ISO-NE by selling into or withholding its storable power from the U.S. markets.

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7 This is the transfer capability of the ties interconnecting the HQ transmission system with NYISO and ISO-NE.

6 HQ exports under long-term contracts of up to 2,000 MW into Sandy Pond, in the center of ISO-NE, will also expire during 2001 and become available for shorter term sales within New England.
By way of illustration, at a point in time when the parent is withholding much of its storable power and thereby driving up both real-time prices and expected future prices, HQES can sell a large block of power at the expected high prices into ISO-NE for future delivery. Later, when the forward contract goes to delivery, the parent HQ releases large quantities of power into the ISO-NE market, driving down the price that HQES has to pay in order to secure power to fulfill its forward contract commitment. As a result, HQ and its marketing affiliate recognize far greater revenues than they would have if HQ had not driven up forward prices. This post-1997 practice is driving other competing sellers out of the forward market for future deliveries into New York and New England. The day-to-day variations in HQ exports to New England and New York, indicating a pattern of withholding, followed by releases of substantial amounts of energy, are illustrated in Tables 1 through 4 (attached hereto as Exhibit B).

A second example of potential market power abuse can occur if HQES buys supplies for future delivery at a price that has been driven down by expectations that the parent HQ will also be providing energy. At the delivery time agreed to in the forward contracts held by HQES, the parent HQ can withhold its supplies, driving the real-time price up, and allowing HQES to arbitrage between its low, forward purchase price, and the higher real-time price that results from HQ's withholding. Not only can this produce a windfall for HQES, it can also harm any load that is short on supplies and must buy energy on the spot market.

New York is domination by West to East transmission constraints that result in three dominant price zones that each trade in the forward market as financial swaps. HQ's deliveries into New York or wheels through New York have a dramatic impact on the congestion and therefore, on the settlement prices in these zones. When there is physical congestion, price differences can
vary by as much as several hundred dollars. Since HQ has the ability to independently create or relieve congestion by increasing or decreasing imports or wheel-throughs, it can profit by buying a sway at one location and selling at another and then change its physical deliveries and manipulate the price difference. In sum, this gives HQ the ability not only to influence the overall price of the market, but also the relative price between zones. Market participants are well aware of HQ's manipulation power and are thus reluctant to trade in the market when HQ is an active participant.

B. Transmission Access Within and Into HQ Is Not Available on A Meaningful Basis & Through Service Is Priced to Discriminate against HQ's Competitors

TransEnergie, HQ's transmission system, possesses unmitigated market power in transmission that should preclude its eligibility for market pricing authority. There are few if any buses internal to the HQ system at which a competitor could buy or sell energy in competition with the provincial monopoly; consequently, open access to the TransEnergie transmission system, for service within or into the HQ system is a meaningless concept.

Nevertheless, a competitive seller may need to wheel power through the TransEnergie system in order to make sales in competition with either HQ or HQ's into New York, New England, the PJM Interconnection or MECS. Such through service is technically possible under TransEnergie's tariff, but it is economically infeasible because of TransEnergie's exorbitant charges for this service. For comparison, the charge for wheeling through ISO-NE is $15.57 per kW-year; the comparable rate for service through NYISO ranges between $19 and $24 per kW-year. The rate

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Note that the NYISO rate structure does not offer service at a $/kW-year rate. Consequently, a direct comparison is not possible. These values were calculated using the rates for July 2000 for the ConEd.
posted for HQ is a staggering $80 per kW-year (Canadian) and $32.29 per kW-year (US). This very high wheeling rate prevents wheeling through the HQ system.

Not only is there no economical access to TransEnergie, the uneconomical service that TransEnergie does offer is grounded in a highly discriminatory rate structure. Many of HQ's hydro-electric generating stations are in the Province's far north. High voltage radial transmission facilities connect those generators with load centers farther south and to export ties on the U.S. Typically the cost of such radial interconnections should be classified as a generation expense for cost allocation purposes, as is the case with other provincial hydro-electric systems.¹⁰ Not so, however, for HQ. Rather, these are allocated fully to TransEnergie, which in turn allocates these costs disproportionately to the through service transmission that is theoretically available to competing sellers of power.

⁰ See British Columbia Hydro and Power Authority Wholesale Transmission Services, Section 21.5 (British Columbia Utilities Commission, Apr. 23, 1996), http://www.bcuu.com (directing British Columbia Hydro and Power Authority to adjust its "transmission revenue requirement and associated tariffs that reflect functionalizing 100 percent of the GRTAs [Generation Related Transmission Assets] to generation. This Decision, therefore, directs a treatment of the GRTAs similar to that found in the 1993/94 FACOS study."

