WMG&T
Regional Dialogue Comments
October 31, 2006

Introduction

The seven members of Western Montana Electric Generating and Transmission Cooperative, Inc. (WMG&T) are all net requirements customers of BPA who serve over 100,000 member/owners in western Montana. Six are served under pre-Subscription Hungry Horse Reservation contracts and four are served all or in part over GTAs. The majority of our members' load is residential and small commercial, with some urban and industrial loads.

The members of WMG&T have actively participated in discussions over the future of Bonneville since the Governor's Comprehensive Review a decade ago. We support the general direction of the Regional Dialogue proposal as the embodiment of that original recommendation.

In particular, the WMG&T members:

- Support the concept of utilities taking more responsibility for their own resource decisions;

- Agree with Bonneville's effort to incorporate the PPC allocation proposal into this document; and

- Agree that time is of the essence and that further delay will only frustrate the successful implementation of this proposal.

The Bonneville staff has done an excellent job of encouraging a dialogue regarding the elements of the proposal. This is an extremely complex proposal with a multitude of details. The Bonneville staff has actively encouraged a lively conversation with the customers and have been receptive to alternative ideas and approaches.

These comments are organized into three areas: first priority issues that must be addressed immediately; implementation issues; and content issues. The lines between the first priority, implementation, and content issues are not firmly drawn, but driven primarily by timing. Additionally, we continue to gain considerable insight into the details of the proposal as it has been clarified by Bonneville.

There are three first priority issues: the use of Federal Base System (FBS) flexibility to provide load following products to preference customers; the need to get greater clarity and coordination on transmission issues; and the need to engage with IOU representatives and the public service commissions on the issue of IOU benefits.

First Priority Issues

Use of FBS Flexibility

WMG&T members are concerned about the uses of system flexibility and Bonneville's ability to provide load shaping to preference customers, without additional costs from BPA market purchases for flexibility resources. This issue needs further discussion and analysis.

There is a huge potential for additional demands on FBS flexibility beyond the needs of preference customers for shaping products. For example, calls for additional wind integration could increase with the renewable portfolio standards already in place in Montana and those being contemplated in Oregon and Washington. Regional reliability standards may also increase demands on FBS flexibility. The potential for additional flows for salmon, which would decrease existing flexibility, already caused Bonneville to halt its previous wind integration product offering.

Power sales under the Northwest Power Act to preference customers include capacity. Section 5(b)1(A) of that law describes the Bonneville Administrator's obligation to offer to sell electric power to requesting utilities whose loads exceed their firm peaking and energy resources. The Congress clearly intended that energy and capacity were preference products of the FBS.

The members of WMG&T believe that antecedent to any sales of wind integration products or other products of FBS flexibility, BPA must assure preference customers that:

1. The flexibility of the FBS is being reserved for them in sufficient quantities at the cost of the existing FBS so as to prevent BPA from having to make market purchases in order to meet other obligations of a lower priority and charging these costs to the existing preference customers;

2. Sales of FBS flexibility to non-preference customers or to meet the non-net requirements purchases of preference customers will contain recall provisions to meet the obligations of preference customers; and

3. Any sales of shaping to preference customers must be made on cost-of-service based principles, not opportunity cost of service based pricing.

We strongly support a regional discussion of existing FBS flexibility, including a delineation of all demands placed on that flexibility and a greater understanding of exactly how Bonneville intends to show its prioritization of these flexibility demands is meeting both the Power Act and other preference requirements.

Greater Clarity and Coordination on Transmission Issues

There is far too little discussion of transmission issues in the Regional Dialogue paper and the Transmission Services (TS) has been conspicuously absent from the discussions to date. The result is that while the region may be developing the best alternative from a power perspective, without adequate transmission capacity or appropriate transmission policies in place, the entire plan may be unworkable.

