**COMMENTS OF THE WESTERN PUBLIC AGENCIES GROUP
ON THE
BONNEVILLE POWER ADMINISTRATION
LONG-TERM REGIONAL DIALOGUE POLICY PROPOSAL**

1. Introduction

These comments are submitted on behalf of the utilities of the Western Public Agencies Group ("WPAG")[1] in response to the Bonneville Power Administration's ("Bonneville") Long-Term Regional Dialogue Policy Proposal issued July 13, 2006 ("Policy Proposal"). Some WPAG members will also be submitting individual comments.[2]

WPAG is composed of twenty preference customers of Bonneville who purchase about one-quarter of the power Bonneville sells to preference customers in the region. The WPAG utilities are a diverse group which includes municipalities, mutual associations, cooperatives and public utility districts. They also purchase power from Bonneville in a variety of ways, including full requirements, partial requirements, block and Slice. Some of the WPAG utilities use substantial amounts of non-federal power to serve their loads, while others rely completely on Bonneville for their power supply. Given this diversity, WPAG does not comprise a special interest group with a singular focus. Rather, it is a cross-section of Bonneville's preference customers that brings a balanced and comprehensive approach to the policy, legal and operational issues presented by the Policy Proposal.

At the outset, the WPAG utilities would like to express their appreciation for the hard work put into the Policy Proposal by the Bonneville staff and management, and for the time they spent explaining both its content and the reasoning behind it. The process engaged in by Bonneville leading up to this comment period has been exemplary in its scope and openness. The WPAG utilities appreciate the opportunity to continue this dialogue by providing Bonneville these comments.

[1] The utilities that comprise the WPAG include Benton REA, the Cities of Ellensburg, Milton and Port Angeles, the Towns of Eatonville and Steilacoom, Elmhurst Mutual Power and Light Company, Lakeview Light and Power Company, Ohop Mutual Light Company, Parkland Light and Water Company, Peninsula Light Company, the Public Utility Districts No. 1 of Clallam, Clark, Grays Harbor, Kittitas, Lewis and Mason and Snohomish Counties, Washington, Public Utility District No. 3 of Mason County and Public Utility District No. 2 of Pacific County, Washington.

[2] Snohomish PUD does not join in sections 3(b), 5(b)(iii) and (iv), 5(d), (k), (l) and (m) of these comments.

2. Overview of WPAG Comments

a. Need to Respond to Preference Customer Concerns

Implementation of the Policy Proposal would alter the power supply and benefit distribution approaches codified in the Pacific Northwest Electric Power Planning and Conservation Act ("Regional Act"), 16 U.S.C. § 639, *et seq.*, under which Bonneville has served the region since 1981. These departures from the Regional Act include eliminating service to preference customers at melded rates, terminating residential exchange and billing credit benefits for new resources, altering the method for calculating residential exchange benefits for residential and small farm customers of preference customers and investor owned utilities ("IOUs"), and changing the power supply role of Bonneville in the future.

Such a shift in Bonneville's business relationship with the region, and in the way it fulfills its responsibilities to its preference customers, cannot be implemented without the support of Bonneville's preference customers. To proceed down the path described in the Policy Proposal without such support would result in a political and legal free-for-all that would stymie efforts to implement this change.

The ability of Bonneville to obtain preference customer support for implementing the Policy Proposal depends on Bonneville continuing to respond with positive solutions to the issues and concerns raised by preference customers in their comments. And finding such solutions will require change not only in the way preference customers relate to Bonneville, but more importantly, it will require Bonneville to accept changes to the way it conducts it affairs as well. Bonneville and its preference customers must all change together, or there will be no lasting change.

b. Allocation versus Tiered Rates

The Public Power Council ("PPC") executive committee unanimously endorsed and provided to Bonneville a proposal that was based on a contractual allocation of the output of the Federal base system ("FBS"). While it did not constitute a transfer of ownership in federal assets or power, this contractual approach was designed to provide a high degree of contractual protection to preference customers' access to low-cost federal power, free from political meddling and policy shifts. It was expected to "secure the benefits" of low-cost federal power for preference customers.

The shift to a tiered rate construct laid out in the Policy Proposal provides preference customers with less protection from political meddling and policy shifts. Under the Policy Proposal, the protection provided to preference customers' access to low-cost power is dependent on the integrity of the Bonneville rate process, and the ability of preference customers to enforce the provisions of the new power contracts and the tiered rate methodology.

As a consequence, the Policy Proposal presents a plethora of important issues in its ninety-five pages. To respond to these issues, these comments will first focus on a select number of overarching issues that go to the heart of whether a rate-based approach can be constructed in a manner that will actually "secure the benefits" of the FBS for preference customers for the long-term. This will be followed by responses to the two specific questions posed by Bonneville in the Policy Proposal. Finally, these comments will address, in the sequence in which they appear in the Policy Proposal, the remaining issues.

