NRU

Northwest Requirements Utilities

(503) 233-5823
Fax (503) 233-3076
jsaven@pacifier.com

825 NE Multnomah, Suite 1135
Portland, Oregon 97232

October 31, 2006

Bonneville Power Administration
Public Affairs Office – DKC-7
PO Box 14428
Portland, OR 97293-4428

Re: Northwest Requirements Utilities Comments on BPA's Long-Term Regional Dialogue Policy Proposal

Preliminary Comments

Northwest Requirements Utilities ("NRU") appreciates this opportunity to respond to the BPA Long Term Regional Dialogue Policy Proposal dated July 13, 2006 ("Policy Proposal"). NRU represents the interests of 52 load following customers on issues related to power supply and transmission service. NRU members account for over 1,700 aMW, roughly a quarter of BPA's public power loads. Load following customers rely upon BPA primarily or exclusively for both power supply and transmission services. As a result, the questions raised and proposals made in this Policy Proposal are critical to our membership and the retail customers they serve. While we have extensive comments and proposed revisions to the Policy Proposal, on balance it is well crafted and responsive to the views of public power, as expressed in the April 2006 allocation proposal sent to BPA by the Public Power Council (PPC).

Our comments were drafted by NRU staff, reviewed with our Power Supply Committee, and discussed with and approved for submittal by the NRU Board of Directors. While these comments will describe the overall views of the membership of NRU, it is difficult to achieve unanimity on such a broad range of topics, and some utilities may have additional or stronger views regarding specific topics. Therefore, as a general policy, we have encouraged individual members to submit their own comments if they deem necessary.

The fact that NRU's comments, of necessity approach 50 pages in length speaks to the overall potential complexity of the changes Load Following utilities will be facing in the future. BPA should be open to adjustments in the overall schedule if necessary so that customers can make well informed choices with sufficient time for deliberation.

The NRU comments are organized to parallel the organization of the Policy Proposal.

We expect to continue our active participation in this process as the proposals described in the Policy Proposal are more fully developed. If you have any questions in the interim, please contact either John Saven or Geoff Carr.

I - Introduction

NRU generally supports the broad goals and approach taken by BPA in the Policy Proposal. We agree that it is essential to retain the value of the Federal Base System ("FBS") for the region and for BPA's customers. It is also essential that we clearly define BPA's responsibility and rate treatment for meeting both its current load and the load growth that will be placed on the Agency. Therefore, these issues must be timely addressed so that customers will have the ability to plan for the future. Proposed solutions need to create the greatest possible stability, and provide customers with a reasonable set of product and service choices, yet minimize unnecessary complexity over the long term. NRU also agree with the need to accomplish the goals of the Policy Proposal without federal legislation. Federal legislation is simply too risky and opens the door to the potential for adverse unintended consequences. Finally, we support BPA using, as a starting point, the PPC Allocation proposal of April 10, 2006 ("PPC Proposal"). NRU staff and members worked for many months to come to the final agreement that was presented to BPA and incorporated in that document. BPA has made a number of changes to the PPC Proposal in the Policy Proposal; NRU concurs with a number of these changes, as described later in this response.

NRU agrees with BPA that there is a need for an aggressive schedule to implement the Policy Proposal. Utilities need as much time as possible to plan and take actions for the contract period beginning October 1, 2011. We would emphasize, however, that it is important for utilities to have sufficient and timely information regarding both BPA power and BPA transmission policies, products, practices and other matters in order to make informed and coordinated decisions.

The President's FY 2007 budget proposal for BPA of earlier this year is referenced on page 6 of the Policy Proposal. This involves early payments of Federal bond debt in future years when excess power sales revenues exceed $500 million. NRU believes that this proposal or possible future variants of it, present uncertainties and potential negative consequences to BPA's customers and the region. Estimates demonstrate that the President's budget initiative could increase BPA wholesale rates by 10 percent or more if the Federal government continues to rely on this vehicle for reducing BPA debt levels.

By letter to Mark Gendron dated July 31, 2006, NRU (joined by WPAG and PPC) asked BPA to provide the basic financial information necessary for us to better understand both the likely financial effects of the President's budget proposal and the extent to which it could be mitigated by other financial transactions involving the U.S. Treasury. We have not yet received a response from BPA to our data request. Therefore, based on conversations with BPA staff, NRU concludes that by a separate process we will have an opportunity to continue to engage BPA and the Administration regarding this issue. We will provide additional comments following the review of the BPA response to this letter. In the interim, we view inclusion of the President's budget initiative in the Policy Proposal as unhelpful at best.

II - BPA Loads and Resources Post-FY 2011

BPA's post FY-2011 load and resource projections appear reasonable given what we know now. However, a number of points do need to be made about the forecast.

- The forecast is based on BPA's projection of its customers' net requirements. This load-minus-resource calculation is a notoriously difficult one, especially on the customer resource side. Clear, transparent and understandable rules for this net requirements determination have yet to be developed.

- The forecast of BPA resources assumes that the Calpine's Fourmile Hill Geothermal project is in BPA's resource base. Inclusion of this 50 aMW resource is questionable.

- The forecast assumes that BPA will not lose a major resource in the future and that the current capability of the hydro system will be maintained over time.

- This analysis is based on an energy only analysis of the system under critical water. With increasing capacity constraints the issue of capacity sufficiency must also be addressed.

- Given the above assumptions and excluding the Centralia resource from the firm resource exhibits of the public power participants in this plant, BPA projects it is in load resource balance in 2012, under a medium load growth scenario.

Changes to any of these assumptions could affect BPA's load/resource balance picture in 2012 and beyond. If BPA's loads are significantly higher than the resources available in 2012, this could affect future viability of the proposal. In other words, for the Policy Proposal to be widely embraced among load following utilities, BPA will need to convincingly show that, as of the start of the new contracts, all or nearly all of their net requirements can be served by Tier 1 power.

III - Service to Public Utilities

The issue of service to public utilities is of paramount importance to NRU members. The current open-ended nature of the BPA obligation for load service led to a major rate increase from 2001 to 2002, when 3,000 aMW of load returned to BPA during a period of unprecedented market price volatility. Since BPA's load placement rules in effect at that time allowed load to leave and then return with relatively short notice, BPA was forced to meet this load at a very high price to its customers. NRU's members felt the effect of this even though they (for the most part) kept their loads on BPA throughout the 1990's. It is clear to us that BPA needs to define its responsibility in this area. BPA's High Water mark ("HWM") proposal, which generally follows the PPC Proposal, coupled with appropriate contractual provisions, is an approach to solving this problem that is generally workable for the NRU membership, except as noted below. BPA will serve load below the HWM of its public power customers at Tier 1 rates. To the extent that customers place load above this level on the agency, this load will pay for service at Tier 2 product rate(s) which reflect the direct cost of providing this service. While this approach sounds simple enough, many questions arise in its application, and many important details need to be worked out. The following comments on this topic are really only the beginning of this discussion.

Setting the HWMs, the Six Steps

BPA provides a six-step process to establish HWM for individual utilities. This process seems appropriate, but as noted in Step #1, it will be essential to develop a "*consistent, simple and transparent approach that would be used to establish net requirements for and during the contracts, consistent with BPA's 5(b)9(c) policy*". This step is critical because it will be a fundamental determinate of the size of each utility's HWM and how much of the low cost Tier 1 resource will be allocated to each customer.

Step #2 provides customers with a preliminary look at what their HWM will be for planning purposes using a 2007 forecast of 2010 net requirements. The resources to be used in the net requirements calculation will be those included in each customer's Subscription contract for 2010. It is appropriate to use 2010 firm resources dedicated to serve firm load under each customer's Subscription Contract, however certain limited adjustments will need to be made to reflect such circumstances as the Grant PUD arrangement. This preliminary look at the HWM is necessary for planning purposes and consistent with the approach taken by PPC with the exception that PPC Proposed using forecasted 2012 loads and resources. The 2010 preliminary look, as proposed by BPA, is more workable given the three more years of load and resource uncertainty in the PPC Proposal. This will help to limit or remove some of the potential variance and uncertainty in the net requirement determinations of the utilities with significant customer owned resources. This in turn should result in a more stable and predictable HWM for the NRU members.

Step #3 "trues up" the preliminary HWM forecast using actual 2010 loads. This true up is done in 2011. This contrasts with the PPC Proposal to use 2010 loads and 2012

resources. This BPA proposal here is superior to the PPC Proposal because it uses the same year for both loads and resources for purposes of setting the HWM. NRU will, of course, be interested in the techniques and other factors used to normalize for weather or make other adjustments to 2010 actual loads.

As a part of this initial true up for HWMs, BPA will need to true up the customer commitment to purchase Tier 2. This could occur as a result of variance in a customer's 2011 load compared to the 2007 forecast, or a change in their HWM due to final adjustment BPA makes to the HWMs of all other BPA customers. We therefore propose that the commitment as to the amount of Tier 2 purchase be made the year before the beginning of the FY 2012 contract commencement. This does not preclude contract signing for the provision of Tier 2 power in 2008, but it would not be binding regarding amount. BPA should provide for this element of flexibility particularly in the context of the Tier 2 Default Portfolio option. In this portfolio, BPA is only making commitments for shorter term resources, and forecasting 20-30% of them are one or two years in duration. (See BPA Tiered Rates Costing Methodology – Preliminary Draft for Discussion). Therefore an adjustment option with one year advance notice should pose little if any risk to the Agency and other Tier 2 purchasers, particularly compared to the longer term resource acquisitions of other Tier 2 portfolios. Some utilities may be increasing their Tier 2 commitments, while others may be reducing their commitment, with little overall net change.

Step #4 determines the total FBS Available for the HWMs. BPA allows for augmentation under this step of up to a total of 7,400 aMW but not more than 300 aMW above the existing FBS. This 300 aMW of augmentation is also consistent with the PPC Proposal. The proposal does need more clarification on how this augmentation would work in the first rate period (2012 and 2013) and each subsequent rate period. For example, we propose that if only 100 aMW were needed in the first rate period and 200 aMW were needed in the second rate period (2014 to 2015) that 100 aMW more would be augmented for in the second rate period (100 aMW plus 100 aMW equals the 200 aMW needed). This would occur up to the 300 aMW and 7,400 aMW limits if this level of augmentation is needed in subsequent rate periods. Also, the augmentation(s) that could occur up to the limits will be for the term of the contract (if supported by the need for power).

In step #4 BPA also asks what should happen to unused HWM amounts that are excess to the sum of the HWMs. NRU first proposes that, from a ratemaking standpoint and on an individual utility basis, to the extent that a utility's net requirement is below their individual HWM, BPA should sell this power and the revenues generated should be credited back to Tier 1 power. Credits should apply only to the load following Tier 1 customers, as Slice and Block customers will be better able to take all of their Tier 1 purchases due to their own resource flexibility. Second, also from a ratemaking standpoint, if the sum of all utilities' loads is less than the sum of the HWMs, BPA should sell the power and the revenues generated should be credited back to Tier 1 load following customers. Individual utilities would be allowed to grow back into their

HWMs at the Tier 1 rate. On a real time basis the financial proceeds from BPA's sale of excess HWM power would be added to BPA's financial reserves.

Step #6 accounts for Conservation Achieved. The PPC Proposal added back energy to HWMs for all self-funded conservation achieved from FY 2002 to 2010. Because the purpose of this add back should be to encourage utilities to continue to undertake new conservation, BPA's FY 2007 to 2010 conservation "add back" proposal is more appropriate. BPA also chooses to credit self-funded conservation for 100% of the energy savings achieved and BPA funded conservation for 50% of the energy savings achieved. While the 50% limit for crediting savings from BPA-financed conservation (i.e. through rate discounts and bi-lateral contracts) does appear to be somewhat arbitrary, it is clear that self-funded conservation should be credited at a higher level than BPA funded conservation. NRU believes that the level of crediting for BPA funded conservation should be increased above 50%. Based on discussions with public power utilities, a 75% level seems more appropriate.