For example, the recent TS public meeting to discuss NT contracts turned up numerous challenges with implementing exactly the type of structure for Power Services' sales that are included in the Regional Dialogue paper. If a customer with an NT contract wants to obtain a non-federal resource, depending on the size of the resource and the system impact, it may require the customer to seek additional ATC or even face the inability to receive Bonneville service for the load. Since the majority of Bonneville's preference customers are served via NT contracts, this is a huge issue.

The proposed changes to the customer served load (CSL) policy will also have a chilling effect on resource acquisition by customers. Although this issue has yet to be resolved, it could force NT customers to pay transmission costs for load that is served from a non-Bonneville source and never touches a Bonneville transmission facility. The point is that this issue is as yet unresolved and at least one of the potential outcomes could be to double-charge on transmission for non-Bonneville resources a customer may pursue.

The TS needs to immediately be brought in to these discussions and all transmission issues affecting the Regional Dialogue and customer development of non-federal resources must be addressed concurrently with the Regional Dialogue policy development.

IOU Benefits:

Bonneville's paper strongly encourages the public utilities and the IOUs to get together to settle the issue of how much money the IOUs should get from Bonneville. Bonneville also provides a "settlement" figure of $250 million/year in the event that the two parties are unable to reach agreement.

First, we find the $250 million/year figure lacking in substantive foundation and ultimately not helpful in furthering the likelihood of settlement. The $250 million/year number was apparently seen as the "middle" of a data set that ranged from $0 - 330 million/year. Additionally, by creating an unreasonable expectation as to the outcome of the negotiations, it has made those discussions that much more difficult.

Second, and potentially more important, the public service commissions must be made to realize that the lack of a settlement and the return to average system cost determinations by Bonneville carries substantial risk for IOU residential customers. The impact of an equitable and complete 7(b)(2) rate test would likely push those IOU benefits significantly below both the current level of benefits and the $250 million/year Bonneville has suggested. Without a realistic view of what IOU benefits might be under the traditional ASC calculations, the public service commissions are unlikely to be willing to support a settlement that can be agreed upon by all parties.

Finally, although to date settlement talks with the IOUs have failed to generate an agreement, WMG&T remains willing to continue to participate in those talks.

Implementation Issues:

Process Sequencing

Our concern is that Bonneville customers will have to make decisions and obligate themselves (or not) to products that are yet-to-be-defined and/or without prices. There needs to be a better coordination between resolution of issues and the pricing of products before customers can be expected to sign new contracts and commit to resource purchases.

For example, according to the proposal, Bonneville will require a 3-year notice for Tier 2 purchases. This will obligate a utility to decide whether or not to purchase Bonneville Tier 2 power well in advance of actually knowing what the price of the Tier 2 power is. Short of an indexed price, which generally comes with collars to protect both parties, no other power supplier we are aware of would require such an open-ended commitment.

More attention needs to be placed on the sequencing of events based upon the decisions that individual utilities will have to make, and considering the alternatives available to them.

Cost Control

The Bonneville proposal indicates that instead of cost recovery adjustment clauses (CRACs) with defined trigger mechanisms, the agency is interested in pursuing true-up mechanisms for all rates. We prefer CRACs and are predisposed against true-up mechanisms for several reasons. First, true-up mechanisms have proven to be highly controversial, pitting one customer group against another. If the goal is to increase harmony between customer groups, a series of true-up mechanisms will frustrate that effort.

Second, true-up mechanisms, unless they are very carefully crafted, can be vehicles for financial mischief. The experience with the current Slice true-up has been increased customer acrimony, the necessity for expensive audits and financial reviews, and ultimately litigation. There is the feeling on all sides that this is not a mechanism that has worked at all well.

Third, true-up mechanisms are unlikely to lead to better cost control. This approach is essentially a mechanism for financial absolution once the budget levels are set. If those budget levels are exceeded, the true-up would trigger to cover the difference. This approach also provides additional incentives to those who desire to increase Bonneville's spending on their pet programs.

True-up mechanisms have caused increased customer acrimony and appear to be an inferior cost recovery alternative. We are not supportive of them.