3. Comments on Overarching Issues Presented by the Policy Proposal

a. Opportunity Cost Pricing

The Policy Proposal suggests that for Tier 1 load following power products, energy will be priced at the cost of production from the FBS, while capacity and load variance charges would be based on opportunity or market costs. (Policy Proposal, p. 31) If such charges produce revenues in excess of the revenue requirement, the energy charge could be scaled back to fit revenues within the revenue requirement. Under this approach, energy would generally be priced below the cost of production from the FBS, while capacity and load variance charges would likely be priced at or near market levels.

This is *not* the result sought by preference customers. Support for a tiered rate approach by preference customers is based on the principle that all Tier 1 power products (including energy, capacity and load variance) will be initially based on the cost of producing them from the FBS. It is only when the FBS is incapable of supplying all of a product that is required by Tier 1 purchasers that market costs come into play in the form of purchases to supplement the capability of the FBS to supply that product. The pricing approach in the Policy Proposal translates the statutory preference rights to cost based power into the right to purchase energy at below cost, and capacity and load variance at market price.

It may be suggested that the opportunity cost pricing is necessary to convey the correct price signals. This makes little sense in the tiered rate construct. As described in the Policy Proposal, the Tier 1 power purchase obligation is take or pay, and is predicated on an annual HWM and forecast retail load. (Policy Proposal, p. 19) Under such an approach, there will be little or no opportunity to respond to price signals, and no benefit in doing so.

The fact that the excess revenues generated by market based capacity and load variance charges will reduce the energy charge has also been cited as a mitigating factor. This suggestion fails for two reasons. First, those who contribute the excess revenues by paying the market-based capacity and load variance charges purchase relatively less energy than other customers, and hence do not benefit from the reduction in the energy charge in a manner commensurate with their contribution to the higher revenues. And second, market-based revenue streams are politically vulnerable, as shown by the President's proposal for mandatory debt prepayment from secondary revenues.

If implemented as set out in the Policy Proposal, the opportunity cost pricing approach will result in only the Slice product purchasers receiving all of their Tier 1 power products at the cost of production from the FBS. Preference customers purchasing load following Tier 1 power products will pay either more or less than the cost of production from the FBS, based on their relative load factor. This is not an outcome preference customers intended or desire.

There are two potential solutions to this problem. One would be to price all three Tier 1 power product components (energy, capacity and load variance) at opportunity or market levels, and then scale all three prices back proportionately to fit within the revenue requirement. A second approach would be to apportion to Tier 1 purchasers the Tier 1 revenue requirement based on the greater of their high water mark ("HWM") expressed as a percentage, or their forecast Tier 1 load, which amount would be collected as a flat monthly charge. This is the approach currently used with Slice purchasers. Any additional costs incurred to provide Tier 1 service in excess of the FBS capabilities would be collected in an additional charge paid by the customers receiving such service.

This is not a rate design issue that can be resolved at a later date. Rather, it is a pricing issue raised by the Policy Proposal that goes to the heart of the tiered rate construct, and whether it will deliver to all preference customers all of the Tier 1 power products at the cost of producing them from the FBS. The Record of Decision ("ROD") must contain an commitment from Bonneville to provide to preference customers all three Tier 1 power products at the cost of production from the FBS to the extent it can provide such products.

b. Cost Control

i. Process Considerations

There is little benefit to preference in constructing a system that provides cost-based Tier 1 power products from the FBS if the costs of the FBS do not remain low. Since the expected benefit of the tiered rates construct is low cost Tier 1 power, it is essential to securing such benefits that durable cost control mechanisms be instituted that will perform well throughout the term of the new power contracts.

The track record of Bonneville in recent years regarding cost control and financial transparency has been exemplary. This is due in no small measure to the commitment of the current Administrator, management and staff to providing the information needed to inform its customers. This has been accomplished through largely informal processes initiated by Bonneville.

However, such informal arrangements that depend on the good will of the Administrator are not sufficiently durable to withstand the shifts in policy, political pressure and changes in Administrators that will occur over the next twenty years. For the tiered rate construct to deliver the benefits of low cost power to preference customers over such period, the cost control mechanisms must be capable of functioning under unfavorable policies and political climates.

Achieving the goal will require, regardless of the cost control process (or processes) ultimately selected, that Bonneville's commitment to the nature and timing of the cost control process (or processes) be memorialized in the new power contracts. Doing so will provide assurance to preference customers that their ability to provide timely and meaningful input on spending decisions will be secure for the long term.

The Policy Proposal suggests three alternatives for providing preference customers with timely and meaningful input on decisions with cost implications. (Policy Proposal, pp. 74-76) Of the three proposed, the Cost Management Group ("CMG") appears to provide the most reliable mechanism for securing preference customer access to relevant financial information, and timely input on Bonneville decisions with cost implications. There are a number of reasons for this conclusion.