Monthly HWMs

Throughout the Policy Proposal, the HWM concept is portrayed as an annual right to buy power at the Tier 1 rate. Purchases above the HWM by a utility are at Tier 2 (or from another provider). In further discussions with BPA it appears that BPA has begun exploring a monthly approach to HWMs. While the monthly HWM approach may provide a better approximation of seasonal costs and the capacity issue, the annual approach to HWMs provides more stability for the customers. Monthly HWMs would lead to complexity, likely higher costs of administration, and customers seeing Tier 2 right away in 2012 in months where BPA is deficit. The annual approach would lead to higher balancing power purchases and lower Tier 2 purchases. Given what we know now, NRU prefers the annual approach to HWM. If BPA is going to move to monthly HWMs, then the Policy Proposal should be revised, the comment period for this proposal must be lengthened, and more discussions with customers about the implications of this change will be necessary.

Changes to HWMs

BPA proposes that *"BPA contracts and the long-term rate methodology would list the FBS resources and capabilities that would be used to establish the initial HWMs and the rate case process that would be used to periodically adjust resource capabilities and the HWMs."* Policy Proposal, p.16. The HWM sets the upper limit of the right to purchase Tier 1 power, and therefore it becomes the pivotal component for determining over time whether the allocation of the economic value of the FBS resources is equitable among BPA's customers. A customer's net requirement will determine how much of this Tier 1 power a customer can actually purchase. BPA will continue to play a major role in making periodic net requirement determinations for each utility. Therefore, customers entering into long term contracts will want assurances built into their contracts that the HWM change process will continue to be performed within mutually agreeable parameters.

NRU believes that the Policy Proposal approach may provide BPA too much discretion rate case to rate case to change both the parameters for determining the HWMs, and for ensuring HWM results. Therefore, to achieve greater certainty, the circumstances under which BPA may change HWMs must be clearly detailed in the contract. For example, we generally agree with BPA's intent regarding how changes in the resources of the FBS and changes in load serving obligations due to annexations are addressed in the Policy Proposal. However, these resolutions need to be memorialized as a contract matter. It is unclear how miscalculations would be dealt with, and we therefore encourage BPA to address that issue. Would this be a rate case issue? To the extent HWM changes are addressed as a rate case issue, customers would want assurances that BPA would not use its Federal Register Notice to declare that HWM changes are not rate case issues. It needs to be made clear that the policy and contracts will require rate case process for HWM changes. These are important issues that are as yet unaddressed; the issues need to be resolved in the months ahead while new prototype contracts are being developed.

Pooling

The Policy Proposal states that "*HWMs cannot be pooled among members.*" Policy Proposal, p. 17. In clarification discussions with BPA it became clear that this statement is too constraining and that entities such as Joint Operating Entities (JOE) should be able to provide operational pooling services for each individual member of the JOE. The JOE should be able to request delivery of Tier 1 power to different delivery points within its member systems, but the load of each member should have to meet or exceed their HWM. The JOE could also provide for the net requirements of each member. This concept needs to be more fully developed and described. The ability to pool the loads and resources of a number of utilities can have obvious benefits, especially in the context of issues such as renewable portfolio standards and meeting conservation goals, in addition to the obvious power supply and potential transmission benefits.

It is important to note that the JOE legislation limits the ability of customers to act as a JOE to those entities formed before January 1, 1999. BPA's customers that are not members of a JOE will also want the ability, if they so chose, to act in a joint fashion. NRU will work with BPA to explore opportunities for operational flexibility between utilities in the future, within the confines of current law. We encourage BPA to do what it can administratively to facilitate pooling by utilities that are not part of a JOE, once their annual HWMs have been set.

Annual Net Requirements Calculation

Under the Policy Proposal a customer's purchase of power under its HWM will be at Tier 1 rates. This right to purchase is determined by a customer's net requirement. Each year, BPA proposes to calculate each customer's net requirement to determine the quantity of power it can take at Tier 1 rates. Provision of resource removal rights will allow customers to maintain their take of Tier 1 in the event of load loss. The PPC Proposal stated that this net requirement determination should be done once each rate period and

not annually in order to provide resource and rate planning certainty for BPA and its customers. BPA's proposed annual net requirement determination would be burdensome for both BPA and the customers. In addition, since rate periods are expected to be for two or more years, a net requirement that is done for the rate period will work better from a ratemaking standpoint. Therefore, NRU supports the rate period approach. This is clearly an issue that needs further discussion.

Relationship Between HWM and Tiered Rates

The proposal states that "*A Tier 2 rate would apply for power to meet a customer's net requirement above its HWM amount, reflecting the marginal cost of serving the load.*" (p. 17). NRU notes that the Tier 2 rate(s) will not necessarily reflect the "marginal cost" of serving the load, but rather the fully allocated costs to BPA of the Tier 2 product chosen. The price of these products will vary by the term and type of product selected. Pure marginal cost pricing for Tier 2 may be an over statement of the approach BPA intends to follow for Tier 2 pricing, and would raise significant new issues.

Treatment of Centralia

NRU participated in the discussions that led to the PPC Proposal. The treatment of Centralia was a key element in those discussions. In the context of the overall Policy Proposal, we continue to believe that it is acceptable to remove Centralia from the firm resource exhibits of the affected BPA customers, even if this has a negative consequence for the HWM amounts received by the Agency's load following customers. However, our support for Centralia is predicated upon other key aspects of the Policy Proposal being adopted that are important to NRU members. If the package cannot hold together, then all aspects of any future power supply approach including the treatment of Centralia will need to be re-assessed.

Resource Removal Rights

BPA proposes two sets of resource removal rights: (1) a limited, within rate period, resource removal right for existing resources, and (2) a resource removal right for new resources. These resource removal rights are proposed to allow a customer to maintain its level of Tier 1 purchases in the event of load loss. While the rules for these rights are yet to be determined, NRU believes they are appropriate and necessary. A customer's ability to develop new resources should not interfere with its right to take the full amount of Tier 1 power otherwise available under their HWM.

Take or Pay Requirements for Tier 1 and Tier 2 Purchases

BPA proposes that both Tier 1 and Tier 2 purchases be "take or pay". The use of the concept "take or pay" in this context needs clarification for load following customers without resources. Take or pay suggests that a customer must take the power as specified in the contract and pay for the amount of power contracted for whether or not there is load available to take the power. Customers owning generation resources can remove

those resources in order to accommodate the contracted for BPA purchases. Customers without resources cannot do this. For these load following customers, where the net requirement of the customer is below the HWM, the take or pay obligation should be clearly stated to apply only to that net requirement. Any excess Tier 1 power above that would be sold by BPA and the revenues credited to the cost of Tier 1 for load following customers.

With regard to Tier 2 take or pay, in the event of load loss, BPA proposes to establish a contractual relationship that will allow BPA to remarket any excess Tier 2 power. The proceeds or costs from that re-sale would be credited back to the individual customer. This is appropriate, and although there are many details to work out, this remarketing function is necessary in order to allow the effected customer to maintain its Tier 1 purchases. This is also parallel treatment to those customers that have resources.

The take or pay issue is also intertwined with the question of yearly versus rate period net requirement determinations. For example, what happens if a customer unexpectedly moves from Tier 1 into Tier 2 from year one to year two of a rate period? Based on initial conversations with BPA staff, we have been advised that this will be covered by the purchase of the load variance product within a rate period. This customer would face Tier 2 for its load above the HWM in the next rate period. We agree with this approach, as opposed to changing Tier 2 amounts based on an annual net requirement determination. However, the BPA approach is not clearly delineated in the Policy Proposal. This needs to be stated more clearly in the final document, and we would prefer the load certainty of the two year rate period.

Access to the Public Exchange

BPA proposes to include language in the Regional Dialogue contracts that would settle the residential exchange claims for all existing public customers. This proposal makes sense for new resources and market purchases since the ability to exchange high cost resources is at odds with the goals of the Regional Dialogue. However, for resources that have already been developed prior to the Northwest Power Act, different rules are necessary, especially those developed in response to a notice of insufficiency. For further discussion of this topic see our comments in Section V of this document.

New Public Customers

BPA proposes a measured and fair approach to the issue of service to new public power customers. This topic was discussed many times within public power and also in the BPA Regional Dialogue process. Because, under the Policy Proposal, BPA's obligation to provide load growth service to its existing public power customers at the embedded cost of the system is removed, the ability of new publics to request service at the Tier 1 rate also must be re-assessed. BPA proposes that a limited amount of Tier 1 power will be provided to newly formed public utilities that meet BPA's standards for service. Because BPA is forecast to be at load resource balance by 2012, this power will be acquired through augmentation purchases. The cost of these purchases will be recovered

through Tier 1 rates. Without such limitations, BPA's existing customers would face higher Tier 1 rates and more exposure to Tier 2 prices. We agree with this approach.

Effect of Reductions in FBS Capability on HWMs

BPA proposes that it will augment the firm power capability of the FBS in the future only for (1) 300 aMW for existing publics; (2) 250 aMW for new publics; and (3) the DSIs, if BPA decides to sell them power.

While NRU accepts the reasoning and level of the first two augmentation amounts, we remain opposed to any future BPA power sales to the DSIs. (See NRU response to Section VI.)

This section of the Policy Proposal does not address what happens if there is a major resource loss on the federal system. Under the BPA proposal the HWMs of all customers would be reduced, and Tier 2 exposure would increase for those customers of BPA requesting this service. NRU proposes that under such circumstances, those customers that wish BPA to replace the lost FBS resource be able to formally request resource replacement by BPA and that this be a contractual right. The cost of this resource replacement service would be recovered from those customers requesting this service. However, in such circumstances customers should have the opportunity to replace the lost FBS resource with non federal power.

Federal Income Tax-Exemption on CGS Bonds

NRU agrees that an equitable solution must be found that does not impair the tax exempt status of the CGS bonds in the event that a reduction in HWMs is due to the reduction or loss of CGS. We note that the potential solution provided by BPA, requiring only rural electric cooperatives to replace their reduced HWM with Tier 2 power, fails the equitability test and violates the principle that Tier 2 should be "market neutral." We urge BPA and the customers to look for other solutions to this problem.

Products Available to Requirements Customers

In the introduction to this section BPA makes a very telling statement: "*Transmission products are not covered under this proposal; however, for load following customers that do not have in house expertise, BPA would offer a transmission management product at its cost of providing the service.*" This essential service has been offered in the past, load following customers have relied on BPA to provide it, and will continue to do so in future. We expect that this statement means that there will be a seamless transition to the provision of delivered power to load following utilities under the future contemplated in the Policy Proposal.

Some of the members of NRU may have a continuing interest in BPA providing a bundled transmission and power product, particularly those willing to make a long term

commitment to BPA as an exclusive power supplier. For such customers, the Agency should continue to develop a bundled product.

We need better definition of the Transmission Management Product and plan to work with BPA on this essential aspect of the proposal. Five examples of where much more work is needed include: (1) the integration and delivery of power over the network from new non-federal resources to serve Tier 2 power, (2) BPA's proposal to change the way the agency charges transmission rates for customer-served load after 2011, (3) congestion management, (4) the delivery of non-federal power over General Transfer Agreements, and (5) the provision of ancillary services. In each of these areas the transmission issues could change an economic non-federal purchase to serve Tier 2 into a lost opportunity. If BPA's goal is to bring non-federal resources to serve Tier 2 on an impartial basis, then the transmission issues are paramount. Transmission access must be addressed with priority given to load service.

An example of where significant difficulties have occurred in the past includes a situation where BPA's TBL was not capable of satisfying a transmission request prior to the completion of a non-federal resource, and the generation project owner was not able to sign a Power Purchase Agreement without the purchaser having the ability to take the generation to load through a transmission agreement. This presented the customer with an impossible dilemma. This type of dilemma must be avoided in the future.

Load Following Products

It is essential that BPA provide a load following product, and NRU agrees with the basic Policy Proposal approach. Nevertheless NRU has concerns with regard to the cost of that product and with the acquisition of resources for BPA's load following function. There are increasing claims on BPA energy and capacity resources, which go beyond the overall growth of the customer base. From wind integration, to Slice capacity issues, to fish flow operations: these claims on capacity must be balanced against BPA's statutory obligation to provide requirements service, including load following at reasonable rates. BPA and the customers are still defining and pricing Tier 1 and Tier 2 products. Therefore, these comments will focus primarily on BPA's initial design regarding these topics.