Dispute Resolution/Contract Enforcement

The combination of the various requirements to forego opportunities to legally challenge aspects of the Regional Dialogue proposal, the question of what constitutes a policy change versus an interpretation, and the question of available remedies all cause us some degree of hesitation regarding this proposal. Pending further legal review and policy discussion, we reserve comment on the elements of dispute resolution and contract enforcement. However, we are concerned about the impact of the combination of these elements in the event there is a dispute about what the contracts say or how they are being implemented.

Content Issues

Determination of the HWMs

The members of WMG&T support the proposed method for determining high water marks (HWMs) as described in the paper, including the proposed changes from the PPC proposal. One concern has arisen, however, regarding the expiration of existing non-federal power purchase contracts after the FY2010 date for establishing the HWMs. In several cases, WMG&T members have non-federal contracts that expire after the FY2010 date and that are outside their control. These two factors could lead to a situation where these utilities find their HWMs, which will be based on FY2010 actual net loads adjusted for force majeure events, decremented for resources that will shortly disappear. We want to discuss with Bonneville what alternatives exist for these utilities who face resource expirations past the FY2010.

Load Loss and Decrements to Tier 1 Service

In the event a utility purchasing both Tier 1 and Tier 2 service suffers a load loss within a rate period, Bonneville's proposal would decrement that utility's Tier 1 purchases. This proposal appears to result from a concern that decrementing Tier 2 purchases would cause rates for those products to be unstable. How a utility would react to a similar load loss that extends beyond a rate period depends in part on the contract provisions surrounding their Tier 2 purchase. Under the current Bonneville Tier 2 proposal, changes in Tier 2 service would require at least 3 years notice. This approach appears to unfairly punish a utility by decrementing its cheapest power source first.

An alternative to this approach is for Bonneville to offer another Tier 2 product based upon short-term market purchases. A utility could agree to purchase some amount of this short-term product and have it decremented first in the event of a load loss. If the load loss were greater than the short-term purchase, Tier 1 purchases could be subsequently decremented. This approach allows the utility to determine what load loss risk it faces and act accordingly by increasing or decreasing the amount of short-term Tier 2 purchases it makes.

Operational Pooling

Although the draft proposal says that there will be no pooling of HWMs, Bonneville staff has stated during clarification that they do not object to the concept of operational pooling. As it was discussed at clarification, as long as a group of utilities that wish to pool do not individually have loads less than their own HWMs, Bonneville will not object to those utilities scheduling their Tier 1 power to different points of delivery. This concept of operational pooling needs to be included in the final record of decision so as to avoid future confusion on the issue of pooling.

GTA Service

Since the majority of WMG&T members receive their all or some of their Bonneville power over third-party transmission facilities, we are pleased with the progress that has been made in the discussions on transfer service. Bonneville staff and other parties have done an excellent job addressing the major issues as we consider transfer service in the post-2011 world. That progress is reflected in the Regional Dialogue proposal. Several elements in the draft proposal dealing with the transfer of non-federal power are cause for concern, however.

The October 1, 1996 date by which a point of delivery must have been established in order to be eligible for non-federal service seems unnecessarily arbitrary. We believe this date should be October 1, 2011, the starting date for the new Bonneville contracts.

The maximum cost that Bonneville would allow for non-federal deliveries is $800,000 per year for the term of the contract. This figure declines in real terms because it is not indexed to inflation or actual transmission costs. That essentially reduces the amount of power that can be transferred via this program over time, thus again disadvantaging transfer customers versus those connected directly to the federal grid. We believe this treatment is inappropriate. The $800,000 amount should be indexed annually to the rate of increase in transfer costs so that the amount remains constant in real terms over time.