The CMG creates a group that accepts responsibility for participating in the process, making regular attendance more likely. This in turn will create a cadre of knowledgeable individuals who will understand Bonneville's financial structure, eliminating the need for constant education. It will also enable Bonneville to obtain quick input on issues *before* a decision is taken, rather than receiving complaints after the fact. Lastly, while the CMG process permits anyone to participate in the process, there is a clear identification of who has committed to participating in the process. As a result, both Bonneville and other preference customers will know who to go to regarding cost issues.

The Policy Proposal suggests that staffing the CMG will be contentious. (Policy Proposal, p. 77) It is a fact that any process that does not include everyone with an interest in participating generates complaints. It is also a fact that all major groups that participate in Bonneville processes have demonstrated the ability to select a limited number of representatives when circumstances require it. This is particularly true when the benefits of representative participation are so apparent, as would be the case with the CMG.

There are also serious concerns with the robustness and durability of the Regional Cost Review ("RCR") favored in the Policy Proposal. (Policy Proposal, p. 78) Because of the size of the group, and the sporadic attendance, it is difficult to develop at the policy level a group of knowledgeable individuals that can provide Bonneville with consistent and useful policy advice. Further, the structure of the RCR makes it difficult to focus on the relevant financial and cost details. Additionally, because RCR meetings must be noticed well in advance, the RCR cannot respond as promptly to Bonneville cost issues. For the same reasons, the RCR tends towards the slide show approach in which decisions already taken are reviewed, rather than providing the opportunity for meaningful input before decisions are taken by Bonneville.

A third option that was not discussed in the Policy Proposal would be to meld the best features of the RCR and CMG approaches. This approach would retain the open architecture of the RCR process, but with three explicit changes. First, the RCR process would expressly permit groups (such as the PPC) to appoint spokespersons who would commit to participate in the process, and would be recognized as such in the RCR process. Second, the RCR would be expressly permitted to establish a representative standing committee, which would be authorized to respond to issues brought to it by Bonneville for prompt input. And third, expressly permit the RCR to make joint recommendations on Bonneville cost and financial issues. These modifications would capture the benefits of both the RCR and the CMG in a single approach.

Based on the foregoing, it is recommended that Bonneville reassess whether the RCR approach will fulfill the need for cost control over the term of the new power contracts. The merits of the CMG approach outweigh those offered by the RCR, and should be seriously considered. However, the hybrid approach that incorporates the attributes of both the RCR and the CMG approaches is also worthy of careful consideration.

ii. <u>An Alternative to Off-Ramps</u>

The Policy Proposal correctly assessed the preference customers' lack of enthusiasm for contractual off ramps as a cost control mechanism. (Policy Proposal, p. 78) This is due to the complexity of constructing and administering off ramps.

A better alternative would be to permit customers who feel that load removal is the only effective means of cost control to elect to sign a ten year contract. This would permit these customers to assess the trajectory of Bonneville's rates, but at the risk of uncertainty regarding the nature of the contract they would be offered at the end of the ten year term.

Such an approach would be easier to construct and administer than off-ramps, and would provide a useful cost control tool that can be voluntarily selected, or not, by each preference customer. It would also stagger the expiration dates of the new power contracts, which would mitigate the contract expiration cliff that a uniform expiration date poses.

c. <u>Migration of Costs from Tier 2 to Tier 1</u>

Access to Tier 1 power at cost-based rates will be of little benefit if Tier 1 becomes a dumping ground for costs generated by bad Tier 2 deals. Such an outcome could occur as a result of the type of commitments Bonneville makes in Tier 2 contracts. Examples of this include making sales to counterparties that are not credit-worthy, and committing to a power sale at a fixed price without a fixed price power supply to fulfill it.

The financial losses from such Tier 2 transactions can become Tier 1 costs if the Tier 2 contracts that Bonneville signs do not give it the ability to collect such costs from Tier 2 customers, or provide a secure means of obtaining payment (such as a letter of credit) from the specific Tier 2 customer. In such event, Bonneville would not be able recover its revenues from Tier 2 customers, and under the "necessity of revenue collection" test these costs would migrate into Tier 1 for collection. (Policy Proposal, p. 83) This is not an acceptable outcome. Tier 1 cannot become a repository for the costs of Bonneville conducting its Tier 2 business.

To alleviate this concern, Bonneville should make a commitment in the ROD to include in Tier 2 contracts provisions that will provide Bonneville with the authority and ability to collect from Tier 2 customers all of the costs of providing Tier 2 service, including the costs of mistakes, miscalculations and credit failures.

d. Enforcement of Key Tiered Rate Elements

i. The Importance of Enforceability under Tiered Rates

Implementing tiered rates will require contract provisions, rate methodologies and policies that operate in an integrated and interdependent manner. The key elements of tiered rates that will be incorporated in the new power contract, methodologies and policies include the tiered rate methodology, and determinations of net requirements, HWMs, and the FBS capability.