Perhaps the most confusing part of the Policy Proposal as it pertains to specifics of service to Load Following customers is the description of service at Tier 1 and Tier 2 rates. Under the BPA construct, when a customer's net requirement is below its HWM it will pay Tier 1 rates. As described earlier in this paper, we expect that this will be a rate period to rate period determination. Under the Policy Proposal Tier 2 will be delivered as an assumed flat block at the bottom of the load shape of the customer. To the extent the forecast net requirement exceeds Tier 1 on a monthly basis (after taking into account any Tier 2 purchase underneath the load), this increment will be covered through balancing power purchases.

A number of issues come up as we consider this construct. First, earlier in the Policy Proposal (p. 9), BPA stated its intention to provide a contractual approach to re-selling

Tier 2 power in the event of load loss, and crediting the proceeds back to the customer with the load loss in the amount of the lesser of that customer's Tier 2 purchase in aMW's or the load loss in aMW's and then crediting the remaining amount (if any) to the load following pool. As stated earlier in our comments, this is a reasonable approach. However, it is difficult to equate this to the concept of Tier 2 as a flat block at the bottom of a customer's load shape. The load loss would have to be so significant as to be greater than the Tier 1 purchases of the customer.

This construct could also be read in another way. If Tier 2 is considered as a true flat take or pay block, then it appears that Tier 1 will take the load swings. In consultations with BPA staff, we have been advised that the load variance product will likely take the load swings, and further that the value of Tier 1 will stay with the customer up to the utility's net requirements. Another approach to this issue would be to provide a flexible Tier 2 market-based product that would take the load swings on top of the Tier 1 load. Clearly this is an area that needs more work both to explore conceptually and to analyze it when compared to the current BPA proposal. We would like BPA to engage in those discussions with us prior to the issuance of the Policy Proposal ROD.

In order to re-shape the FBS generation output into products that follow the loads of customers, BPA will have to provide both balancing purchases and sales, and load variance. Load following customers will have to pay for these services, based upon the cost of providing these services. This is similar to current practice. The difference in the post 2011 period will be that the cost of these services will in all likelihood increase over time as the BPA's capacity becomes more constrained due to such factors as the overall loads placed on the agency, fish flows, wind integration and the operation of the Slice product. Claims for capacity in these areas have an effect on the pricing of the load following product, which is used most extensively by the load following customers. NRU encourages BPA to maintain sufficient capacity to provide load following services as its first priority, and to keep the cost based structure for charging for these services as low as possible, similar to the current rate design.

Partial Service Product

BPA proposes to remove the distinction between Partial and Full Service products in the future. BPA states that it will provide a single load following product that will have clear rules for the addition of new resources and existing resources. These rules are needed to prevent costs being imposed on BPA's other customers. While we agree wholeheartedly with the need for BPA to design power products that do not lead to cost shifts between customer groups, the Agency may have gone too far here in limiting product design, and needs to reconsider expanding the basic portfolio of products offered.

NRU believes that there is a need for a product that will allow customers to integrate resources into their power supply portfolio, in a way that is economically and operationally efficient for them, and that does not result in cost shifts to other customer groups. A number of larger NRU members may be interested in such a product. We also believe that a significant number of customers currently taking service through the Slice

of the System product ended up doing so in part because there was not a viable alternative to Slice that allowed these utilities to integrate their generation resources.

BPA needs to offer a more robust partial service product that provides greater flexibility for utilities to integrate resources. BPA's product description is simply too limiting, and will not fulfill the objectives that a number of customers that own or will develop resources with varying output are reasonably seeking. BPA should avoid the situation that occurred in 2000 where the customers and BPA spent months developing the Actual Partial Service – Complex. This product proposal became so complicated and economically uncertain that it was not taken by any of BPA's customers. We are committed to help develop a Partial service product that will work for customers. While such a product likely cannot be developed prior to the issuance of the ROD, NRU requests that BPA both agree to develop the product and commit to a schedule for product development that concludes reasonably in advance of the new contract offerings. NRU will devote its resources to help in the development of a viable partial service product.

Tier 2 as a Flat Block

In BPA's proposal Tier 2 is illustrated as an annual flat block. We believe that other Tier 2 shapes should be allowed on a cost neutral basis to BPA's other customers. The flat annual block, while a simplifying approach, may not be viable or available over the long run. NRU is also mindful of the complications that could arise in the pricing structure and administration of the product, as we attempt to apply the principle of cost neutrality.

Tier 2 Alternatives

In this section of the Policy Proposal BPA briefly describes four options for Tier 2 service: new renewables, a default pricing construct, long term purchases, and full load growth coverage. We have reviewed these product descriptions in conjunction with a BPA document entitled "Tiered Rates Costing Methodology - Preliminary Draft for Discussion" which describes in greater detail the components of the Tier 2 product purchases. In these documents BPA discusses resource acquisitions for renewables, but otherwise describes "market purchases" of various durations as the portfolio for the other Tier 2 purchase options.

In reading these documents, it is not clear the extent to which BPA, on its own initiative, or on behalf of many of its public power customers, wants to actively play a role in long term resource acquisitions of federal power, beyond various renewables, or rather whether it wants to simply provide Tier 2 resources as market contract purchases. We strongly urge BPA to be competitive and aggressive on behalf of customers in the Tier 2 power supply business.

In addition to various renewables, BPA may need to acquire the output of new generation resources, which would become federal power. BPA needs to convey to customers that it will acquire, consistent with customer commitments, cost effective thermal generation

output as necessary as a federal power resource base to support Tier 2 products. This should include consideration of gas, coal, nuclear, or other sources of generation, consistent with applicable statutory or other regulatory provisions. In that regard, BPA should consider acquisition from a number of alternative suppliers, rather than putting all its "eggs in one basket." BPA should also factor in geographic diversification of resources as well as the capabilities of the transmission system to deliver increments of new generation to customer loads. BPA needs to retain sufficient staff expertise to analyze such projects, assemble resource portfolios, and provide necessary information to prospective Tier 2 customers.

It is premature for NRU to speculate at this time regarding particular thermal resource(s) of choice. However, even with some regional interests pushing for legislative guidelines regarding renewable portfolio standards, the region will need additional thermal or hydro capacity to back these resources up, including cold days and hot days, as experienced last July.

Within this context, the third BPA Tier 2 product, "Long Term Purchases" should be labeled "Long Term Market Purchases and Resource Acquisitions." We expect a high level of interest by NRU members in new Federal power Tier 2 resources that are longer term in duration, say a minimum of 10 years, or potentially for the term of the contract, with the possibility of extension.

In addition to BPA offering a federal power Long Term Tier 2 option, BPA should agree to "federalize" for a contractually agreed upon period of time, those resources that are developed or purchased by individual utilities or groups of utilities. In this scenario the utilities would retain the long term ownership rights and financial obligations attached to the new resources. The Agency, however, could agree to purchase the output and resell it to the same customers in a manner that is cost neutral to other customers but allows the utility to more closely align their own resource with their Tier 1 purchases and any other product selections. For example, a utility could select a combination of a Tier 2 renewables product from BPA to be used in conjunction with a customer owned but contractually federalized thermal resource to serve their load growth.

We recognize that there are many product design and implementation issues surrounding the future development of the Tier 2 products. However, even at this stage BPA needs to allow for "vintaging or layering" of Tier 2 purchases, particularly for the long term product and the renewable products. For example, assume that one group of utilities signs up initially for a Tier 2 product that has a resource portfolio that over time costs $50 MWh in real dollars. Five years later BPA acquires new resources that cost $60 MWh in real dollars to serve new load growth of 150 aMW. In this scenario, the new loads should pay the full $60 MWh and not have their rate reduced by blending the $50 MWh and $60 MWh resources into a common pool for pricing purposes. In this scenario, those who previously secured the $50 MWh power could participate in the new resource offering for new incremental load growth, but at the $60 rate. In making this proposal, we recognize that if five years later, Tier 2 is lower in price, the earlier Tier 2 customers with long term commitments would stay on the old Tier 2 price.

Utilities need to have the flexibility to serve load over its high water mark with a combination of BPA Tier 2 power and non-federal power. This is not clearly stated in the Policy Proposal, and it seems to indicate a choice of one or the other, which we would not support.

There are a number of questions that could be posed regarding various combinations of resource portfolios individual customers may want to pursue, and how utilities can work collectively in a Tier 2 environment, but we will leave them until subsequent discussions of product design. We believe that a robust Tier 2 program can work administratively without becoming too complex for BPA, while providing customers with the certainty they will be seeking that the value of their resource selections are not subsequently lost by the decisions of other parties.

Additional Tier 2 Implementation Issues

Under the Policy Proposal, the customer must make a Tier 2 choice at the time of contract signing in 2008, and if they do not, the Default Pricing Construct is applied, which is a five year purchase commitment with a three year notice provision to switch to another product or apply a non-federal resource. Given all of the unresolved rate design and contract issues, and time required for reasonable planning, it is unlikely that a large number of current Full Requirement customers will be prepared by 2008 to make the best threshold resource decision committing them to a five year period. At a minimum, at least for the initial period, BPA should seriously consider 2 years notification to switch to another BPA product, and a 4 year maximum commitment to purchase the default product.

BPA also provides a Full Load Growth Coverage Product. This product would have a customer commit to purchase its entire load beyond Tier 1 from BPA over the term of the contract. Load growth beyond the HWM of each utility would be at a Tier 2 rate. NRU believes that this product should come with a notice period and an off ramp. Up to 20 years is a significant amount of time and much can happen over that period.

BPA proposes a New Renewable Tier 2 product under terms that would reflect the terms of the renewable resource purchases made by BPA. NRU would like to stress two key points. First, the Renewable Tier 2 will need to be developed so that it will meet the various Renewable Portfolio Standards (RPS) in the states that have, or are expected to have RPSs. As a result, these products will need to be tailored to each customer's need since the RPS's requirements regarding qualified renewable resources are likely to differ from state to state. Second, in offering the RPS, a short term RPS should also be available so that customers that are developing renewable resources on their own can turn to BPA to meet their RPS requirements for a period of limited duration. This is necessary since many RPSs are expressed as a percentage of load or load growth. Resource development will not necessarily follow the incremental rate of change of load growth or increasing RPS requirements over time.

With regard to all of these Tier 2 products and the ones yet to be defined, there will need to be a clear identification of the cost construct of each Tier 2 product, both initially and over time, as well as means to effectively control Tier costs. BPA does not intend to collect any Tier 2 shortfalls from Tier 1 customers. In this context, it is important that customers selecting Tier 2 service have a reasonable opportunity to participate in decision making in order to control the cost of the product, and to address the terms and conditions of the product offering. See NRU comments regarding Section XI Cost Control.

Long term rates methodology

A problematic statement in the Policy Proposal is that customers must agree to not challenge the Tiered Rates methodology in order to be able to sign a contract (p. 29). This prohibition on challenge extends to the rate methodology, *establishing and changing HWMs in the rate case, accounting for existing FBS resources and the changes in the firm capability of the system, including the source of information and the process that would be used to periodically adjust resource capabilities.* This prohibition has not been the case in prior contracts and we do not see that it is necessary to implement the Policy Proposal. BPA has asserted in the past that it can employ tiered rates. If the proposal that the agency designs in conjunction with customers has a solid foundation, it will likely have the broad based support of public power, including a willingness to defend it against legal challenge. We are not aware of a similar prohibition in other power supply relationships involving public power systems. BPA should withdraw its proposed prohibition on legal challenges. The costing construct for Tier 1 and Tier 2 rates must be part of the rates methodology

Establishing Rates for PF Preference Power

The positive outcome of the new long term rate methodology will be essential to the success of the Policy Proposal. The key issues that will need to be addressed include the costs that will be in Tier 1, initially and over time. BPA and customers will also need to identify and differentiate the costs of the various Tier 2 products, initially and over time. Also, the extent to which and under what conditions Tier 2 costs can migrate into Tier 1 and vise versa will need to be addressed. The conditions under which cost migrations could happen need to be extremely limited and migrated costs recoverable when the event is over. Tier 1 and Tier 2 pricing rules must be developed over the next year as part of the Long Term Rates Methodology. NRU will be involved to assure the durability and fairness of the Methodology over time. We appreciate the initial work the BPA Rates staff have already initiated with customers to address these issues.

