

October 26, 2006

Mr. Paul Norman, senior vice president
Bonneville Power Administration
P.O. Box 3621
Portland, Oregon 97208

SUBJECT: Canby's Comments on BPA's Long-Term Regional Dialogue
Policy Proposal

Dear Mr. Norman:

My client, Canby Utility ("Canby"), endorses many aspects of the Long-Term Regional Dialogue Policy Proposal, but the document postpones too many critical decisions for the future and creates too many potential obstacles to customer choice.

In the absence of a straightforward allocation system that allows utilities to receive their share of the existing federal power system *before* signing 20-year contracts in 2008, Canby prefers the "fallback" policy option BPA has outlined with no modifications.

I. OVERVIEW

Canby strongly supports the goal of BPA's Policy Proposal to allocate the existing federal power system and give utility customers meaningful options for meeting load growth.

Our comments are aimed at reinforcing those elements of the Policy Proposal that encourage utilities to diversify their power supply and assume greater responsibilities for managing load growth.

But we have also identified areas where the proposal is deficient from Canby's perspective. We offer a number of specific recommendations focused on three general themes.

- * **Schedule.** BPA's proposed schedule would have utilities receive their federal power allocation in 2011 three years *after* they signed 20-year contracts. We request instead that BPA assign shares of the federal power system, based on current and/or historic loads, before the contract-signing deadline of 2008. We also request that BPA better define the products and services it intends to offer for load growth before offering contracts.

- * **Augmentation and other issues relating to the separation of costs between Tier 1 and Tier 2.** We request that BPA not augment the existing federal power system for any reason.

If the purpose of BPA's proposal is to separate the existing federal power system (Tier 1) from market resources needed for load growth (Tier 2), then BPA should stick with a clean allocation system and not attempt to water down the allocation with commitments to buy yet more power and meld those costs into Tier 1.

- * **Waiver of legal rights.** We request that BPA abandon its effort to require utilities that waive their legal rights to challenge the yet-to-be determined tiered rates methodology in order to sign 20-year contracts in 2008.

Threatening customers by telling them "waive your legal rights or you won't get a contract" is not the way to build trust for a new 20-year relationship. We realize BPA wants some assurances from customers that they will not tie up the methodology in court, but this part of the Policy Proposal is counterproductive and will have the reverse effect.

Canby understands some of its suggestions run counter to the tentative "regional consensus" that has developed around the BPA allocation proposal. Consensus is a laudable goal but this is a time when BPA needs to make tough choices rather than attempt to satisfy the region's disparate constituents, some of whom seek to postpone the day of reckoning when they must make business decisions for themselves.

II. CANBY AND COMPETITION

Canby, a municipal utility in Oregon with 6,500 customers, has diversified its power supply in the past and believes in the market discipline that comes with genuinely competitive markets for wholesale power.

In 1995, Canby solicited proposals from power suppliers. BPA was the highest of five bidders. The lowest was Portland General Electric (“PGE”). Based on those results, Canby signed a five-year contract to buy virtually all of its power from PGE, leaving only one average megawatt (1 aMW) on the federal power system to avoid triggering penalties under either the net-billing contracts, which required BPA to pay for certain nuclear power plants, or its conservation contracts.

Canby is now a full-requirements customer of BPA until September 30, 2011, and it looks forward to “shopping around” for a power supply for its load growth after that date, when its existing contract expires.

Canby does not want special treatment or favors from BPA, nor will Canby simply choose BPA as its supplier for load growth because of the close historic relationship between BPA and its public power customers.

In selecting a supplier for load growth, Canby intends to make a business choice, after conducting due diligence. If BPA is competitive, Canby intends to stay with BPA. If BPA is not competitive, Canby intends to sign with another supplier.

III. SPECIFIC RECOMMENDATIONS

Canby strongly supports the goal of signing new 20-year power sales contracts that allocate the existing federal power system and give customers choice for buying power elsewhere for their load growth.

We are particularly pleased BPA has asked for comments on key policy decisions at this time, in advance of the rate case and other decision milestones. Also laudable is BPA’s goal for simplicity.

Although we endorse BPA's broad goals, we request that BPA revise the Regional Dialogue proposal as follows:

A. BPA should calculate and assign shares of the existing federal system – the “high water marks”– before contract signing.