For the expected benefits of tiered rates to be realized, both Bonneville and the preference customers must be able to rely on the objective enforcement of all of these provisions, regardless of changes in utilities, Administrators or political policy directions that will inevitably occur. These provisions must be reliably enforced even when one party or the other finds such enforcement inexpedient.

Not only must these provisions be subject to objective enforcement, they must also be enforced in a timely manner. A decision on the enforceability of a contract, rate or policy matter that takes five years to obtain, as has been the case with recent 9^{th} Circuit challenges to Bonneville rate decisions implementing the Subscription contracts, is impractical from a business perspective. But more importantly, such a delay in obtaining enforcement of any of the key tiered rate elements will severely jeopardize the likelihood that the expected benefits of tiered rates will be realized.

To provide the timely and objective enforcement of the key tiered rates components, non-judicial dispute resolution presided over by a neutral third party must be employed. While the Policy Proposal discussed a variety of methods that *could be used* to enforce these key elements of tiered rates, it does not contain a commitment to use any specific enforcement processes. (Policy Proposal, p. 83)

In order for preference customers to continue their support of Bonneville's implementation of tiered rates, they must have confidence that the key elements of tiered rates will be enforced in an objective and timely manner for the entire term of the new power contract. To have such confidence, Bonneville must make an unambiguous commitment in the ROD to utilizing specific non-judicial processes, presided over by objective third parties, to enforce the key elements of tiered rates. While some details of these enforcement procedures must await contract negotiations, the commitment to specific non-judicial enforcement processes need not, and indeed cannot, be delayed until contract negotiations.

ii. Specific Recommendations for Tiered Rates Enforcement

The following are recommendations for processes that Bonneville should adopt in the ROD to ensure the objective and timely enforcement of the key elements of tiered rates.

1. Tiered Rates Methodology

The Policy Proposal suggests that the tiered rate construct and key elements *could be* protected against change by contract provisions. It is also suggested in the Policy Proposal that the contract *could* empower the rate case hearing officer to resolve disputes over whether Bonneville proposed changes to the tiered rate construct and key elements made in the rate case were contractually prohibited, and that the decision of the hearing officer on such issues *could be* binding on Bonneville.[3] (Policy Proposal, p. 83)

These are positive suggestions for memorializing the construct and key elements of tiered rates and for resolving disputes within the rate case over proposed changes to them. However, these suggestions do not identify what portions of the tiered rate construct would be offered such contractual protection. To preference customers, the *key* element that will determine their benefits under the tiered rate construct is the tiered rate methodology. In the ROD, Bonneville should add needed clarity to its proposal by stating that it *will* provide contractual protection from change to the tiered rate methodology, and *will* adopt the proposal authorizing the rate case hearing officer to resolve rate case disputes over proposed changes to the tiered rate methodology.

Even with such a commitment by Bonneville in the ROD, there will remain the issue of constructing an orderly and predictable process that will enable Bonneville and its preference customers to consider when and to what extend the tiered rate methodology should be revised due to changes in circumstances and the unintended consequences of some tiered rate methodology provisions. The fairness of this process will be crucial, since whenever change occurs to a rate methodology there are winners and losers. However, this is an issue that need not be resolved at this time, and can be left for resolution until after the tiered rate methodology is more fully developed.

The Policy Proposal is less helpful on the question of how to deal with disputes over interpretations of the tiered rate methodology. The Policy Proposal states with regard to disputes over interpretations that occur outside (or between) rate cases, that such disputes should be handled in an administrative process open to all, with the final decision being

[3] This section of the Policy Proposal also suggests that the Administrator could, after a mini trial within the rate case, overturn the decision of the hearing officer if the change is reasonably necessary to insure cost recovery or comply with a court order. It is assumed that this "necessity" test would require a demonstration that the Administrator has exhausted all reasonably available alternative means of ensuring cost recovery. The will require a discussion of how spending reductions, and revenue increases from tier 2 and transmission rates will be incorporated into such a test.

made by the Administrator. Customers would have to challenge these decisions in the 9th Circuit to have them overturned. (Policy Proposal, p. 87) In essence, this would be a notice and comment process with the Administrator making the decision. The Policy Proposal is silent regarding how tiered rate interpretative disputes that arise in a rate proceeding should be handled.

The suggested approach to resolving interpretative disputes occurring outside the rate process is unlikely to inspire confidence that the tiered rate methodology will be objectively enforced in a manner free of political pressure or policy shifts, since it places solely in Bonneville's hands the power to interpret the tiered rate methodology. Further, recourse to the 9th Circuit to challenge any Bonneville interpretative decision will not provide resolutions that are timely from a business perspective.