NIMO and NYSEG systems, and assuming a capacity factor between 80 and 100 percent.
II. CONCLUSION

For the foregoing reasons, EPMI and Coral protest HQES's market power analysis and urge the Commission to reject HQES's market power analysis and condition continuation of its market-based rate authority on HQ participating fully in an RTO and undertaking whatever other market power mitigation measures the Commission deems appropriate to mitigate HQ's transmission and generation market power. In the alternative, and at a minimum, the Commission should suspend HQES's market pricing authority pending an evidentiary hearing to address the issues raised herein.

Respectfully submitted,

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Andrea M. Settanni  
Brucewell & Patterson, L.L.P.  
2000 K. Street, N.W., Suite 500  
Washington, D.C.  20006-1872

Attorneys for Enron Power Marketing, Inc. and Coral Power, L.L.C.

December 7, 2000
UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

H.Q. Energy Services (U.S.) Inc.  }  Docket No. ER97-851-012

CERTIFICATE OF SERVICE

Pursuant to Rule 2010 of the Commission's Rules of Practice and Procedure, I hereby certify that I have this day served a copy of the foregoing document on all persons designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 7th day of December 2000.

__________________________
Andrea M. Sottanni
EXHIBIT A
Figure 1: NYPP Summer 2001 Supply Curve

Figure 2: NEPOOL Summer 2001 Supply Curve

EXHIBIT B
The day-to-day variation in imports by Hydro Quebec to both the New England and New York control areas during the first ten months of 2000 is considerable. This is particularly true in New York, and especially for the July through October period, as shown in the summary statistics below in Table 1. The standard deviations around the average daily on-peak import quantities illustrate that there are significant day-to-day swings in import quantities, so that for any given day the actual average import is likely to be hundreds of MW different from previous or future days. These swings have a considerable impact on the market for wholesale energy in New York and New England.

<table>
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<th>New England: Ph. Mw HQ Interface</th>
<th>HQ-New York Interface</th>
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</thead>
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<tr>
<td></td>
<td>Average Daily Rate MW</td>
<td>Coeff. Of Variation</td>
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<tr>
<td>On-Peak Import</td>
<td>Std Dev. ($/Mw/Mw)</td>
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<tr>
<td>January</td>
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<tr>
<td>October</td>
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<td>193</td>
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<td>Average 10 Months</td>
<td>1,352</td>
<td>432</td>
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Table 1: On-Peak Average Daily Imports from HQ to New England and New York

(Source: New England and New York ISO data on intrate flows.)

Table 2 below illustrates the huge day-to-day swings in imported power from Hydro Quebec to the New York Control Area for the months of July and August, 2000. Table 3 shows the same data for imports from Hydro Quebec into New England.
Table 2

Average Daily MW Imports Into New York Control Area from NYISO Hydro Quebec Zone For Off Peak and On Peak Periods, July and August, 2000

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<tr>
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Website: http://www.nyiso.com/landingpage/landingpage.html

http://rimsweb1.ferc.fed.us/rims.q?rp2=PrintNPick 00-12-11
Table 3

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Website: http://www.iso-ne.com/Historical_Database_Interface
ATTACHMENT H

DESCRIPTION OF BRITISH COLUMBIA PARTICIPATION

The British Columbia Hydro and Power Authority (“BC Hydro”) and West Kootenay Power Ltd. (“WKP”) have actively participated in the RTO West negotiations. The Filing Utilities, BC Hydro and WKP have reached consensus on a framework that would provide consistent RTO transmission service over the RTO West transmission system and the transmission system in British Columbia, while recognizing Canadian sovereignty and the differing regulatory structures in Canada and the United States. This framework is a major step towards achieving a “natural transmission region” in the Pacific Northwest that does not stop at the U.S.-Canada border.

The basic elements of this framework, developed as a model by the Adjunct Committee Technical Work Group, are as follows:

1. An independent grid operator would be formed in British Columbia (“BC IGO”), that would meet the independence standards of Order No. 2000. The BC IGO would be a public utility regulated by the British Columbia Utilities Commission (“BCUC”);

2. RTO West and BC IGO would act in a coordinated fashion to provide RTO service to the Pacific Northwest region, including British Columbia;

3. BC Hydro and WKP would transfer operational control over their transmission systems to BC IGO, under Transmission Operating Agreements (“TOA”) that

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1 EAL (the Alberta Transmission Administrator) and the Alberta Power Pool also participated in these discussions.