Opportunity Cost Pricing for Load Following Products

BPA makes the following statement in the Policy Proposal, *"BPA proposes that charging reasonable opportunity-cost-of-service-based adjustments for shaping services is an important element of the overall proposal to equitably provide access to BPA's lowest cost-based rates. Charging less than BPA's projected opportunity cost of service would allow a customer's use of system flexibility to reduce the value from the existing*

Federal system to the remaining customers. BPA's proposal is designed to ensure that a customer's use of FBS flexibility is provided equitably to all customers."

This statement is troublesome. In defense of the above proposal BPA staff has stated that the proposal is no different from current ratemaking practice. BPA currently prices demand and load variance at market values and then reduces its monthly energy charges to recover its overall cost of service. NRU proposes that a new approach to ratemaking is necessary here. In a tiered rates environment the cost of power from the existing system will need to be clearly separated from the costs of new resources or market purchases. BPA's proposal would use a pricing mechanism that would likely negate this separation.

Under NRU's approach, BPA will clearly delineate through ratemaking the cost of those resources that form the FBS and those resources or purchases that are needed beyond the capability of the existing system, to provide for load shaping. To the extent that the existing system provides for load shaping and load following, these services should be priced to reflect the embedded cost of the system. If load shaping and following requires additional market or resource purchases, these incremental amounts would be reflected in the prices of these services.

The NRU approach makes sense as BPA currently provides shaping services from both the flexibility of the existing FBS and from market purchases. For example, in months that BPA is forecast to be deficit, it makes market purchases to ensure that it will have the resources available to serve load in those months. However, it is the FBS that provides the bulk of power available to its customers in these deficit months. In addition, the existing system is available to provide the bulk of load following customers' needs on a moment to moment basis with market purchases filling any short term gaps.

In summary, NRU believes that to the extent the existing FBS provides load following and or shaping services, the cost of this service should be provided at the embedded cost of the FBS. Only to the extent that market purchases are necessary to fulfill this function should the cost of these added purchases be included in the pricing of the load shaping product. To the extent that a customer imposes a disproportionately larger or smaller market purchase capacity obligation on BPA, this should be reflected in the pricing of that load following and shaping product. The question of whether there should be separate charges for load following (short term) and shaping (over the year) is an open one and should be addressed in the upcoming discussions of pricing. The overall costing/pricing concepts beings discussed here must be part of the Long Term Rates Methodology.

Service to Publics - Other Issues Excluding Transmission

Low Density Discount

BPA acknowledges the statutory requirement to provide low density discounts ("LDD") to customers in low density systems, but emphasizes the phrase "*to the extent appropriate.*" BPA states that it can set the criteria for the LDD, and then based upon the criteria, determine whether it is appropriate to offer an LDD. BPA reports that as of FY 2004, fifty-five customers receive LDD benefits at an annual cost of $20 million. In conclusion BPA proposes to review and revise the LDD in future general rate case proceedings, including eligibility and discount levels.

The LDD is a major issue for NRU members. As of August 2005, twenty-nine NRU members were eligible for LDD benefits, over half of the total recipients. Given the importance of the LDD to many of our members, NRU urges that BPA be clearer as to the generally expected value and applicability of the LDD in the Policy Proposal. We agree that the details of the program will be worked out in contract negotiations, and implemented in subsequent rate cases. However, two basic issues need to be addressed at this time as a matter of policy. These include:

- The LDD recipients believe that a direct relationship between the LDD and the overall financial benefit levels available to the residential and small farm customers of IOUs, and

- Whether the LDD should be applied to BPA Tier 2 purchases?

Relationship of LDD to IOU Benefits

Many NRU members believe there is a relationship between the LDD and the financial benefit levels available to IOUs for the residential and small farm customers. (See discussion of Section V – IOU Benefits) A number of NRU members in low density and rural areas have service territory that is adjacent to one or more IOUs. While wholesale power rates from BPA are generally equivalent, NRU members receiving the LDD have proportionately greater distribution costs than higher density systems. Their concern about Exchange benefits for IOUs usually hinges on whether the IOU can offer lower rates for residential and small farm customers, where the Exchange benefits are a significant offset to the retail cost.

Currently, BPA is providing over $300 million in financial benefits to IOUs for residential and small farm customers. We have examples of NRU members receiving the LDD that have residential monthly rates that are significantly higher than the residential rate of the neighboring IOU. We do not anticipate in the base proposal (rather than the fallback proposal) that BPA will require financial tests tied to average system costs of each IOU for distributing the aggregate IOU benefits. Such a test could help to equalize

some of the clear disparities, but those decisions may be left to the State regulatory bodies, as occurred with the current contracts.

NRU is not asserting that residential and small farm rates need to be comparable between public power systems and IOUs. However, a large number of public power customers receiving the LDD do believe that their LDD benefits are either unduly constrained or shrinking, and exposed to future uncertainty in rate cases, while proposed IOU benefits are generous and secured by a methodology that will provide benefit growth in the long term. In this circumstance, it may be difficult to convince these utilities to waive their statutory rights to challenge IOU benefit levels.

Application of LDD to Tier I and Tier 2 Power Purchases

The question of whether the LDD should apply to Tier 2 as well as Tier 1 purchases is complex. If the LDD does not apply to Tier 2 and a utility grows at 1.25% per year, then after 10 years, about 20% of its power will not be eligible for the LDD, which is a significant reduction. On the other hand, applying the LDD to Tier 2 tends to favor a Tier 2 BPA purchase versus a non-BPA purchase and creates difficulties for the common pricing of the Tier 2 product.

One possible solution to this would be to take what would otherwise be the likely values of the LDD post 2011, for the utility's total power purchases, and increase them by a predetermined prorated amount over the term of the contract, but only applied to Tier 1 purchases. This could be a fixed number based on all load growth, or perhaps a proxy for the proportion of load growth likely to be placed on BPA, regardless of the resource choice of each utility. For example, a utility with 80% Tier 1 plus 20% Tier 2 on average would see an increase in its LDD of 25% applied to Tier 1 only. In this manner the value of the LDD is preserved for utilities, but BPA is not sending a price signal that encourages selection of its own Tier 2 product over market alternatives. Rather than nailing down a specific proposal at this time, we would like the opportunity to work with BPA between now and time the ROD is issued to see what can be done to provide greater certainty regarding the expected value of the LDD program. The amount of money is not great, but the effect on impacted communities is extremely important.

Irrigation Mitigation

The members of Northwest Irrigation Utilities are also members of Northwest Requirements Utilities. NRU supports the long term Irrigation Mitigation program described in BPA's Policy Proposal. The program basically incorporates contract features in place during FY 07 – 11. The program limits the qualifying MWh, which is consistent with the Agency's overall approach in allocating the benefits of the existing FBS through utility HWMs. The members of Northwest Irrigation Utilities have submitted separate comments supporting BPA's recommendations, and NRU supports those comments.

Section IV – Slice of the System Product

Summary of NRU Position

NRU recommends that BPA proceed with Alternative #2 of the Policy Proposal: "*Continue sales of the Slice product at approximately the current amount, with modest reductions in the current level of operating flexibility and/or clarification of the nature of the capacity rights and flexibility.*" If BPA does not implement Alternative #2, then NRU would alternatively recommend Alternative #1: "*Replace the Slice product with flexible power and capacity products at appropriate cost-based rates.*" We prefer that BPA proceed with developing another product choice for Slice customers to consider (see our comments on the Partial Service product in Section 3), even if Alternative #2 is implemented.

NRU supports the "10 Proposed Principles for Post 2011 Slice Product" in the Policy Proposal. p. 38. These principles are an improvement over the original Slice principles which were too general and reflected a lack of experience in operating under the product. We also have a strong interest in putting Slice and non-Slice products on a more common financial basis moving forward that does not involve a "true up" mechanism. Our rationale is set forth below.

Background

While no NRU members are Slice of the System customers currently, NRU has devoted a significant amount of staff time to the Slice product. Our interests have been (1) financially to protect against inequitable cost shifts to BPA's Load Following customers, and (2) operationally to help ensure that BPA maximizes the generation value of the Federal Columbia River Power System ("FCRPS") for all customers. We also seek to improve the product from a contract implementation standpoint by simplifying it, reducing conflict potential, and better aligning all BPA preference customer interests.

BPA describes the current Slice product as "*untested and complex.*" The Slice product initially was offered on an experimental basis, with an assumption that it would be best suited for utilities that had significant generation resources of their own. One of the original principles for Slice was "*no risk of cost shift to non-Slice customers.*" NRU believes that the complexity of the product creates opportunities for cost shifts and both a perception and reality of financial "winners and losers" between Slice and other customer groups on a range of issues. For example, setting aside issues surrounding recent litigation, NRU needed to become involved as an advocate for BPA's load following customers in the complexities surrounding BPA's potential recall of excess Slice power for FY 2007, following BPA's identification of a power supply deficit for the operating year.

NRU also believes that the current contractual provisions and operational flexibilities of Slice result in the generation resources of the FBS not being operated for the maximum

benefit of all customers, raising concerns about BPA's ability to assure overall system reliability. These problems are more evident as the flexibility of the FBS becomes constrained. Growing FBS capacity shortages, evidenced this summer, are a primary example of the problem. Capacity is becoming more and more constrained due to (1) changes in river operations for fish, (2) BPA's commitment to integrate new resources such as wind, and (3) buffers for prudent system operation. To compound this problem, there is no clearly documented and generally understood analysis of the extent to which the system is capacity constrained. Clearly Slice is not the only contributing factor to capacity constraints, but Slice is one factor that needs to be carefully reviewed in conjunction with the other factors.

NRU is concerned that the overall Regional Dialogue approach, "allocation through energy product rate design", contains a huge variable regarding how capacity constraints will be equitably addressed and how system flexibility will be used to serve the net requirements of preference customers. The Bonneville Project Act provides that rates for requirements service shall be based upon the recovery of the cost of producing and transmitting electric energy. 16 U.S.C. § 832f. The Pacific Northwest Electric Power Planning and Conservation Act provides that BPA will supply, if requested, the net requirements (energy and peaking) of preference customers at cost based rates. 16 U.S.C. §§ 839c(b), 839e(a)(1).

If BPA does not maximize the operational flexibility of the FBS, and as a result has to increase the cost basis for services such as load shaping from what they would otherwise be, then this becomes a potential cost shift to the detriment of the Agency's load following customers. Similarly, if BPA commits FBS capacity to other uses (surplus sales, integration of resources for non-preference customers, transfer of ancillary services to transmission providers for other than preference customer needs, or the advanced sale of surplus capacity to slice customers), then load following customer costs could increase. We strongly recommend that BPA evaluate this issue, share the results of its evaluation with customers, and take necessary actions to assure cost shifts do not occur.

NRU responded to the May 31, 2005 BPA Draft Slice Report ("May Report"), in a June 20, 2005 letter, where among other things we expressed a concern that operating in a Slice world creates the potential for cost shifts as parties tried to maximize the economic value of their products. We stated that the BPA assessment of cost shifts at that time was too limited in scope and asked for an update of the 2002 rate case cost shift study. BPA declined to provide the update. While we would have preferred having such a study available, BPA's review of the Slice product provides sufficient information for parties to draw conclusions that address the cost shift issue.

In June 2005, NRU also recognized and decided to critically examine the operational issues BPA had raised in the May Report about the Slice product. In the ensuing months NRU participated in the BPA review of the Slice product. In our November 30, 2005, letter, NRU expressed a willingness to support "Alternative #2 – *a Slice product roughly proportionate to the current volume.*" However, NRU's precondition for supporting Alternative #2 was that it would address and eliminate the perceived deficiencies or

ambiguities contained in the current contract and that operational and cost shift issues would be addressed.