This fact is demonstrated by the interpretative disputes over the current Slice contract and rate, which have been pending in the 9th Circuit for over four years, during which period Bonneville's interpretation has prevailed. Clearly, a more timely and objective method of dealing with interpretative disputes is necessary to successfully implement the tiered rate concept. And while the process (or processes) for resolving interpretative disputes within and outside the rate case process are similar in many respects, they are sufficiently different to warrant separate treatment.

a. Distinguishing Interpretations from Changes

In constructing a process (or processes) for resolving tiered rate methodology interpretative disputes, whether occurring within or outside the rate case process, the first question presented is how to distinguish between a proposed change to the tiered rate methodology and an interpretation which results in a substantive change to it. Within the context of the rate process, authorizing the hearing officer to make the decision on whether a Bonneville proposal is change or interpretation of the tiered rate methodology is both a fair and expedient way to resolve this issue. The WPAG utilities urge Bonneville to adopt this approach in the ROD for interpretative disputes that arise in the rate case context.

Deciding whether a dispute arising outside the rate case process over a Bonneville proposal is about an interpretation, or is in fact a change to the tiered rate methodology in the guise of an interpretation, presents a more complicated issue. If the matter is referred to the neutral third party for determination, that person's decision has substantial consequences. If the decision is that the proposal is in fact a change to the tiered rate methodology, regardless of how it is characterized by Bonneville, the change cannot be made until the next rate proceeding. Alternatively, if the decision is that the proposal is an interpretation, then as described below the Administrator gains the ability to accept or reject the decision of the neutral third party, with recourse limited to review by the 9th Circuit.

Although Bonneville will likely have concerns about maintaining its ability to interpret its own policies, in the context of a tiered rate methodology interpretative dispute that arises outside the rate case process, referring the issue of whether the disputed matter is proposal to change the tiered rate methodology, or merely one of interpretation, to the neutral third party is the best way to deal with this issue. Doing so will maintain the integrity of the decision-making process, and avoid the appearance of forum shopping by Bonneville. That said, the WPAG utilities are ready to collaboratively investigate with Bonneville alternative means of resolving this issue that would permit Bonneville to conduct its business in a timely and orderly manner, while respecting the need of preference customers to timely decisions rendered by a neutral third party.

b. Process for Resolving Interpretative Disputes During a Rate Case

The specific process used to resolve interpretative disputes over the tiered rate methodology that arise during the rate case should be the same as that used for Bonneville proposals to change the tiered rate methodology. That is, the matter should be referred to the hearing officer for disposition, and the decision of the hearing officer should be binding on Bonneville, subject to the exceptions for revenue recovery and compliance with court orders noted above. Such a binding decision is permissible in such circumstances since it is the rate process that establishes what the rates and tiered rate methodology mean, and does not constitute a binding decision on a rate or rate methodology that is in effect being made outside the rate process.

Bonneville and its preference customers will need to collaborate on a means of invoking this process during the rate case process in a way that ensures that material and consequential issues are resolved, but without providing an opportunity to endlessly litigate frivolous issues in a way that would unduly delay the rate process. At the same time, this method of invoking the process must respect the need of individual parties to obtain resolution of issues that are important to them. Once invoked, the dispute resolution process would be open to participation by all rate case parties. For all such parties, as well as Bonneville, the hearing officer's decision would be final, regardless of whether they participated or not.

c. Process for Resolving Interpretative Disputes Outside a Rate Case

In contrast to the binding nature of the hearing officer's decision in the rate case process, decisions rendered by a neutral third party decision maker in the dispute process conducted between or outside the rate case would be subject to being accepted or rejected by the Administrator within a specified time limit after the decision is rendered. If the Administrator accepts the decision of the neutral third party, it would become a Bonneville decision applicable to all customers. Regardless of whether the Administrator elects to accept or reject the decision of the neutral third party, any party with standing could appeal the Administrator's decision to the 9th Circuit. In that event, the record of the process, including the decision of the neutral third party, would be included in the record on appeal to the 9th Circuit.

This non-binding dispute resolution approach is necessitated by Bonneville's position that outside of the rate case process, matters of rate interpretation cannot be submitted to binding dispute resolution.[4] An approach very similar to the foregoing was developed and included in the proposed settlement of the disputes over the interpretation of the Slice contract and rate. And the ability of the Administrator to reject the decision of the neutral third party was incorporated to accommodate Bonneville's position that matters of rate interpretation cannot be subject to binding arbitration. This approach is a practical solution that will provide timely resolutions to tiered rate methodology interpretative disputes.