2 The Commission has recognized that its transmission jurisdiction under the Federal Power Act stops at the international border. See Order No. 2000 at 31,085.

3 This Group included U.S. and Canadian representatives from the Implementation, Ancillary Services and Congestion Management Work Groups of the RTO West collaboration process.
parallel the TOA between RTO West and its U.S. participating transmission owners;

(4) The BC IGO, as a regulated utility in British Columbia, would ultimately be accountable to the BCUC for tariff administration and the reliability of the transmission grid within British Columbia, consistent with principles of Canadian sovereignty and Provincial regulatory requirements. The functional relationship between BC IGO and RTO West would be defined in an Operating Facilities and Services Agreement (“OFSA”) to be negotiated between the two entities and filed with the Commission and the BCUC. It is contemplated that the OFSA would adopt the following principles intended to further seamless wholesale transmission services in the region:

(A) RTO West and BC IGO would file for regulatory approvals of a single, uniform wholesale transmission tariff covering both their transmission systems;\(^4\)

(B) A single set of business practices would be applied on a regional basis;

(C) A single regional Ancillary Services market would be developed;

(D) One Internet web-site for transmission capacity reservations would be used in the region, to be operated by RTO West;

(E) There would be one Security Coordinator for the region; and

(F) A single regional Congestion Management Mechanism would be employed;

\(^4\)RTO West would file the tariff with the Commission, and BC IGO would file the tariff with the BCUC.
(5) RTO West and BC IGO will together perform a control area operator function for the Pacific Northwest, including British Columbia. BC IGO will provide control area operator functions within British Columbia. (This approach will be described in greater detail in documents to be submitted as part of the filing utilities’ Stage 2 submission.) Inadvertent power flow with neighboring control areas and RTOs would be handled by RTO West; and

(6) Electronic links between RTO West and BC IGO will be established to communicate the real time status of the RTO West Operating Plan and to deploy resources through RTO West.

The Filing Utilities, BC Hydro and WKP believe that this framework for coordinating the functions of RTO West and BC IGO advances the Commission’s concept of a “dotted line boundary at the international border” for purposes of RTO formation. The framework is designed to further the objective of seamless wholesale transmission services throughout the Pacific Northwest, and to ensure that the region encompassed by the RTO is of the broadest possible scope.

BC Hydro has represented to the Filing Utilities that BC IGO will be structured to meet the Commission’s requirements in Order No. 2000 that such an entity be independent from control by any market participant, including participating transmission owners. The functions reserved for BC IGO within the RTO recognize Canadian sovereignty, regulatory and tax requirements, and are well within the parameters the Commission found acceptable in a U.S. context in Commonwealth Edison Company, et al., 90 FERC ¶ 61,192, reh’g denied, 91 FERC ¶ 61,178 (2000).

The Filing Utilities, BC Hydro and WKP intend to work within this framework to negotiate definitive agreements and tariffs, and to resolve the other open issues between the U.S.

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5 Order No. 2000 at 31,085.
and British Columbia entities. If closure on these issues can be reached, the Filing Utilities, BC Hydro and WKP would seek to obtain all necessary approvals for these arrangements from the appropriate governmental and other authorities in their respective jurisdictions.
To Registered Intervenor and Interested Parties:

Re: British Columbia Hydro and Power Authority
Wholesale Transmission Application - FERC Petition for Declaratory Order

The purpose of this correspondence is to keep all Registered Intervenors and Interested Parties apprised of the developments with respect to Powerex’s application for a Power Marketing Certificate ("PMC") from the U.S. Federal Energy Regulatory Commission ("FERC"), as that application is relevant for the Wholesale Transmission Services ("WTS") Application of British Columbia Hydro and Power Authority ("B.C. Hydro").

By Order No. G-77-97 dated July 3, 1997, the Commission directed B.C. Hydro to: "... lead additional evidence regarding the desirability of a two-part rate structure which reflects Long Run Incremental Costs, including, to the extent possible, information with respect to the acceptability of such a rate form to the U.S. Federal Energy Regulatory Commission." This direction reflected concern by the Commission that B.C. Hydro had not submitted sufficient evidence to indicate that FERC might object – because of concerns surrounding reciprocity conditions – to the implementation in British Columbia of a two-part rate structure which reflects Long Run Incremental Costs.

On July 11, 1997 representatives of Powerex met with FERC staff in Washington, D.C. Among the items discussed were possible means by which B.C. Hydro might ascertain, from FERC, the information sought by the Commission.