Assessment of BPA's Recommendations – Operational Issues and Amount of Product

Given the fundamental changes BPA is considering for its regional role post 2011, it was both appropriate and necessary for the Agency to conduct a comprehensive examination of the Slice product. If it is to be reoffered, BPA needs to perform a "tune up," in consultation with customers, that addresses operational and financial issues related to the Slice product. We agreed to use the existing Slice product as the point to begin discussions, and to suggest modifications that may be required for the future.

The preponderance of the management time spent by BPA, Slice Customers and NRU during the Slice product review focused on BPA's Alternative #2. We believed at that time it was generally acceptable. NRU is willing to support BPA's Alternative #2 – continuing Slice at approximately the current level, but with the modest reductions in flexibility and clarifications as described on pages 41 – 45 of the Policy Proposal. NRU is willing to support expansion of the Slice product stated in Alternative #2, up to a 10% increase, from 22.6% to 25% of the FBS, post 2011.

It is also prudent to cap the Slice product offering at this amount because of the inherent power supply uncertainties Slice introduces. Slice is a sale of requirements energy and capacity, combined with an advance sale of surplus. While the advance sale of surplus removes some uncertainty from the BPA revenue picture, it introduces another uncertainty on the power supply side. It cannot be known in advance that the surplus will be excess to BPA's needs (as determined by the future net requirements of load following customers). Similarly, the actual future net requirements of slice customers cannot be known. Consequently, complex mechanisms, such as slice exhibit N, seek to deal with such problems. A greater amount of slice could compound this already difficult set of issues.

If Alternative #2 as drafted by BPA is unacceptable to the Slice customers, then NRU recommends Alternative #1 – a replacement of the Slice product with other flexible cost based products. We support BPA offering cost based products that will mesh with the operational needs of utilities with generating resources and help BPA maximize the value of the FBS – assuming such products do not cause cost shifts to other customers. (See additional comments in Section #3 – Service to Public Utilities).

Alternative #3, expanding Slice but with sharply scaled back flexibility, garnered little if any support from Slice customers or NRU during the Slice product review. Therefore it should be dropped from further consideration.

Alternative #4, expanding the current Slice product, is unresponsive to the operational concerns that BPA has raised, would exacerbate perceived cost shift issues, risks diminishing the flexibility of the FBS to produce maximum operational value, and

disregards the public policy need for BPA to critically review the product before it is offered in the long term. Ancillary services are a particularly complex, important, and contentious component of the deliberations regarding the future of slice. BPA has not developed a process to allocate ancillary service capability of the FBS to the highest priority needs of net requirements customers, and the importance of these services is becoming increasingly clear. Further, the system capability to provide such services is probably limited. Matters are also complicated by the fact that such services are provided through BPA's transmission organization, after transfer of necessary FBS capability from Power Services. Inclusion of such services through Slice would create a de facto distribution that may or may not resemble actual need.

We agree that, from an operational perspective, Slice should be a "*system sale of requirements and surplus power indexed to the variable FCRPS energy and storage capability within defined delivery limits, rather than a sale of resource capability.*" This should help simplify the product and address issues BPA has raised regarding system capacity, as follows.

- We support the elimination of dynamic scheduling, self supply of operating reserves, and self supply of energy imbalance.
- We agree that the Slice product should not include within hour load following or ancillary services.
- We concur that generating capacity and energy provided to the Transmission Business Line for Interconnected Operating Services would come "*off the top*" of the FBS, but the revenues from these generation inputs should be shared proportionately with Slice customers.
- We recognize other new "off the top" obligations that may be necessary for wind integration, system optimization, generation redispatch, and operational uncertainty, and any BPA power revenues relating to them should be shared proportionately with Slice customers.

NRU believes these modifications, as well as the balance of those contained in the document, are necessary changes to the Slice product. Based on the opinions expressed by BPA staff, by NRU consultants, and our direct participation in Slice product review, we believe that Slice customers will retain sufficient flexibility for the future with the revisions contained in Alternative #2. However, we would like to have an opportunity to review the comments submitted by Slice customers during the comment period to see if it is possible for BPA, Slice customers and NRU and others to come to a future consensus regarding the product features described in Alternative #2.

We strongly support and expect that BPA will make a determination in the Regional Dialogue ROD that Debt Optimization costs would be shared by Slice and other customers in their PF rates, and that such costs would be recovered by true ups or cost recovery adjustment clauses.

Assessment of BPA's Recommendations - Financial Aspects and Related Items

The Slice review team (BPA, Slice Customers, and NRU) did not come to a common conclusion regarding a cost recovery mechanism that would provide Slice and other customers with the same method to mitigate risk tied to commonly shared expenses. This issue will likely not be settled before the 2012 rate case. BPA should not reach any conclusions on this topic as part of the Regional Dialogue ROD. While BPA has a stated preference for a "true up" mechanism, this issue requires further analysis. NRU staff support the application of CRACs (cost recovery adjustment clauses), if needed, rather than a true up. True ups create too much rate uncertainty. In addition, true ups provide less cost control pressure on the Agency, since costs increases would simply flow through to the customer. If the true ups move forward as currently used in the Slice contract as the risk mitigation choice, then all customers would seek audit rights over Agency costs.

In other sections we address the issue of the President's budget initiative for BPA and the question of surplus sales revenues over $500 million per year potentially being used for advanced payments to the U.S. Treasury. It is important to recognize that Slice customers are not contributing to BPA's reserve levels, because they are directly taking the financial risks and rewards attributed to variances in secondary sales volumes and market prices. In that context, a diminishment in BPA's anticipated reserves has a likely cost and rate impact on BPA's Load Following and Block customers, but not Slice purchasers. If there is an eventual resolution of the President's budget initiative that has any potential of impacting rates, the financial impact needs to be shared equitably between all customer groups. It would be premature at this time to describe in any detail the nature of such a solution, at least until there is greater certainty regarding the outcome of the Administration's budget initiative.

Section V – Benefits to the Residential and Small-Farm Customers of the Investor-Owned Utilities and Public Agencies

Proposed Settlement Offer to Investor Owned Utilities

BPA proposes that the region agree to an appropriate level of Residential Exchange Program (REP) benefits for the residential and small farm customers of investor-owned utilities and public agencies. In an overall context, NRU agrees with BPA that the likelihood of achieving a long term and durable distribution of the benefits of the FBS is greatly enhanced by a settlement among BPA, public power, and the IOUs. Also, we concur that any future benefits of the FBS for IOU residential and small farm customers needs to be provided in the form of financial payments, rather than the physical delivery of power. BPA forecasts that the public power loads placed on the Agency beginning in FY 2012 will be roughly equivalent to the generation output of the FBS, using critical water planning assumptions. Delivery of power to the IOUs would require BPA to augment the FBS, which is at cross purposes with the stated goals of the allocation proposal.

In the Policy Proposal BPA is requiring public power to voluntarily contractually waive statutory rights to legally challenge the level of REP benefits provided to the IOUs beginning in FY 2012. This is predicated upon an assumption that parties can agree to a REP initial benefit level, and a methodology for adjusting benefits over the term of the contract. If an agreement cannot be achieved, BPA describes a "fallback" proposal that does not require a waiver of statutory rights.[1] The "fallback proposal" relies upon a reinstatement of an exchange program and update of the 7(b) (2) rate test methodology.

BPA provides a methodology for determining changes in REP benefits based on the ratio of change of average system costs for the six IOUs compared to the ratio of change in a proxy BPA Priority Firm Power rate for a Full Requirements customer. This methodology does have significant merit. The Agency includes extensive background information supporting their view that a FY 2012 beginning REP benefit level for IOUs of $250 million.

NRU is willing to actively explore the approach BPA has recommended, mainly a negotiated settlement with the IOUs that would be implemented through long term agreements where the publics would voluntarily agree to waive rights to subsequently challenge the components of the settlement regarding IOU benefits. However, waiving certain statutory rights broadly within the public power community will be difficult to achieve. The likelihood of this occurring is predicated upon (1) the level of REP benefits provided to the IOUs and the methodology for their periodic future adjustment, and (2) the overall satisfaction level of public power regarding the broader based regional dialogue proposal, taken a whole.

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[1] The fact that there are no requirements to "waive" or "settle" statutory rights in the fallback proposal is not directly clear in the text of the Regional Dialogue Proposal, but was clarified in discussions with BPA Staff.

As discussed in Section III, a number of NRU's members are eligible for BPA's Low Density Discount. From a competition standpoint, the LDD helped to equalize the costs of utility service between public agencies in rural areas and the costs paid by residential and small farm customers in adjacent service territories of the IOUs. The LDD used to apply to Transmission purchases from BPA as well as Power products. Now it only applies to Power purchases, and the criteria for eligibility and determining the level of benefits have been tightened. Given current IOU benefit levels, we have many instances where the current cost of power is much lower in an IOU service territory than in a nearby public power system. These disparities need to be remedied. The remedy includes not only the benefit levels to the IOUs, but also the nature and application of the LDD for public utilities. We intend to pursue this issue both in the Regional Dialogue process, as well as subsequent contract negotiations and rate cases.

Because we are engaged in negotiations with the IOUs and BPA regarding the REP, it would be counterproductive for NRU to respond in detail to the financial levels and methodology BPA proposed in the Policy Proposal. In summary, the current REP benefits are excessive and are the result of a flawed methodology that individual NRU members and others from public power have challenged in court. Current contract payments are not an acceptable basis for future negotiations. While BPA supports $250 million beginning in FY 2012, the Agency's own data can be analyzed from other well reasoned perspectives that would produce a much lower number. Any methodology that is used needs to have a strong element of stability over time, and the BPA "ratio" approach appears to meet that test as long as it includes a reasonable proxy for all public power load growth.

BPA should consider some form of re-opener of the methodology for determining financial benefits that can be triggered if needed mid-way through the contract period. The circumstances that affect the overall value of BPA to the region can change significantly over time. All parties should have an interest in including a mid course correction to the methodology if needed.

In the event that a consensus is not reached during negotiations, NRU reserves the right to supplement our comments following the close of the comment period, or to otherwise advocate in all necessary forums for an outcome that is acceptable to our members.

Proposed Settlement Offer to Public Agencies

We agree generally with BPA that in order for allocation to work, public agencies with high cost resources will need to be eligible for an REP settlement comparable to the settlement offer provided to the IOUs. BPA proposes post 2012 that REP benefits would be available for public agencies based on a forecast proxy ASC above a $45 threshold (medium range forecast without Mid-Columbia resources in stack.) NRU cannot comment on the dollar threshold for public agency ASCs until we know the outcome of the benefit levels provided to the IOUs.

A few members of NRU participated in the construction of generation resources prior to the passage of the Northwest Power and Conservation Act in 1980, and pursuant to a BPA notice of insufficiency. These NRU public utilities members believe they are differently situated from other public utilities that built or acquired resources as a matter of choice after 1980, and not in response to a BPA notice of insufficiency. They may have continuing financial exposure in the event their project is terminated in the future as an environmentally unacceptable resource, but the debt service obligations will continue. We would ask that BPA review the more detailed comments of these NRU members carefully. BPA should strongly consider developing individually crafted settlement approaches for public agencies that developed resources prior to the Regional Act in the event that these resources are used in the future to serve utility load or are terminated.

The only way for an allocation to work is to have a settlement of public REP issues for any resources that have been developed, and then place all utilities on a common footing going forward where they can develop future resources as a matter of choice or select BPA Tier 2 products.

Section VI – Service to the Direct-Service Industries

Rather than making a specific proposal, BPA asks for general comments regarding service to the DSIs post 2011. BPA references the September 2005 Concept Paper, which proposed extending the FY 2007 – 2011 service construct with an overall cap of 577 aMW and $59 million. BPA cites various options, references the "Regional Employment and Economic Impact Study" of 2006, and calls for public meetings to discuss options.

NRU members understand that BPA as a Federal Agency is subject to receiving policy input both from the Administration and the Congressional Delegation. We recognize that the aluminum companies have had some success in Washington D.C., preserving benefits from the FCRPS after their 20 year contracts expired in 2001. BPA has no legal obligation to serve DSI loads, but for a variety of circumstances has continued to provide either power deliveries or financial benefits.