And as with the rate case dispute resolution process, Bonneville and its preference customers will need to find a means of invoking this outside the rate case dispute resolution process in a way that winnows out frivolous claims, while respecting the right of each customer to obtain resolution of its disputes. Once the process is properly invoked, Bonneville and the customers requesting the process would select a single individual to hear the dispute from a list of pre-approved individuals with knowledge of Bonneville matters and without any conflicts of interest. Once invoked, the process would be open to any party that can demonstrate sufficient standing to warrant participation.

d. **<u>Procedures for Dispute Resolution Processes for All Tiered Rate Methodology Disputes</u>**

The procedural approach that is recommended for use in both of the foregoing dispute resolution processes (changes and interpretations in the rate case, and interpretations outside the rate case) would be essentially identical. Since these disputes are more akin to disputes of law rather than disputes of fact, the process would more closely resemble an appellate proceeding dealing with an issue of law rather than a full scale arbitration proceeding dealing with disputed facts. There would be no depositions, no discovery and no cross examination. Instead, each of the parties (or groupings of parties) to the proceeding would simultaneously submit to the decision maker a statement of their recommended resolution of the issue, and a brief (with attachments) of a specified length arguing why its recommended solution should be adopted. Reply briefs would be permitted at the option of the decision maker. There would be oral argument before the decision maker, which could be followed (at the option of the decision maker) with questions to the parties. The decision maker would be required to render a decision within ten (10) days of the conclusion of the proceeding, and the decision rendered would

[4] Including in these comments a suggestion that Bonneville incorporate in the ROD a non-binding dispute resolution process for interpretative disputes regarding the tiered rate methodology does not constitute agreement with the Bonneville position that matters of rate interpretation or administration cannot be subject to binding dispute resolution, nor does it constitute a waiver of any argument to the contrary.

have to adopt one of the recommended resolutions. The decision maker would not be free to create his or her own resolution.

Acceptance by Bonneville of the foregoing dispute resolution recommendations will still leave a number of procedural issues that are more appropriately resolved later in the tiered rate implementation process. These include such matters as when during a rate case should the process occur, who will have the burden of proof, what presumptions (if any) will be made, and what standard will the hearing officer or neutral third party use in rendering decisions. These issues should be collaboratively resolved by Bonneville and its preference customers.

Nothing in the foregoing procedures would prohibit Bonneville and interested parties from attempting to resolve through negotiations the issue or issues presented by an interpretation. However, the purpose of the foregoing procedures is to provide a complete adjudication of any controversy over the tiered rate methodology in the period of one month or less, while giving interested parties an adequate opportunity to present their arguments to a neutral third party decision maker. Because of the speed with which these processes could take place, any proposed Bonneville interpretation of the tiered rate methodology outside the rate case process would not take effect pending the completion of the dispute resolution process.

2. Net Requirement Determinations

Under tiered rates as described in the Policy Proposal, the net requirement determination will take on more importance than it has previously had. Not only will it establish how much power a customer can purchase under the Tier 1 rate, it will also establish the amount of more expensive Tier 2 power the utility is obligated to acquire. These determinations will have substantial financial impacts, since they will result in take or pay obligations that will apply for at least a year regardless of the amount of load the utility actually places on Bonneville. (Policy Proposal, p. 19) This is a substantial change from present circumstances for most preference customers, where the amount of power they purchase from Bonneville is driven by their actual load, not by their net requirement determination.

The starting point for any discussion of net requirement determinations under a tiered rate construct must be a net requirement methodology that should set forth a standardized manner which will be used to make net requirement determinations. This methodology should also specify the rights of preference customers to participate in net requirement determinations of other preference customers, and be attached as an exhibit to all of the new power contracts. Such a methodology should do much to reduce the number of disputes that will arise over net requirement determinations.

Nevertheless, it is anticipated that the money at stake in the net requirement determinations will prompt some disputes, necessitating a resolution process that will be prompt and fair. The Policy Proposal correctly points out that net requirement determinations involve a number of factual and policy determinations, including utility load forecasts, non-federal resource declarations, consumer-owned resource declarations, decrements under § 9(c) and changes to non-federal resource declarations under §5(b). (Policy Proposal, pp.84-85) Disputes arising in these areas can present issues that involve strictly questions of fact, the application of a clear policy to facts, or the application of a policy that is ambiguous or has gaps. Although these disputes may present differing combinations of factual and policy issues, each of these matters can and should be subjected to neutral third party dispute resolution processes, the nature of which are described below.

When the matters involved in a net requirement determination are strictly issues of fact, or issues of fact to which a clear and unambiguous policy can be applied (such as the utility load forecast, resource declarations and consumer owned utility declarations), they can appropriately be subjected to binding dispute resolution before a neutral third party. In contrast, net requirement determinations that contain issues of fact and the application of a policy that is ambiguous or contains a gap relevant to the dispute (such as § 5(b) and § 9(c) matters) present a different dilemma. Such a case presents a matter that requires either interpretation of a Bonneville policy, or the filling of a gap in a Bonneville policy.