Out of that meeting came the suggestion that Powerex submit to FERC a Petition for Declaratory Order ("PDO"). This process would allow Powerex to solicit FERC's view on specific issues related to incremental pricing. A PDO application could be submitted on a parallel course with Powerex's application for a PMC (the latter based on the WTS Application that was granted interim approval by the Commission on July 3, 1997). However, unlike the PMC application (where a 60-day response time is mandated), FERC is under no statutory requirement to deliver a decision within a fixed timeframe when considering a PDO.

On July 15, 1997 B.C. Hydro and Powerex met with Commission staff to seek input on a PDO submission. At that meeting, B.C. Hydro proposed that the PDO might be designed to elicit FERC's view only on the acceptability of a two-part rate for point-to-point transmission. This reflects B.C. Hydro's position that a two-part rate for network use is of purely academic interest at this time, since Power Supply is Transmission and Distribution's only network customer and since British Columbia currently maintains a postage-stamp system of rates.

According to B.C. Hydro, the advantage of pursuing a two-part rate only for point-to-point transmission is that offering such a change would require only minimal amendments to the Terms and Conditions.../2
-contained in the WTS Tariff. Offering a two-part rate for network service would require more substantial changes. It appears to be B.C. Hydro’s view that strict adherence to FERC’s pro forma tariff, particularly in the area of Terms and Conditions, is essential to ensure receipt of a PMC.

On July 16, 1997 Commission staff spoke by telephone with FERC staff on the subject of Powerex’s upcoming application for a PMC. In that conversation, FERC stressed that they have no interest in local transmission pricing issues – including incremental pricing. Instead, FERC seeks only to ensure that a local utility cannot control transmission pricing in a manner which would allow them to manipulate market prices into the United States. FERC staff also stressed that it is Powerex’s decision to file a pro forma tariff, and that this is not a requirement of FERC. FERC staff reiterated that their interests lie in the areas of open access, comparability, and reciprocity, and do not extend to the issues of incremental versus rolled-in pricing, unless those pricing issues convey market power inappropriately to any party. This position, they point out, is supported by the absence of prices in the pro forma tariff.

Still, the Commission staff endorse Powerex’s proposal to submit a PDO on the issue of incremental pricing for point-to-point service. It is our view that this is a largely costless exercise, with the potential for significant benefit should FERC choose to render a decision on the PDO prior to the November 17, 1997 commencement of the B.C. Hydro WTS public hearing.

In an effort to enhance the likelihood of a timely decision from FERC, we will likely attach a letter to the PDO application emphasizing the value to British Columbia of a decision ahead of the November hearing date. While FERC rules place them under no obligation to heed this request, FERC staff did indicate that they are sensitive to electricity policy issues in British Columbia.

We will keep Intervenors informed of any developments or changes in these matters.

Yours truly,

Original signed by:

W.J. Grant

CBI/mmc

cc: Mr. Darlene M. Barnett, Senior Vice-President
Marketing and Customer Services
British Columbia Hydro and Power Authority
Commission Panel
Appendix 4
85 FERC ¶ 61,071

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: James J. Hoecker, Chairman;
Vicky A. Bailey, William L. Massey,
Linda Breathitt, and Curt Rébert, Jr.

British Columbia Power Exchange Corporation

Docket No. EL98-64-000

DECLARATORY ORDER

(Issued October 19, 1998)

On July 23, 1998, British Columbia Power Exchange Corporation (Powerex) filed a petition for a declaratory order seeking a Commission determination that there will be no adverse effect on Powerex's authorization to sell power at market-based rates in the United States if its parent, British Columbia Hydro and Power Authority (BC Hydro), implements a transmission rate directive of the British Columbia Utilities Commission (BC Commission). We will grant the petition.

I. Background

Powerex states that the Commission granted authorization to sell power at market-based rates to Powerex in British Columbia Power Exchange Corporation, 80 FERC ¶ 61,343 (1997) (Powerex I). 1/

Powerex asserts that the BC Commission ruled on April 23, 1998, that BC Hydro should adopt a locationally-sensitive wholesale transmission rate, incorporating long-run incremental

1/ Powerex Petition at 4. Powerex also states that its original application was denied without prejudice because BC Hydro's original wholesale transmission tariff did not adequately mitigate market power in transmission. British Columbia Power Exchange Corp., 78 FERC ¶ 61,024 (1997) (Powerex II).