BPA currently proposes to assign the shares of the existing system in 2011 based on loads in 2010. But the 2011 date is three years *after* utilities have signed 20-year contracts. For utilities that intend to perform “due diligence” on BPA's contract, this schedule makes little sense.¹ We request that BPA allocate the system based on current and/or historic loads *before* signing contracts. Utilities need to know exactly what they are purchasing.²

From Canby's perspective, BPA should allocate the system by 2008. There are any number of ways to meet Canby's objectives. BPA, for example, could choose a combination of current and historic loads (i.e., the five-period between FY 2003-2007).

We also believe it is in BPA's interest to assign shares of the federal power system by 2008. BPA should not encourage utilities to decide at the last minute that they will rely on BPA for Tier 2. In the absence of an early allocation, we fear a repeat of the “let BPA buy for me” syndrome that contributed in part to BPA's supply problems during the West Coast energy crisis in 2001.

¹ The 2010 loads forecast relies on a net requirements methodology that has yet-to-be developed but will be based on BPA's existing 5b/9c policy. Thus, BPA is several steps away from determining “high water marks” (allocations).

² We understand that the “early” assigning of “high water marks” may create some inequity. If a utility loses 30% of its industrial load in 2009, after signing the BPA contract, it will have a larger share of Tier 1 than if the Tier 1 allocation had been made in 2011. Similarly, a utility that is growing faster than the regional average will receive less of a Tier 1 allocation than it would have received after 2008. There is no clean, easy solution. On balance, Canby believes that it will create more predictability for utilities *and* BPA if the allocation occurs prior to contract signing.

B. BPA should explain why it shows the federal power system has the capacity to produce only 7,100 aMW in critical water when BPA's "White Book" shows larger numbers.

BPA should more precisely define the energy in the federal power system that it proposes to allocate. As things stand now, the numbers in the Regional Dialogue proposal show the output of the federal power system is significantly smaller than the numbers in the Pacific Northwest Loads and Resources Study ("White Book").

The firm federal resources, according to BPA's Policy Document, are expected to be only 7,111 aMW in 2012.³ But BPA's White Book, revised in November 2005, shows total federal firm resources of 9,575 aMW for 2006.⁴

Why is BPA projected a decline of almost 26% (equivalent to 2,464 aMW) in federal firm resources between 2006 and 2012?⁵ To answer these questions, BPA needs to very carefully explain what changes it is making to the White Book and what assumptions it is using that produce different results.

C. BPA should define the Tier 2 products and services it intends to offer as quickly as possible.

BPA's Policy Proposal states that it will require utilities to decide in 2008 whether to place Tier 2 load growth on BPA starting on October 1, 2011, for five years. But the 2008 date is not likely to work unless BPA has fully developed and disclosed the types of products and services it intends to offer for Tier 2.

³ BPA Policy Document, Table 1, at page 9.

⁴ White Book, page 19.

⁵ Elsewhere in the White Book, BPA shows the system shrinking to 8,309 aMW in FY 2012. See page 22. Even that number, however, is 1,198 aMW more than what BPA shows in the Policy Proposal. A similar anomaly is found in BPA's Loads and Resources Study, adopted as part of the WP-07 power rate case, which shows the total amount of federal firm resources as 8,518 aMW without transmission losses, and 8,278 aMW with losses. See, WP-07-FS-BPA-01A, page 10.

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If we do not know the products and services, and if we do not know the price, how are we expected to make a business decision on whether BPA is competitive or not?

BPA's proposal forecloses Canby from doing any due diligence – the type of due diligence Canby did in 1996 when it bought from PGE and which it intends to conduct when it decides whether or not to diversify its supply again.

We understand BPA needs to have some idea of how many customers will stay with BPA for Tier 2. BPA can then price the product accordingly.

But that concern belies a threshold question that BPA should answer in the forthcoming Record of Decision: Will BPA acquire major resources⁶, as defined by the Northwest Power Act, for the first five years of the contract period (FY 2012-2016)? Under Section 6c(3), BPA may not acquire major resources that are inconsistent with the plan of the Northwest Power and Conservation Council.

On the other hand, if BPA is intending to go to the market for Tier 2, rather than acquire major resources (i.e., wind or natural gas), then the list of BPA's products and services looks very different starting on October 1, 2011 (FY 2012).