Bonneville has historically taken the view that when one of its policies is ambiguous or contains a gap, the ultimate authority for resolving the ambiguity or filling the gap resides with Bonneville.[5] This leads Bonneville to the conclusion that such matters cannot be subjected to binding third party dispute resolution.

To accommodate position, it is recommended that when the net requirement determination dispute presents issues of fact and an applicable policy that is ambiguous or has a gap, the dispute should still go to a neutral third party for resolution. However, in such a case, only the facts found by the neutral third party would be binding, and the Administrator was retain the right to accept or reject the decision of the neutral third party regarding the interpretation or application of the Bonneville policy. If the decision of the neutral third party is accepted by Bonneville, it would become the Bonneville interpretation applicable to all customers. Regardless of whether the Administrator elects to accept or reject the decision of the neutral third party, any party with standing could appeal the Administrator's decision to the 9th Circuit. In that event, the record of the process, including the decision of the neutral third party, would be included in the record on appeal to the 9th Circuit.

It is also recommended that participation in individual utility net requirement determinations that result in no dispute only be open to participation by Bonneville and that utility. The results of each such net requirement determination should be posted on the Bonneville website and be available for all preference customer to review. Such

[5] Including in these comments a suggestion that Bonneville incorporate in the ROD a non-binding dispute resolution process for interpretative disputes regarding certain aspects of some net requirement determinations does not constitute agreement with the Bonneville position that such matters cannot be subject to binding dispute resolution, nor does it constitute a waiver of any argument to the contrary.

transparency should encourage a more uniform treatment of net requirements determinations.

The procedural aspects for both of these dispute resolution processes would be similar to those described above for resolving disputes about the tiered rate methodology. Under this approach, there would be no depositions, no discovery and no cross examination. Each of the parties (or groupings of parties) would simultaneously submit to the decision maker a statement of their recommended resolution of the issue, and a brief (with attachments) of a specified length arguing why its recommended solution should be adopted. Reply briefs would be at the option of the decision maker. There would be oral argument before the decision maker, which could be followed (at the option of the decision maker) with questions to the parties. The decision maker would be required to render a decision within ten (10) days of the conclusion of the proceeding, and the decision would have to adopt one of the recommended resolutions. The decision maker would not be free to create his or her own resolution.

These dispute resolution processes would be open to participation by any party that could demonstrate standing sufficient to warrant participation in the process. To avoid duplicative processes, net requirement determinations that present the same or similar issues would be dealt with in the same process.

These recommended processes for dealing with issues presented by net requirement determinations will provide timely and uniform decisions that will have sufficient transparency to ensure customer confidence in the integrity of the decisions, while accommodating Bonneville's viewpoint on policy interpretations.

3. High Water Mark Calculations

Under the Policy Proposal, the HWM establishes the maximum amount of Tier 1 power a preference customer is eligible to purchase. (Policy Proposal, pp. 13-17) However, the exact amount of Tier 1 power that can be purchased under any particular HWM will vary, depending on the expected output of the FBS during the relevant period. (Policy Proposal, p. 22) To simplify this process, the HWM of each preference customer should be stated in its contract, and should be set out as a percentage of the output of FBS. If it is done in this manner, changes in the amount of Tier 1 power available to a preference customer under its HWM due to changes in the size of the FBS will be a simple mathematical computation.

This is the approach that has been used under the Slice contract, and disputes over these calculations have been non-existent. However, should a dispute arise over such a calculation, it should be subjected to the same process recommended above for resolution of net requirement disputes over factual matters (such as the utility forecast).

4. **FBS Capability Determinations**

Under the Policy Proposal, the third factor that determines the amount of Tier 1 power available to a preference customer, after the net requirement and HWM determinations, is the determination of the capability of the FBS for the relevant period. (Policy Proposal, pp. 16-22) As noted in the Policy Proposal, this is an especially difficult area since the generating capability of the FBS is subject to considerable fluctuation from year to year. (Policy Proposal, p. 87)

The identical issue was presented by the Slice contract, and was successfully resolved by using independent regional resource planning data (Pacific Northwest Coordination Agreement) as the source of the FBS capability. This has virtually eliminated any controversy regarding these resource numbers.

It is recommended that a similar approach be utilized in this case. The resource numbers used to establish the FBS capability for Tier 1 power availability should be obtained from an independent source that is used regionally for power planning purposes, and is recognized as being accurate, objective and up to date. Such an approach will remove the need for any dispute resolution process regarding FBS capability.

5. **Use of Contractually Determined Values in Rate Cases**

The Policy Proposal recognizes that many values that are important in determining the benefits preference customers will obtain from tiered rates will be determined under contractual provisions and outside of the rate case. These should include the individual utility net requirements (including forecast loads and non-federal resources), utility HWMs and FBS capability. These same values are used in the rate process for a variety of purposes.