Under the proposal for transfer service to annexed load, Bonneville proposes an arbitrary cap of $7/MWh for transfer service for existing subscription customers. If the actual transfer cost exceeds this amount, Bonneville will not pay for <u>any</u> of the transfer costs. This proposed "death penalty" for any existing transfer customer unlucky enough to be served over an expensive third-party transmission system is both illogical and inequitable, and should be eliminated

First, any cap on transfer service costs is discriminatory against customers not directly connected to the grid. Utilities should not be charged additional costs or face arbitrary charges simply because Bonneville chose not to construct federal transmission facilities to connect them to the federal grid.

Second, during clarification Bonneville staff indicated that the $7/MWh figure was chosen arbitrarily. There was no particular logic to the figure. Third, there would not be <u>any</u> payment for transfer service if the rate exceeded the $7/MWh figure. Again, why Bonneville is willing to reimburse a utility facing a $6.99/MWh transfer charge but make another utility facing a $7.01/MWh charge pay the full cost is unclear. This death penalty for crossing the $7/MWh threshold is totally inappropriate.

Lastly, as transfer charges increase over time, this $7/MWh cap will catch more and more utilities. While some Bonneville customers would face transfer costs that already are close or exceed this figure, more and more customers would be caught by this penalty as transfer costs increase over time. The proposal to set a $7/MWh cap on the transfer service costs that Bonneville will cover should be eliminated.

We find the discussion on the additional staffing requirement and cost to implement the agreement on transfer service to be both unnecessary and gratuitous. No other part of the Regional Dialogue paper contains such a discussion, although it is difficult to believe that the multitude of other changes proposed by Bonneville in the paper will not require changes in staffing or budgets. We find it gratuitously inciteful to single out the costs of implementing this particular agreement as opposed to all the other changes the Regional Dialogue will undoubtedly occasion at Bonneville.

<u>Tier 2 Costs Shifting into Tier 1</u>

There appear to be several instances where Tier 2 costs can be shifted into Tier 1. In the first instance, we understand as a business necessity that Bonneville must keep open the possibility of recovering some Tier 2 costs from Tier 1. That is, there may be some limited and extremely rare instances when the agency is simply unable to meet all its Tier 2 costs and must seek other sources of revenue. The terms under which Tier 2 costs could temporarily and on a reimbursable basis be charged to Tier 1 customers must be very limited and clearly delineated prior to the completion of this process.

We believe and support Bonneville's assertion that it will not subsidize Tier 2 sales with revenue from Tier 1. However, there are at least two instances where Bonneville appears to support having Tier 1 customers subsidize Tier 2 products. The Bonneville proposal to spend $21 million/year plus annual escalation on renewable resource "facilitation" activities is unnecessary and violates the very premise of this entire exercise – namely utilities taking responsibility for their own load growth. Aside from sending the appropriate price signals and offering a Tier 2 renewable resource product, the members of WMG&T do not support renewable "facilitation" costs being placed in Tier 1.

This expenditure is unnecessary as Bonneville customers will directly face market price signals for the costs of serving their load growth through the price of Tier 2 products. Additionally, renewable portfolio proposals and standards in at least three of the Northwest states will further obviate the need for this expenditure. It is also unclear exactly what these "facilitation" dollars would be used for. With no clearly defined need or goals, this expenditure should not be included in Tier 1 rates.

Although the paper asserts that "BPA is likely to have some ongoing responsibility to acquire power for Tier 2 rate service..." it is unclear how Tier 1 costs will not end up subsidizing this effort for renewable resource acquisitions. In fact, pages 59-60 of the proposal clearly state that Bonneville may well acquire Tier 2 renewable resources using Tier 1 monies, but that the costs will be hidden under the rubric of "facilitation" costs. This is obviously contrary to the earlier Bonneville statement about prohibiting the cross-subsidization of products. Any Bonneville spending on renewables, whether it be for Tier 2 products offerings or "facilitation," should be included in Tier 2 rates.

The second area where costs that appropriately belong in Tier 2 appear to bleed into Tier 1 rates is for conservation programs the agency wants to offer to Tier 1 customers. A more detailed discussion of this issue is included below under the "Conservation" heading.