The bottom line for utilities is that without knowing more about what products BPA will offer to supply load growth, it is difficult to sign a contract in 2008, as BPA has proposed.

We believe it is in the best interest of BPA *and* its customers for BPA to delineate as soon as possible what types of load growth products and other services BPA intends to offer on October 1, 2011.

⁶ Any resource with capacity larger than 50 aMW. 16 U.S.C. § 839a(12)(A).

D. BPA should *not* augment the existing federal power system (Tier 1) for any purpose.

BPA's Policy Proposal calls for it to augment between 300 aMW and 1,127 aMW, depending on the amount of power sold to new public power utilities and the Direct Service Industries ("DSIs").⁷

Canby requests that BPA allocate the existing federal power system *without* augmenting any power.⁸ BPA is under no legal obligation to sell power to the DSIs, and should not do so for 20 years. If new public power utilities form, Canby proposes that BPA "shrink" the existing allocations by a pro rata amount. This option makes more sense than permitting BPA to buy resources at the market and meld them in to Tier 1.⁹

E. BPA should remove the penalty for challenging its yet-to-be adopted tiered rates methodology.

BPA's policy proposal states that parties will be required to waive their legal rights to challenge the methodology in court. "Customers accepting the contract would ultimately need to agree not to challenge the final tiered rate methodology."¹⁰

⁷ BPA's Policy Proposal proposes to augment the existing federal power system by 300 aMW for existing public power utilities; 250 aMW for new public power customers; and an unspecified amount for the DSIs. Page 22. If BPA supplied the DSIs with 577 aMW (the current amount that has been monetized for the 2007-2009 period), then BPA would augment the system by a total of 1,127 aMW.

⁸ We believe the resources and loads on page 9 of the Policy Proposal already assume the return of about 268 aMW of load by public power utilities that owned a share of the Centralia coal plant in Washington.

⁹ Canby does not recommend that BPA ignore the new public power utility issue. The choice here is between augmenting the existing federal power system or reducing existing "high water marks" to reflect the fact that the "newcomer" has a statutory right to buy its net requirements (or some share) from BPA.

¹⁰ BPA Policy Proposal, page 29.

If utilities do not waive their rights, they apparently will not be allowed to sign the 20-year contracts in 2008.

Canby requests that BPA remove this penalty, which is punitive and counterproductive. If, however, BPA retains this provision, BPA should clearly explain what happens to a utility that does not agree to waive its legal rights. Does BPA propose to deny service under section 5 of the Northwest Power Act to the utility? Or is BPA suggesting that it would offer an alternative contract for the utility? How would that contract differ from the contract offered pursuant to the Regional Dialogue proposal?

BPA needs to answer those questions clearly in the forthcoming Record of Decision.

F. BPA should clearly state that it will not use surplus firm or non-firm surplus (secondary) revenues to subsidize Tier 2 products.

BPA's Policy Proposal is not clear enough on the issue of how BPA intends to treat revenues from the sale of surplus firm or non-firm power. The implication in the proposal is that BPA will "credit back" these revenues to Tier 1 customers.¹¹ Canby endorses that approach. But BPA needs to unequivocally state that it will not use revenue from surplus firm or non-firm sales to underwrite or subsidize Tier 2 products and services, thus giving itself an unfair advantage for Tier 2 customers. Creating a level playing field for Tier 2 products and services is essential.

G. BPA should create a genuine "firewall" between the existing federal power system (Tier 1) and resources for load growth (Tier 2).

BPA's current proposal for separating the two tiers is more like a fence with holes than a firewall. There is no reason, for example, for Tier 1 customers to underwrite Tier 2 expenditures in renewable energy development.

¹¹ BPA Policy Proposal, page 30.

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“BPA proposes to spend *up to* a net of \$21 million a year (plus annual escalation) on a range of facilitation activities with its public power customers, to the extent necessary to meet the renewables target [of the Northwest Power and Conservation Council].”¹²
Those costs would be placed in Tier 1 rates.

BPA also proposes to move the cost of certain renewable resource acquisitions “in advance of need” into Tier 1.¹³

Canby objects to this part of BPA’s proposal and requests that BPA place all development, facilitation and other costs associated with renewable energy targets in Tier 2.

