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Long-Term Transmission Rights and Fuel Diversification

Need for Expanded Native Load Service Obligation Protection To Facilitate Power Plant Investment and Avoid Over-Dependence on Gas

None of the FERC-approved Regional Transmission Organizations (RTOs) today have any mechanism in place to allow utilities to secure long-term transmission rights for new power plants or power contracts. As a result, there is no way to obtain reasonable delivered-price certainty. This is making construction of clean coal plants and wind generation by load-serving entities very risky, since the fixed costs of these plants are high and the savings is in lower energy costs over the life of the plant. What matters is the delivered energy cost to customers. Without a long-term transmission right, the delivered cost may be much higher than expected.

Consider these real-world examples:

1. *Lack of Long Term Rights Deters Planning*: TAPS member Wisconsin Public Power Inc. has been approached by utilities in Iowa, Minnesota and Nebraska about participating in several possible new coal plants, but has been unable to seriously consider such options because of the absence of long rights. The availability of long-term rights that provide reasonable certainty about the delivered price of energy from new coal plants would bring greater construction opportunities and increase access to capital.

2. *Lack of Long Term Rights Complicates Investment Decision*: Eight investor-owned, municipal and cooperative utilities (including several TAPS members) are participating in development costs associated with the Big Stone II Generating Station in South Dakota. The 600 MW plant, which will have the best available emission-control technology, would be located on the Otter Tail Power system. However, no firm commitments to construct have yet been made and the lack of long term rights significantly increase the difficulty and risk for participating municipals, such as Southern Minnesota Municipal Power Agency, to decide to make such a commitment.

3. *Lack of Long Term Transmission Rights Causes Concerns about Financing*: Six municipal and cooperative electric systems (including several TAPS members) have made commitments to purchase ownership shares amounting to 47% of the planned 1600 MW Prairie State Generating Station, a mine mouth plant with two 800 MW units. It will be among the cleanest coal plants in America and is the largest capital project planned for Southern Illinois in the state's history. Prairie State will generate low-cost electricity for the Midwest, create more than 450 permanent jobs and inject nearly $100 million in economic benefits into the Illinois economy each year, according to a study by Southern Illinois University at Carbondale. However, the absence of long-term transmission rights is causing concerns about the financing for this important project.

Chairman Domenici opened the January 24, 2005 Natural Gas Symposium, held by the Senate Committee on Energy and Natural Resources, by outlining what he believes is a natural gas "crisis for the United States as consumption will vastly outstrip production in the next 20 years." He stated: "The natural gas crisis is already affecting residential, commercial and industrial consumers. It has cost American consumers billions of dollars." As a number of conference participants noted, the increasing reliance on natural gas for electric generation is putting increasing pressure on gas supplies, which contributes significantly to today's high gas prices.[1]

Congress should mandate the provision of long-term transmission rights to stimulate investment by load-serving entities in diversified electric generation resources. In the absence of long-term rights, the only "safe" investment is one where transmission congestion risk is minimal—a gas-fired unit close to load. Investment in gas-fired generation is not only a very expensive choice for around-the-clock generation, it will also add to U.S. over-dependence on gas. This choice is neither safe nor wise for our nation's electricity and gas supply future. Long-term transmission rights assuring deliverability to load with reasonable price certainty is an essential ingredient to achieving fuel diversification.

Gas-fired generation located near load is well-suited to peaking and intermediate service—for power needed for a few hours at a time to meet energy requirements as they increase during the day, or during very hot or cold spells. It is a costly alternative for baseload generation—for power needed every hour of the year. In addition to resulting in significantly higher fuel costs for electricity, use of gas for around-the-clock generation will place tremendous upward pressure on already volatile gas prices, and tighten availability, for other gas needs. Coal-fired generation, in contrast, promises to provide much lower and more stable energy costs over the long-term.

Like coal-fired generation, the other major diversification alternatives—wind power and, potentially, new nuclear plants—need long-term transmission rights because they also are high fixed cost, low energy cost resources and will likely have to be located at a distance from population centers and so are very dependent on transmission.

Industrial, commercial and residential consumers care about the delivered cost of energy they pay, not the price at distant plants. Absent the delivered-price assurance obtained through long-term transmission rights, a load-serving utility that builds a coal plant will incur the high fixed costs of such generation and at the same time risk having to charge its customers a high gas-fired energy price because transmission congestion will block delivery of energy from the utility's coal plant. Thus, the utility and its customers will experience the worst of both worlds—high fixed costs and high energy costs. This makes no sense.

Until recently, the long-term rights required to support new generation were a standard feature of all Federal Energy Regulatory Commission tariffs. On the basis of those long-term rights, load-serving entities could and did make and finance generation commitments with reasonable long-term delivered-price certainty. Now in the transition to RTOs, no such rights are available because all of the focus at RTOs is on short-term spot markets. Spot markets will not get high fixed cost coal plants, with long construction lead times, built.

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[1] The National Association of Regulatory Utility Commissioners cited Energy Information Administration statistics that over 90% of the capacity added between 2000 and 2004 was gas-fired and most of the new generation that will become operational over the next several years will be gas-fired. William Rosenberg of Harvard's Kennedy School of Government confirmed, using EIA data, that this trend is expected to continue, with electric power gas demand projected to increase by 90% by 2025.

The lack of long-term rights is a concern for financial rating agencies. In a report prepared in September 2004,[2] Moody's indicated:

> [T]here is potential risk in the short-term marginal pricing model being used in various regional energy markets in the U.S. Without long-term contracts for transmission rights and price certainty for the transmission of energy from new generation facilities, cost recovery in the long term may not be assured. The certainty of cost recovery represents a major factor in the credit assessment of financings for new generation projects.

If Congress legislates comprehensively on electricity, TAPS urges Congress to augment the Native Load/Service Obligation protection in Sec. 1236 of H.R. 6 (the energy bill conference report from the 108th Congress) that safeguards existing transmission rights with additional language that requires that the grid be planned to enable load-serving entities to obtain new long-term transmission rights for new generation resources dedicated to load, as attached. If a comprehensive electricity bill is not passed, Congress should urge FERC to require that long-term transmission rights for new resources be made available to load-serving entities.

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[2] "Credit Issues Resurface as New Electric Generation Projects by Public Power Utilities Take Center Stage," Moody's Investor Service, September 2004, at 4.