The DSIs have always pressed the "jobs" issue as a leading rationale for maintaining BPA power deliveries and/or financial benefits. Yet the August 2006 independent study performed for BPA concludes as follows: "*Should the plants close, in the long-term, given the resiliency of the regional economy there is no significant drop in regional employment and income.*"

NRU submits the following recommendations regarding service to the DSIs post 2011.

- There should be no physical delivery of power from the current FCRPS resources to the DSIs, nor should BPA make short or long term augmentation purchases on a rolled in cost basis charged to all customers to provide power to the DSIs.

- The current cap of $59 million per year in financial benefits to the DSIs should never be exceeded annually during the term of any future contracts. A lower cap would be preferable, including the option of no benefits.

- BPA has allocated the value of 577 aMW of surplus power among the DSIs as follows: Alcoa 320 aMW, Columbia Falls Aluminum Company 140 aMW, Golden Northwest Aluminum 100 aMW, and Port Townsend Paper Company 17 aMW. BPA permits shifting between companies during FY 07 – 11 if the full amount cannot be used. No shifting should be permitted post 2011.

Most NRU members would prefer that BPA terminate support to the DSIs at the end of the current contract period. Some DSIs are located in or close to the service territories of NRU members, and they would prefer to keep current good paying jobs tied to the industry. However, the Priority Firm Rate could be about $1/MWh lower without BPA financial payments to the DSIs. Our focus in the short term should be to contain the amount of financial benefits provided to each of the remaining plants, and not to further concentrate the support to the remaining few plants, even as they continue to face challenges of economic viability in an extremely competitive world market.

Section VII – Conservation

NRU agrees with the goals BPA identifies for conservation post 2011 – "*ensuring development of the cost effective conservation in the load BPA serves while keeping the costs and rate impacts of doing so as low as possible.*" Thus BPA should continue cost effective conservation within Tier 1. BPA references the Council-defined cost effective conservation targets. While the Council has the responsibility pursuant to the Regional Act to establish such targets, we would like BPA, in conjunction with its customers, to be proactive in working with the Council in setting goals for BPA post 2011. We would like to know if the proposed blend of BPA funded and self funded conservation programs, in conjunction with the likely Tier 2 price signal, is sufficient to meet the Council's target.

The movement to tiered rates should be a huge inducement to all BPA customers to actively pursue cost effective conservation. This will allow them to preserve as much lower cost Tier 1 power as possible to serve their net requirement. The portfolio approach with the following four components is acceptable: (1) rate credit, (2) bilateral contracts, (3) third party contracts, and (4) regional infrastructure support. We agree that BPA should try to "*improve*" the approach over time based on what the region learns. However, this should not necessarily translate into BPA unilaterally deciding to make greater financial commitments to conservation in the future.

As a matter of regional equity, NRU does not support BPA using Tier 1 funds to target conservation by utilities through "bi-lateral contracts." BPA suggested that "*depending upon circumstances*" it could develop financial incentives to assist in the development of conservation in lieu of the utility making more expensive Tier 2 purchases. While this may appear to be a public benefit in the limited context of fostering more conservation, it also represents an opportunity for a few utilities, most likely in the I-5 corridor, to forego some Tier 2 purchases, through a program financed by the rest of BPA's customers. Other regional customers may not have a retail base that is as attractive for aggressive conservation measures. Thus if Tier 1 is used to pay for such bi-lateral agreements, the financial benefits that accrue to participating utilities should go back to all Tier 1 customers, rather than the individual utility.

We have separately noted that for FY 2007 – 2009, BPA scaled back the emphasis on residential applications in the Conservation Rate Credit (CRC). For NRU members that have few commercial and industrial applications, this has meant they needed to turn to the renewable option in CRC. For 2007 this option was over-subscribed. If the CRC is to be continued as discussed in the BPA proposal, consideration should be given to a separate discount for conservation and renewables. This is especially the case given the increase in interest in renewable resources.

Section VIII – Renewable Resources

NRU supports BPA meeting the goals for renewables under the Northwest Power Act, and achieving them at the least possible cost. BPA identifies a goal for the renewables resource program of about 100 MW a year. BPA proposes spending up to $21 million per year as Tier 1 power cost on "facilitation activities" – not to reduce Tier 2 rates, but to encourage the development of new renewable resources. Unfortunately, the Policy Proposal does not address some of the key issues to Load Following customers regarding renewables. These key issues are identified below. NRU requests that the issues be addressed in the ROD and that the Agency discuss them with us in the interim.

Relationship of BPA Activities to State Renewable Portfolio Standards

Some NRU members in Washington State could be affected by passage of the renewables ballot measure, initiative #937. There also is the prospect of renewables mandates in Oregon and other states. Our concern is that a renewables resource portfolio mandate which increases over time may exceed the level of retail growth a utility experiences. In this circumstance, there is a potential for a utility to have to acquire renewable resources, from BPA or elsewhere, and effectively reduce what is otherwise their Tier 1 power available, given their HWM. Absent some revision, the Policy Proposal has unused HWM levels sold by BPA, with the resulting revenues used to reduce Tier 1 rates for all customers rather than the individual customer below their HWM. That is an unfair outcome and poor public policy.

NRU recommends that if load following utilities are legally mandated to acquire renewable resources such that they cannot fully purchase Tier 1 power under their HWM, then the revenues or losses associated with the resale of their residual Tier 1 power should be credited to the individual utility rather than all Tier 1 customers.

Hydro Resources Are Renewable Resource

BPA should aggressively pursue the increase in the generation capability of the FBS as a renewable resource. This should include both expansions of the generation output of facilities (for example new efficient turbine blades) or changes in river operations that expand the generation energy and or capacity of the FBS. BPA needs to be an advocate here on behalf of its customers in support of our renewable, clean energy supply. BPA should be aggressive in pushing for FCRPS expansions counting toward new renewable resources, regardless of the prohibitions contained in initiative 937.

Capacity Constraints for Wind Integration

BPA has not highlighted the potential tradeoffs between water generation as a renewable and wind as a renewable. In the discussion of Integration Service the document says "*BPA intends to use the flexibility of the FCRPS to provide cost based wind integration products for wind projects...*" The document expresses uncertainty regarding the flexibility of the FCRPS to do this, given pending litigation regarding the Biological

Opinion. We have observed in a variety of forums that the capacity availability issue is not yet resolved, and we support BPA's current studies to address it. While NRU endorses use of system capacity for wind integration products, our support is tempered by the need for assurances from BPA that the use of the FCRPS in this manner makes overall economic sense. In other words, the "*opportunity cost pricing*" that BPA proposed for charging for load following is very important. The cost of serving load following for requirements load should not be distorted from an embedded cost approach as a result of BPA moving too far to support wind integration services. Further, integration services supported by the current FCRPS should not be offered if they have the effect of increasing the cost or decreasing the availability of capacity or energy to BPA's Load Following customers.

Funding Renewables out of Tier 1

NRU does not object to funding the facilitation of renewable resource development by $21 million annually (plus inflationary adjustments) from Tier 1 power costs, as a component of new long term contracts and rate methodology. BPA discusses "*resource contingency planning*" as a safe middle ground strategy. Alternatively, NRU suggests that initially the agency be more aggressive in actually developing a fewer number of wind projects, with available capped funds, with the expectation that they will be purchased by customers beginning in 2012 and beyond to meet their RPS obligations. We would like to see a plan where BPA can eventually recover these annual capped investments in renewable resource development from Tier 2 purchasers.

Other Considerations

NRU agrees that certified renewable resources developed between July 2006 and 2010 should not serve to decrement a customers HWM determination in 2010.

Any renewable product that BPA offers will need to meet the various state renewable portfolio standards. This will be a challenge since RPSs vary from state to state. BPA and customers need to ensure that Green Energy Premiums (Green Tags) are eligible for meeting any RPS requirements.

Section IX – Transfer Service

In section IX of the Policy Proposal BPA acknowledges that 80 preference customers receive all or part of their Federal power through transfer service. This is a key issue because 32 of NRU's 53 members rely upon transfer service. We greatly appreciate the work BPA and its customers completed in 2005 for the 20 year Agreement Regarding Transfer Service (ARTS) with transfer service customers. That agreement in large measure provides equitable treatment regarding Federal power deliveries between those customers that are directly connected to the FCRTS and those served over non-federal transfer facilities. It also set the groundwork for addressing the delivery of Non-Federal power, which is addressed now in the Regional Dialogue proposal.

In subsection #5, BPA sets the appropriate policy framework for considering payment for delivery of Non-Federal power. *"Transfer service should not unnecessarily bias a customer to buy only Federal power to avoid the additional cost of wheeling over third party transmission facilities. Similarly BPA should not use transfer service as leverage to induce customers to buy Tier 2 power from BPA, if practical. This would be contrary to a fundamental goal of Regional Dialogue[.]"* NRU agrees wholeheartedly with this view and offers the following suggestions, modifications, or clarifications to the BPA proposal. While not explicitly stated in this section of the document, the only way this policy makes sense is if BPA is committing to roll these costs into the Tier 1 product cost. We request that the ROD contain such a clarification and that the Long Term Rate Methodology also address this matter.

Capping the Costs of Transfer Service of non-Federal Energy

NRU is willing to support BPA establishing an inflation adjusted cap for the transfer of Non-Federal energy. BPA has proposed 30 MW or $800,000 each year, not to exceed 600 MW or $16 million "*for the term of the Regional Dialogue contract*." Our understanding is that the 30 MW and $800,000 basically represents a current snapshot of what would happen during a year if all of the transfer customers took their BPA estimated load growth and covered it with Non-Federal power.

Initially that looks like a reasonable offer. However, over a 20 year period the value of $800,000 declines to about $480,000 using an inflation rate as measured by a forecast of the implicit price deflator of 2.5% per year. There is also a concern that over time the costs of the transfer service for the wheeling transferors may rise faster than the rate of inflation. Therefore, there needs to be some form of periodic adjustment clause to the dollar amount to at least offset the impact of inflation.

The BPA recommendation seems to be premised upon FCRPS resources continuing to be available, and the HWM of the utility remaining relatively stable. This may not necessarily be the case. For example, consider a situation in which the Columbia Generating Station has to shut down, or the firm hydro-generation capability is significantly reduced as a result of court ordered actions regarding fish mitigation. In

those situations the issue is no longer load growth, but rather replacement of power that has been reduced from the historic Tier 1 amount. The 30 MW for load growth is a reasonable cap, but BPA should also include a category of additional MW for the transfer of Non-Federal power for the replacement of "lost" FCRPS resources above a threshold amount.

Relationship Between High Water Mark and Pooling

The BPA document states that "*Non-Federal resource deliveries that BPA would financially assist are those used to serve a customer's net requirement load beyond the customer's HWM amount.*" As a general matter, we understand the rationale for this approach. However, it may conflict in situations where utilities decide to pursue pooling, operationally, within the guidelines that BPA appears willing to establish. That is to say, each utility in an eligible pooling group will have a high water mark set by BPA annually. They would then have the ability to assign amounts of both Federal and non-Federal power between the utilities during the year, for the purpose of reducing transmission constraints. In these situations there is the potential for some utilities to be receiving non-Federal power in amounts that are greater than the difference between the customer's HWM and net requirement load. BPA needs to provide sufficient flexibility in paying for non-Federal resource delivery to allow utilities that are otherwise eligible to pool their resources.

Payment for Delivery of Non-Federal Power

For purposes of limiting non-Federal resource deliveries that would be eligible for financial support, BPA lists 5 requirements. NRU objects to criteria "d" that would limit eligibility only to cover points of delivery of the transfer customer's service territory that existed as of October 1, 1996. If any limitation is imposed for PODs, it should be as of October 1, 2011 rather than 1996, but it is unclear why a limitation is necessary. A retroactive application is simply unfair.