Canby is also troubled by the assertion that BPA might have to collect Tier 2 costs from Tier 1 customers if a utility did not pay its bills or otherwise defaulted on its share of Tier 2 costs.¹⁴

Canby requests that BPA use a variety of tools, including shifting these costs to other Tier 2 customers, if necessary, rather than create a vague authorization to shift Tier 2 costs back to Tier 1.

H. BPA should state clearly what final agency actions it is taking or not taking in the forthcoming Record of Decision.

We applaud BPA for deciding to outline key policy decisions in a Record of Decision in early 2007. However, BPA needs to be very clear about identifying the final agency actions it is adopting.

¹² BPA Policy Proposal, page 58.

¹³ BPA Policy Proposal, pages 59-60.

¹⁴ BPA Policy Proposal, page 13, refers to the possibility that BPA could face “unrecoverable” Tier 2 costs. It is not clear from reading the Policy Proposal when BPA would face such a situation. Furthermore, there are a number of common financial tools (not limited to credit checks and insurance) that would allow BPA to protect itself against utilities that default on Tier 2 costs.

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This request protects the legal rights of customers who may want to challenge certain BPA actions – they will know exactly when the “90-day clock” under the Northwest Power Act begins.

BPA has its own interest in adopting this recommendation. In the absence of a clear explanation, customers will not know what subjects have been deferred to the tiered rate methodology case or other forums, and BPA will likely be inundated with repetitive comments as it gets farther along in the process.

I. BPA should prepare a new environmental analysis of the Regional Dialogue proposal and 20-year contracts.

BPA has stated that it expects its proposal will fall within the scope of its Record of Decision for its 1995 Business Plan and Environmental Impact Statement (“EIS”).

We disagree. The Business Plan and EIS are already 11 years old and will be 32 years old by the time the proposed 20-year allocation contracts expire. To rely on an aging document like the Business Plan and EIS invites a legal challenge to BPA’s new allocation contracts.¹⁵

We believe it is far better for BPA to begin work on an environmental analysis now rather than risk the prospect that a federal court will find BPA’s compliance under NEPA to be insufficient, thus jeopardizing the allocation process before it even begins.

¹⁵ A number of items in the 1995 Business Plan EIS seem out of date or are likely to have different environmental impacts from BPA’s Policy Proposal. The 1995 Business Plan’s preferred alternative – the “Market-Driven” approach – calls for BPA, among other things, to: 1) adopt seasonal rates for three periods; 2) eliminate the irrigation discount; and 3) sign contracts for a declining amount of DSI loads. In contrast, BPA’s Policy Proposal does not address the seasonality of rates; retains an “irrigation rate mitigation” rate; and does not address DSI loads (if any). If BPA, for example, offers a fixed amount (578 aMW) of power to the DSIs for 20 years or monetizes the transaction, that decision would seem inconsistent with the conclusions of the Business Plan.

IV. CONCLUSION

Canby requests that BPA:

- * Assign shares of the federal power system by the date of contract signing (2008).
- * Explain why it shows the federal power system has the capacity to produce only 7,100 aMW, a figure contradicted by other BPA documents.
- * Define Tier 2 products and services it intends to offer as quickly as possible.
- * Not augment the federal power system for any purposes.
- * Abandon its threat to withhold 20-year contracts from utilities that challenge the tiered rates methodology.
- * Clarify that BPA will not use surplus firm or non-firm (secondary) revenues to subsidize Tier 2 products.
- * Create a genuine firewall between Tier 1 and Tier 2, and not shift renewable energy development costs to Tier 1.
- * State clearly what final actions it is taking (or not taking) in the forthcoming Record of Decision.
- * Begin a new environmental analysis now and not rely on the outdated 1995 Business Plan and Environmental Impact Statement ("EIS") to support the new 20-year contracts.

Although this may seem like a long "laundry list," Canby wishes to reemphasize that it strongly supports BPA's decision to allocate the federal power system and tier its wholesale power rates.

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Most of our objections can be cured by BPA adopting a different schedule that assigns shares of the federal system prior to contract signing, creates a genuine "firewall" between Tier 1 and Tier 2, and removes the threat to withhold contracts if utilities do not waive legal rights.

In the absence of BPA resolving these issues, Canby prefers the "fallback" position outlined in the Policy Proposal with no modifications.

Thank you.

Sincerely,



Dan Seligman
Attorney at Law

cc: Mr. Dirk Borges, General Manager, Canby Utility
Mr. Charles Forman, Jr., BPA Account Executive