Conservation

Just as many other Bonneville approaches must change with the implementation of the Regional Dialogue, so too must its approach to acquiring conservation and efficiency. There are four primary elements to Bonneville's post-2011 conservation programs described in the draft Regional Dialogue proposal: a conservation rate credit; bilateral contracts with utilities; third-party and market transformation activities; and regional infrastructure support efforts.

WMG&T members believe that conservation rate credit, and research, design and demonstration programs such as the Northwest Energy Efficiency Alliance properly belong in Tier 1. These are acquisition mechanisms that either do not have equity problems (i.e., the conservation rate credit) or are appropriately RD&D programs (i.e., NEEA). Bilateral contract acquisitions, however, cause serious equity problems and should not be funded out of Tier 1 rates.

The problem with funding bilateral contract acquisition out of Tier 1 rates is one of who benefits and who pays. Under Bonneville's proposal, all Tier 1 purchasers would pay for the bilateral programs. The beneficiaries, however, are those individual utilities who can actually avail themselves of the programs. These beneficiaries get to stretch their Tier 1 purchases further and avoid additional Tier 2 purchases. A non-participating utility would have contributed to the bilateral acquisition program cost through their Tier 1 rates, but they would see no benefit.

There are several alternatives for remedying this problem. First, Bonneville could eliminate all bilateral contracts. Eliminating bilateral contracts, however, removes one of Bonneville's more effective acquisition mechanisms. Not only have bilateral agreements proved to be among the most cost-effective allocation mechanisms, they also allow the agency to target specific conservation measures.

A second approach would be to decrement any savings from bilateral contracts in Tier 1 by the amount of the funding provided by the non-participating customers. This approach, which is currently in place for Slice and Block customers, appears to be a disincentive for utility participation. In addition, it would be difficult to implement and over time to track what savings remain with the utility and what goes back to the Bonneville Tier 1 customers.

A third alternative is to have all bilateral contracts offered as a Tier 2 product. This approach avoids entirely the equity problems associated with bilateral contracts funded out of Tier 1, yet it retains bilateral contracts as an acquisition mechanism. The members of WMG&T support having all bilateral contracts offered as a Tier 2 product.

DSI Service

We reserve comment at this time regarding service to the DSIs in the post-2011 period, but we find it inappropriate for Bonneville to suggest that any resource augmentation for potential power sales to the DSIs should be paid by Tier 1 customers. Having Tier 1 customers subsidize Bonneville augmentation so that the agency can make power sales to the DSIs is not acceptable and should be removed from the proposal.

Tax Exempt CGS Bond Service

The Regional Dialogue paper states that "...to the extent that a reduction in the HWM of a customer is due to a reduction or loss of CGS [Columbia Generating Station], the Federal income tax-exemption on the CGS, and on the bonds issued for the Project, could be threatened." While acknowledging that this issue needs considerably more work and discussion, one "solution" that is suggested is "...that certain customers (generally cooperatives) may be required to replace all or a portion of the related HWM reduction with power from BPA at Tier 2 rates."

This "solution" is unacceptable. To balance the loss in whole or part of CGS on the backs of Bonneville's cooperative customers in order to preserve benefits that have inured to all Bonneville customers is ludicrous. Forcing one subset of Bonneville customers to buy power from a potentially uneconomic source in order to preserve the tax benefits for all is wholly inappropriate. This suggestion should be summarily dropped from further consideration.

Conclusion

Tremendous progress has been made to date on furthering the idea originally put forth by the Governor's Comprehensive Review ten years ago. With the exceptions and clarifications noted in this paper, the members of WMG&T believe Bonneville's draft Regional Dialogue proposal is another positive step in reaching the joint goals of preserving the benefits of the Federal base System for the citizens of the northwest and having utilities take greater responsibility for serving their own load growth. The Bonneville staff has done an exemplary job of clarifying the proposal and incorporating ideas presented by the public. The members of WMG&T look forward to continuing this effort and bringing it to a successful conclusion.