Powerex explains that BC Hydro is engaged in the generation, transmission, distribution, and sale of power to wholesale and retail customers within British Columbia. According to Powerex, BC Hydro is regulated by the BC Commission as a public utility and has functionally unbundled into two divisions: BC Hydro Power Supply, which controls generation assets, and BC Hydro Transmission & Distribution, which operates BC Hydro's integrated transmission and distribution system.
Docket No. EL98-64-000

-2-

cost (LRIC) price signals, for long-term, firm, point-to-point transmission service. According to Powerex, the BC Commission will not require BC Hydro to implement such rates until it is clear that doing so will not affect Powerex's market-based rate authorization, or otherwise jeopardize its access to United States markets. The BC Commission therefore directed BC Hydro to seek such a determination from the Commission. 2/ Pending such a determination by the Commission, BC Hydro's currently effective one-part average embedded cost postage stamp rate will remain in effect. 2/

Powerex explains that BC Hydro has identified the transmission paths on its system that will experience congestion and need to be expanded within the next ten years. 4/ Powerex states that under the BC Commission's preferred locationally-sensitive rate design, long-term firm transmission customers using such paths will pay a two-part rate: an access charge plus the LRIC charge. The LRIC charge will reflect the expenditures over the next ten years to expand BC Hydro's transmission lines. 5/ According to Powerex, the LRIC charge can be collected for point-to-point transmission service without making any changes to the terms and conditions of the BC Hydro's tariff, and only the rate schedule will need to be changed. Powerex states that the LRIC charge will not be applied to network transmission service, since doing so would require numerous, substantive revisions to BC Hydro's tariff terms and conditions. 5/

Powerex notes the Commission's prior finding that the rate and allocation provisions in BC Hydro's tariff "are solely Canadian concerns that are outside [the Commission's] jurisdiction." 7/ It argues that the Commission should reach the same conclusion here concerning the BC Commission's locationally-sensitive rate design preference. Powerex maintains that the total revenue recovered from the two-part rate described above is capped at BC Hydro's embedded cost transmission revenue requirement. 8/ It also argues that applying the LRIC charge only to point-to-point transmission service is a good balance

2/ Powerex Petition at 1.
2/ Id. at 6.
4/ Id. at 9-10.
5/ Id.
6/ Id. at 10-11.
7/ 80 FERC at 62,139.
8/ Powerex Petition at 11.
Docket No. EL98-64-000

between the BC Commission's ratemaking policies and this Commission's policy that standardized wholesale tariff provisions are required for reciprocity purposes.

Powerex seeks a finding that the LRIC-based rate does not affect matters within the Commission's jurisdiction. In the alternative, Powerex seeks a declaration that implementing the LRIC-based rate will not cause this Commission to reconsider its prior determination in Powerex II that BC Hydro's wholesale transmission tariff adequately mitigates transmission market power, or otherwise jeopardize Powerex's market-based rate authorization. 2/


TransCanada Energy Ltd. (TransCanada Energy) filed a timely motion to intervene. Hydro-Quebec filed a late motion to intervene, raising no substantive issues.

II. Procedural Matters

Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (1998), TransCanada Energy's timely, unopposed motion to intervene serves to make it a party to this proceeding. We find that good cause exists to grant the untimely, unopposed motion to intervene of Hydro-Quebec, given the early stage of the proceeding, and the fact that the untimely intervention will not cause any undue prejudice or delay.

III. Discussion

Powerex is a power marketer with a rate schedule already on file with this Commission permitting Powerex to engage in the sale of power at market-based rates. 10/ The LRIC-based rate that the BC Commission has directed BC Hydro to adopt, as described in Powerex's petition for a declaratory order, does not lead this Commission to reconsider its prior finding that transmission market power has been adequately mitigated, or its prior decision to grant Powerex authorization to sell power at market-based rates. 11/

2/ Id. at 13.

10/ 80 FERC at 62,140.

11/ We note that Powerex states in its petition that the LRIC charge "will be levied against all point-to-point customers (including BC Hydro Power Supply) using paths that are..."
Docket No. EL98-64-000

Accordingly, we will grant Powerex's petition for a declaratory order that BC Hydro's implementation of the LRIC-based rate will not result in a reconsideration by this Commission of Powerex's authorization to sell power at market-based rates.

The Commission orders:

Powerex's request for a declaratory order is hereby granted.

By the Commission.

( SEAL )

David P. Boergers,
Secretary.

11/ (...continued)
projected to require expansion based on the transmission planning projections filed by BC Hydro with the BCUC. Powerex Petition at 11. Powerex made a similar commitment in its prior filing, and against this backdrop, we have previously found that rate and allocation provisions in BC Hydro's tariff are entirely Canadian concerns that are outside our jurisdiction. 80 FERC at 62,139.