The document goes on to state "*If firm transmission capacity is not available between the third-party transmission system, or the FCRTS, and the customer's load area, BPA may consider other options on a case by case basis.*" NRU members in Idaho and Nevada are part of the South Idaho Exchange, and NRU members in Nevada are also part of the Sierra Pacific Power Co Exchange, and they do not technically meet the 5 eligibility requirements listed in the BPA document. BPA transmission service is simply not available. As a result, BPA will need to continue an "exchange" or some other comparable means as a substitute for transfer service for these customers. Transfer customers participating in the South Idaho and Sierra Pacific Exchange, or any other similar arrangements BPA has in place, need to have the same financial benefits and operational flexibility as the customers receiving power deliveries through transfer service.

Some NRU members are considering non-Federal resources where, given the transmission path, the power never directly touches the FCRTS. As such these customers

technically may not meet the eligibility requirements for financial support in BPA's criteria for payment of Non-Federal power delivery – subsections "b" and "c". Our initial understanding from discussions with BPA is that such loads would not receive financial support, and that this would represent comparable treatment to all other customers. We disagree. While BPA may technically be correct, such an application is counterproductive to the overall BPA goals stated earlier in this section. Because the South Idaho and Sierra Pacific Exchange represents a unique set of circumstances that needs to be resolved on a "case by case" basis given the lack of available Federal transmission, similar exceptions need to be made to "subsections b and c" when the delivery of non-Federal power does not touch the Federal system. We request that BPA reconsider its position and are encouraged by BPA's recent discussions of this matter with South Idaho customers.

Transfer Service for Annexed Load

We are willing to support a cap applied to transfer service for annexed loads. The cap should be no lower than the 50 aMW for each rate period and 250 aMW for the term of the contract for transfer service for annexed load as BPA proposed.

The recommendation that the customer pay all costs if the transfer service cost is $7/MWh or above seems rather abrupt. The customer has no ability to control the costs that may be imposed by a third party transmission owner. BPA has not provided a satisfactory explanation for how this number was derived. BPA should either eliminate the provision or agree to pay the costs up to a $7MWh level with the customer paying any incremental amount above that level.

Other Provisions

NRU agrees with BPA that the Agency should not be making decisions in the Policy Proposal regarding who should hold the transfer contract with a third-party transmission provider. That issue may be addressed in other forums.

NRU agrees that BPA should add necessary staff to implement ARTS, whether the cost is $500,000 annually or another figure unknown at this time. Given all of the other changes in BPA activities tied to the Policy Proposal, it appears rather inflammatory to highlight this one area of the proposal with a specific cost estimate. In any event, ARTS implementation costs should not be directly assigned to transfer service customers, but should be rolled into the overall cost of transmission service so that directly connected customers to the FCRTS and those receiving transfer service are on a comparable basis.

Section X – Resource Adequacy

NRU agrees with BPA that it is appropriate for the Agency to address the issue of resource adequacy as a component of the Policy Proposal. In this proposal, BPA's obligations to serve load growth on a "rolled in" cost basis are revised, tiered rates are proposed, and utilities have the ability to acquire resources. This raises the question of the need for regional resource adequacy standards, the particulars of such standards, the enforcement authority for the standards, and whether it is appropriate and necessary for BPA to prescribe how such standards might be imposed through new power sales contracts. While BPA attempts to describe an approach to resource adequacy where mandatory standard compliance provisions are not the preferred choice, contractual standards are not ruled out. The following are NRU's concerns regarding BPA's approach to resource adequacy.

BPA's Legal Obligation to Serve Loads

BPA asserts that the Agency "*would not be the short-term supplier of last resort, if a customer fails to secure resources to meet its load growth through a Tier 2 rate power purchase, or through procurement of non-Federal resources.*" This statement is puzzling to us because BPA has a statutory obligation to serve the actual net requirements of public power's load following utilities. We are not disagreeing with reasonable notice provisions for the Tier 2 purchase alternatives described on page 28 of the Policy Proposal. Nor are we interested in having a utility come into the Tier 2 product "pools" on short notice, thereby causing the cost of Tier 2 products to be potentially higher than otherwise necessary to the customers that selected the product with adequate notice. However, as a last resort, BPA should have an obligation to provide power to a utility on shorter notice, priced for that utility based upon the actual full cost of providing the power, thereby causing no financial impact on other customers. By implication, the rate for this service may be significantly higher than other Tier 2 products. BPA has a history of providing this type of service, and charging higher rates for it.

BPA's suggestion that a utility might "fail" to meet its load growth, and that BPA would then refuse to assist that utility in meeting its net requirements, seems harsh, and unrealistic. Utilities should be encouraged to explore all choices for Tier 2 power supply. We don't have assurances yet that transmission will be available in all cases, or reasonably priced, so that utilities can plan for the delivery of Tier 2 power supply options with certainty. Some generation projects that look good may simply prove financially infeasible, or may produce less than the forecasted amount of energy. In these instances BPA needs to serve as a "backstop" or supplier of last resort to a utility potentially left short, while charging that utility the full cost of such service. Having the lights go out, or dimmed, at the local utility level is not an acceptable option. We expect the cost of this service to be sufficiently high to act as a deterrent to utilities failing to address their power planning responsibilities.

Potential Mandatory Compliance Standards in Power Sales Contracts

In general the Policy Proposal does not include specifics as to what features may be included in the long term power supply contracts. However, for resource adequacy, BPA raises the prospect of a mandatory standard compliance provision in contracts if the Regional Resource Adequacy Forum fails to reach a consensus on a resource adequacy standard and implementation approach by the publication date of the Long Term Regional Dialogue Policy and ROD. Because BPA is not making a specific proposal here, we cannot comment on any particulars, other than to say that we do not agree that BPA has the clear authority and the business necessity to impose mandatory standards in contracts.

Resource Adequacy Proposal

Assuming that resource adequacy standards and an implementation approach are completed before contract negotiations begin, NRU has the following comments regarding BPA's *"limited contract and rate provisions."* We have no objection to providing data on a confidential basis to a neutral third party for regional resource adequacy assessments. We agree with BPA that load following customers purchasing all of their power from BPA should be exempted. We agree that power supply contracts should clearly delineate whether BPA or the utility would have the responsibility for serving load growth. As discussed above, we disagree with BPA's proposal that BPA would not be the short term supplier of last resort if the customer has not secured an alternative resource.

Regional Resource Adequacy Forum

BPA's Policy Proposal makes references to ongoing work of the Regional Resource Adequacy Forum. This includes links to a resource adequacy energy metric and target, and a capacity metric. There is a tentative discussion of one implementation option that can be implemented *"without trampling on the prerogatives of utilities or states."* NRU will not respond here to the particulars of any "metrics" for measuring adequacy. That would be better done in other forums, and in conjunction with the balance of public power. The Forum represents work in progress, and it would be premature to comment on alternative approaches until they are more complete. We agree that any guidelines for translating regional metrics and targets for utilities should be non-binding. The statement that we need *"development of incentives for developing adequate resources"* is very broad based and needs further clarification before any meaningful response can be given.

Section XI - Long Term Cost Control

In this section BPA considers three alternative approaches for long term cost control. These include a Regional Cost Review (RCR), a Cost Management Group (CMG) and inclusion of cost levels in BPA rate cases. Following an assessment of alternatives, the Agency recommends the Regional Cost Review. BPA also proposes dropping the feature of Contract Off-Ramps from further consideration based upon limited customer support.

BPA Discussion of Cost Control is Too Limited in Scope

The Policy Proposal focuses entirely on what customers anticipate to be the components of costs associated with the BPA Tier 1 product. In other words, it is a discussion of the controlling costs of BPA power from the current FBS generation resources and the accompanying social costs that are built into Tier 1 service. In a discussion of tiered rates on pages 29 – 30 of the Policy Proposal, BPA lists "other costs" that are built into Tier 1 service, which include REP costs, public benefits (fish and wildlife), conservation, renewables, certain power purchases, new public customers, GTA costs, DSI cost, LDD, and Irrigation Mitigation. BPA essentially argues that there are many potential interests groups that have a stake in the Tier 1 product, and none of them would likely want to be excluded from a Cost Management Group. Therefore a Regional Cost Review is BPA's preferable mechanism.

BPA's analysis and conclusion is understandable, but only in the context of the Tier 1 product. A fundamentally different approach is required for Tier 2 products, and is discussed below. The Policy Proposal, however, makes no distinction between Tier 1 and Tier 2 product cost control.

Cost Control for Tier 1 Products

NRU members and the NRU staff have participated in every effort BPA has initiated in recent years to control or explain costs; we have three members currently serving on the BPA supported Customer Collaborative. From a customer perspective, a properly designed Cost Management Group has advantages over a Regional Cost Review. However, based upon previous discussion and experience, it would likely be impossible to reach a broad based regional agreement regarding the size of a CMG and the proportionate representation between various stakeholder groups. NRU is willing to work in the context of a vigorous Regional Cost Review, and with an assumption that the Customer Collaborative, or a similar mechanism limited to customer stakeholders is continued.

NRU is keenly interested in ongoing mechanisms to control costs for the Tier 1 product. While we do not believe that inclusion of cost levels in BPA rate cases is an entirely effective mechanism to control costs, some structured forum with sufficient opportunity to fully explore the factors and the decisions of various entities driving FCRPS cost increases is critically important. We fully recognize the big drivers of BPA's cost increases are outside the immediate unilateral control of BPA. These include fish and

wildlife spending levels, changes in revenues tied to river operations pursuant to biological opinions and court orders, and the actions of other agencies that rely upon BPA for financial support. Of course, BPA financial choices regarding capital financing and overall financial policies also impact rates. They are within the Agency's control. All FCRPS costs are amenable to development or revision in separate processes involving customer consultation in advance of rate cases, rather than folding them into a rate case along with all of the other rate case issues. An example of this is the recently proposed Memorandum of Understanding regarding BPA's approach to financing for the Debt Optimization Program.

We support effective mechanisms over the course of the contract for customers to be involved in decisions over BPA cost levels, whether they are direct costs of the Agency or costs passed on to BPA by other agencies. Additional work needs to be done regarding this topic. One approach does not necessarily work for all of the functional areas involving significant costs. For example customer involvement in the level of spending for a Regional Council approved Fish and Wildlife Direct Program budget may need to be different than customer involvement in FCRPS renovation projects where BPA provides financial support to the Corps of Engineers. We need opportunities to influence these costs, and to make a case to the Administrator before commitments are made that are subsequently rolled into a rate case. Equally important, customers will need to know the extent to which they have future contractual rights to dispute costs, and the forum for resolution.

Cost Control of Tier 2 Products

The BPA policy paper sets out an approach where there is an intended "financial wall" between Tier 2 and Tier 1 costs, and BPA will only turn to Tier 1 to recover a financial loss in Tier 2 service as a last resort, if needed to make a Treasury payment. This raises the question of the extent to which utilities that sign up for Tier 2 power might face a disproportionately high level of risk in the event that a BPA power acquisition within Tier 2 goes bad financially, or other utilities that signed up for Tier 2 are unable or unwilling to take the power that was forecast and purchased on their behalf.

For the Tier 2 products, BPA should not have the range of social policy stakeholders that are linked to the Tier 1 product, because those costs and benefits are basically all assigned to the Tier 1 product. The fundamental question here is the extent to which BPA wants a robust Tier 2 business product line that is responsive to the needs of the customers, including assurances of vigorous cost control. This should include sufficient involvement by the customers in the planning, development, and operation of resources and financial risk assignment within the Tier 2 class, or the sub classes within Tier 2. For example, within Tier 2, does a customer that signs up to twenty year Tier 2 service have a financial obligation for any cost control issues stemming from a different Tier 2 product that experiences difficulties recovering sufficient revenue to cover costs?

While the answer to these types of questions will likely be deferred to contract negotiation and future product design, the basic point is that BPA has to offer the

customers that sign up for Tier 2 a different and much more encompassing role in cost control than the basic package that BPA identifies for Tier 1 service. We look forward to working with BPA to continue to address this issue.

Section XII – Dispute Resolution

Summary

To implement the Regional Dialogue Proposal, BPA proposes a long term rate methodology that, by its terms, will not change for 20 years, except in instances when the agency cannot otherwise recover its costs or when the agency is required by court order to make a change. BPA states that customer contracts should provide a guarantee against specified changes to the rate methodology and should contain binding processes to enforce the guarantee. Changes to the rate methodology should be undertaken in a traditional rate case, although the hearings officer will be empowered to decide whether a rate methodology change is contractually permitted. (p. 83.)

BPA then addresses treatment of individual elements of the overall proposal, including a customer's HWM, changes to the HWM, net requirements determinations, Tier 1 and Tier 2 cost assignment issues, cost migration issues, and Tier 1 Resource Size. Certain elements of the Policy Proposal, such as HWMs, will be identified both in the rate methodology and afforded a contractual lock. Other matters, such as net requirements determinations, Tier 1 and Tier 2 cost categories, Tier 1 Resource Size, and rate methodology implementation disagreements, would remain essentially administrative determinations, although the contracts or rates methodology could identify processes for policy and factual resolutions necessary to resolving disputes. (pp. 84-86.) Regarding cost migration, BPA proposes establishing a "necessity test," in both the rate methodology and contracts, which would need to be satisfied before BPA could recover Tier 2 costs from Tier 1 rates. (p. 86.)

NRU supports the approach presented by BPA in Chapter XII. BPA basically proposes to secure as many elements of the Policy Proposal in a long-term rates methodology and in contracts as possible, to identify and describe conditions under which the Policy Proposal's commitments cannot be kept (court order and cost recovery), to identify the kinds of dispute resolutions that fit under applicable policy and factual circumstances, to seek third party neutral or independent review of BPA decisions, and to maintain open processes. NRU believes that, if implemented appropriately, the construct goes far towards achieving a power supply future that is reasonably predictable, reasonably transparent and reasonably stable. In particular, the dispute resolution proposal is a useful roadmap to implement the necessary rates, contracts, and policies so as to achieve the long term stability of the Policy Proposal.

NRU's Interests

NRU supports the broad goals expressed in the Policy Proposal to achieve a new power supply role for BPA, which begins with a long term contractual assignment of existing Federal power system benefits to the agency's public power customers and includes a clear segregation of costs between Tier 1 and Tier 2 resources. NRU reviewed the dispute resolution section of the Policy Proposal with two primary objectives in mind.

The first objective is to achieve as much stability in the long term policy approach as can be achieved within BPA's statutory framework. Stability, however, is entirely dependent upon whether the contracts, rates, and policies BPA devises to achieve its policy goals are transparent to customers and legally sustainable over time. Clear and viable dispute resolution processes are a key component of enforcing "the deal" expressed in these contracts, rates, and policies, and therefore are key to achieving NRU's stability objectives.

NRU's second objective is to avoid the inter-customer contentiousness caused by poorly defined (or misinterpreted) dispute resolution procedures in the Slice Agreements. It was a surprise to NRU and its member utilities to discover that the Slice Agreements could result in substantial potential cost shifts as a consequence of a private arbitration to which BPA's other affected customers could not be present. NRU therefore seeks dispute resolution procedures that are, as much as possible, open to any BPA power customer who may be affected by a resolution of the dispute. We specifically note and support the new dispute resolution process contained in the settlement of the Slice litigation, and believe it holds much promise for broader application in the new long term contracts.

Specific Comments

BPA's dispute resolution processes for the tiered rates construct identify significant areas for contract language development and negotiation. According to the Proposal, the post 2011 power sales contracts must address: (1) guarantees against specific changes in the rates methodology, (2) contract processes to enforce the guarantee against changes in the rate methodology, (3) dispute resolution approaches related to at least five particular issues raised in making net requirements determinations, (4) processes for changing a customer's HWM, including four separate processes for resolving disputes related to the matters identified on page 85, and (5) a "necessity test" hurdle involving the use of a third party "neutral" for when Tier 2 costs may be recovered from Tier 1. It appears to NRU that the contract drafting necessary to achieve these important aspects of the Regional Dialogue construct will be both substantial (in terms of the resources that will need to be brought to the task) and of great significance to customers.

However, in Chapter XIII of the Policy Proposal, BPA states that it will create standardized Regional Dialogue power sales contracts and that only limited bilateral negotiations will be available, an approach that BPA used in Subscription. (pp. 90-91.) NRU has no quarrel with standardized contracts, and indeed supports maximum contract standardization. However, when Chapter XIII is read together with Chapter XII, it is apparent that there will need to be customer involvement, perhaps substantial involvement, in developing the rate and contract guarantees and dispute resolution approaches that were identified for the Regional Dialogue power sales contracts in Chapter XII. BPA's Chapter XII roadmap is the right approach to achieving the stability NRU seeks from the Policy Proposal, but the details should be developed with substantial customer input.

NRU urges BPA to convene a group of attorneys to assist in developing contract language to implement the Chapter XII roadmap. The results of that group's effort should inform and be reflected in the first prototype contract templates, prior to general public review.

Section XIII - New Long Term Contracts

BPA proposes that power service for all Regional Dialogue Contracts begin on October 1, 2011. This is consistent with the views expressed by BPA's customers in the Regional Dialogue workshops, and NRU supports this approach. Having some customers begin service earlier under new contracts while other customers start service in October of 2011 would increase an already complicated situation even further. Rate cases would have to address different contract rights and pricing mechanisms, and contractual relationships would be difficult for BPA and the customers to sort out. For example, one customer group that is guaranteed the lowest Priority Firm rate through FY 2011 might find it objectionable if BPA offered service under new contracts to other customers before 2011 if the contract change had an effect on the Priority Firm rate. BPA is making the correct proposal here.

With regard to duration of contracts, NRU has stressed the need to develop long term contracts for power service from the agency. Long term contracts are important to provide planning capability and as much certainty as possible in the future for our members' base power supply and load growth responsibilities. A shorter contract period would mean that we would be facing a "cliff" with regard to these issues likely before 2021, and staggering contract durations is not a viable option. Historically such cliffs have been viewed as distasteful for purposes of effective regional planning. We agree with BPA that 10 year contracts do not have the same advantages as 20 year contracts regarding infrastructure development and securing capital funding commitments. We believe that the effort we are devoting now will be better spent on twenty year contracts as opposed to a shorter term contract. A resumption of work on this topic five years after the contract effective date as is currently the case for contracts beginning in 2011 would be a poor legacy.

NRU worked with BPA to explore all viable ways to achieve as close as possible a twenty year contract starting October 1, 2011. Unfortunately, we have only been able to find ways to extend the contract to September 30, 2027, if contracts are signed in April of 2008 as planned. We suggest that BPA and its customers continue to work to find ways, if possible, but short of legislation, to extend these contracts for a full twenty years by taking advantage of any opportunities that may subsequently arise between now and the date of contract signing. It is also important that the new contracts, regardless of their duration, contain provisions that "roll over" key features to new contracts. For example, BPA should offer in successor contracts a general prohibition against accelerating debt payments as in the current contracts.

NRU supports the contract development process described by BPA. This would include the development of standard contract proto-types using as much material from the currently effective contracts as possible. BPA would then negotiate those issues unique to each customer *or customer class* with the effected customers. To the extent that BPA is developing broad based templates that will be used as a prototype for each of the basic products, this needs to be done in an open process where any interested customer group can attend and constructively participate. There are many elements of the current

contracts that have worked well for customers and can be used in the new contracts. Of course there will be areas where new contract language is needed, for example the role of the HWMs and the ability to bring resources to serve Tier 2. Considerable effort will be needed in these areas, so the use of as much material as possible from the existing contracts makes sense.

We also support the "one contract" approach for both Tier 1 and Tier 2 service. This would seem particularly useful to BPA and other customer groups that are interested in limiting BPA's financial risks associated with the Tier 2 business line. One contract provides greater recourse to the Agency in the event that there is a problem with a specific customer regarding a Tier 2 financial commitment.

Section XIV – Fallback Policy Proposal

The Importance of Regional Consensus

The members of NRU agree with BPA regarding the importance of reaching a regional consensus in order for the new long term contracts to proceed without the distractions of ongoing fundamental disputes over the distribution of FBS benefits. In the limited time remaining before contract signature, load following customers are anxious to move forward to gather information, analyze power supply and transmission options, and plan for their resource futures accordingly. They need greater certainty about what to expect regarding future power supply and the likely cost of that power supply. The region needs to work together in a cohesive manner so that the resource choices for all types of customers in the different geographic sectors of the Northwest are as broad based and cost effective as possible.

For these reasons, NRU supports the "base proposal" contained in the Policy Proposal. While the BPA "fallback proposal" may have either short- or mid-term financial appeal from the load following customers' perspective, those benefits need to be held in abeyance in the pursuit of a more comprehensive regional strategy. In the long term an acceptable regional strategy for FBS benefits should provide even greater value to the NRU members by creating a more positive working relationship with other potential business partners.

According to BPA, the key to forging a regional consensus is an agreement between public power, the IOUs and BPA regarding benefits for the residential and small farm customers of IOUs. In that regard, NRU is currently attempting to try to reach a settlement involving financial benefits only, that is equitable, durable and legally defensible. Conversely, we do not believe that a durable agreement involving the DSIs (if any) will be reached, and BPA should not consider DSI agreement as a necessary prerequisite for regional consensus.

Moving Ahead Lacking a Regional Consensus

Taken as a package, the seven "modifications" to the Policy Proposal contained in the fallback proposal would, as BPA states, "*likely result in lower Tier 1 rates and earlier certainty about load obligations.*" From the overall perspective of load following customers, this is an attractive proposition. But it also needs to be balanced with a projection of each utility's likely change in high water marks.

In this section BPA proposes to determine HWMs in 2007, using a simplified process and/or historic data, without a later true up. The procedure by which BPA would do this is unclear. NRU proposes that under the fallback, BPA base the HWMs on a forecast done in 2007 of 2010 loads and 2010 Subscription contract resources (as adjusted for the Grant PUD sale.) A true up in 2011 would still be appropriate under these circumstances and would not lead to undue uncertainty.

We also recognize that utilities that own generation resources and the four previous public power owners of Centralia would be further affected by the fallback proposal. Whether they find the fallback proposal acceptable as a matter of policy and how they are effected financially, are matters of interest to NRU. We look forward to reviewing their comments. If it is necessary to invoke the fallback proposal, BPA proposes that it not change its treatment of the Centralia Coal Plant previously owned by four public utility districts from the approach now taken in their firm resource exhibits. If BPA diverges from this element of the proposal, NRU requests that BPA augment the system to make up for any increases in HWMs that are conferred upon these utilities.

While we are not commenting on each of the other modifications contained in the fallback proposal, and are generally considering them as a package, it is important to repeat our objections to the suggested treatment of the DSIs. As stated previously, the NRU membership, with a few exceptions, does not support continued BPA payments or power supply for the DSIs. BPA's fallback proposal does not appear to have any negative consequences for the DSIs compared to the base proposal. If Tier 1 power is less expensive in the fallback, as BPA postulates, then it is difficult to comprehend why the DSIs would be motivated to try to advance the base proposal. BPA should address this issue.

In summary, NRU supports the base proposal, assuming that a list of public power identified problem areas can be successfully resolved. In the event there is not support for the base proposal, then on balance the fallback proposal is perceived for the NRU membership as a whole to produce a comparable or marginally better allocation of cost based Tier 1 power at a lower cost (i.e. no Centralia, no 300 aMW augmentation, and no new publics.)

From the perspective of load following customers, there are a number of areas in the base Policy Proposal that need fixing, clarification, sequencing and scheduling adjustments, etc. These issues must be resolved to the satisfaction of NRU members, the balance of public power, and with BPA's concurrence. If that is not the case, then the Policy Proposal unravels.

Key outstanding issues for NRU include the design of the Tier 1 and Tier 2 energy products, the relationship to capacity and Load Shaping Charges, the tiered rate design methodology and cost segregation, the availability of comparably priced transmission for non-federal power, and a workable dispute resolution process. While the details need to be hammered out in subsequent rates and contracts forums, we need to know if BPA and customers are aligned at a conceptual level in these important areas. That high level agreement needs to be reached prior to the issuance of a BPA Regional Dialogue ROD. NRU stands ready to work with BPA, and other representatives of public power to address these issues.