This fact raises a number of concerns. The first is whether, and if so under what circumstances, values determined by contractual processes outside of the rate case can be changed in the rate case process, thereby overriding the contractual determination and changing the benefits enjoyed by a preference customer. The second is a separate, but related, concern that arises from a position taken by Bonneville in the last two rate proceedings regarding the import of the Federal Register Notice ("FRN") that starts rate cases.

In the rate case that implemented the Subscription contracts, and again in the most recent power rate case, Bonneville took the position that it could prohibit rate case parties from submitting testimony or otherwise commenting on a rate case issue by proscribing such testimony in the FRN that commenced the case. Bonneville also asserted that it would remain free to testify on and make decisions on such proscribed matters in the rate case.[6]

[6] Bonneville's claim that it can limit testimony submitted by rate case parties on issues that are relevant to setting rates has not yet been tested in the 9th Circuit. Including in these comments suggestions that Bonneville incorporate in the ROD commitments to not proscribe party testimony on certain topics does

This raises two concerns. First, that future Administrators may use this position to preclude preference customers from submitting testimony on matters relating to Tier 1 and Tier 2 rates that are legitimate areas of inquiry in the rate case. And second, that in the future matters that have been determined outside the rate case (such as utility net requirements and HWMs) may be revised in the rate case process, and preference customers may be prohibited from commenting on such changes by a FRN proscribing such testimony.

While there is no evidence that Bonneville has any current intention of taking such actions, the fact remains that if this loop-hole is left unclosed, Bonneville may be forced by political circumstances in the future to use it to implement policies that will alter preference customers benefits under tiered rates. Since one of the basic objectives of implementing tiered rates is to secure for preference customers the benefits of the FBS, closing this loop-hole is a necessity in order to achieve that objective for the long-term.

In order to close this loop-hole, Bonneville and its preference customers must first determine and memorialize what values will be determined outside the rate case process, and of those values which are not to be altered in the rate case. Based on such a delineation of what is to be determined inside and outside the rate case, Bonneville should make a commitment to two principles in the ROD: First, that there will be contractual assurance that the values that are determined outside the rate process (such as utility net requirements and HWMs) will used without change in the rate process; and second, that it will provide contractual assurance that the ability of preference customers to submit testimony in the rate case on tiered rate matters will not be proscribed in any FRN.[7]

Making such commitments in the ROD will give preference customers the assurance that they will be able to rely on decisions regarding tiered rates, regardless of whether they are made inside or outside the rate process.

e. <u>Contractual Protection from Legislative and Administrative Change</u>

One of the selling points for the tiered rate construct is that it will provide preference customers with contractual provisions that will limit or eliminate the ability of Congress and subsequent Administrations to reduce the benefits (or increase the costs) that are available to them from the FBS via legislation or administrative actions. The Policy Proposal contains no discussion on how this important aspect of the tiered rate construct will be implemented, nor the degree of protection that the preference customers can expect under the new power contracts. This omission has raised concerns among the preference customers.

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not constitute agreement with the Bonneville position that it has such authority, nor does it constitute a waiver of any argument to the contrary.

[7] Even with such a Bonneville commitment in the ROD, it is recognized that additional work will be required to give detailed substance to this concept.

During the public workshops on the Policy Proposal, there was an extended discussion of this topic, during which Bonneville was circumspect regarding the amount of contractual protection from Congressional and administrative actions, if any, preference customers would be offered under the new power contracts. Given the lack of comment on this topic in the Policy Proposal, it is now time for Bonneville to explain in detail in the ROD the degree to which it intends to provide protection from Congressional and administrative actions to change the benefits they are expecting to receive from the FBS under tiered rates. Before we all proceed too far down the road of implementing tiered rates, a forthright explanation of the amount of such protection Bonneville intends to provide is needed.

f. <u>Access to the Federal Transmission Grid</u>

Preference customer access to low-cost Tier 1 power is of little use if such customers cannot gain access to the Federal transmission system under their existing transmission agreements. The Policy Proposal disclaims in a number of locations any intention of resolving transmission access issues in the ROD. (Policy Proposal, pp. 22; 33) While the ROD may not be the ideal location to resolve these issues, these issues must be resolved.

As matters now stand, Network Transmission ("NT") customers signing the new power contract will be required to declare it as a new Network Resource, and will be required to get into the transmission queue behind any other pre-existing service application. This approach will create a rush to the queue, and means that there is some likelihood that some preference customers will not be able to obtain access to the federal transmission capacity they are currently using. The likelihood of this outcome for any particular preference customer is increased if they select under the new power contract a power product that is different from the one under which they current purchase power from Bonneville.

It appears that Bonneville's transmission business is treating the expiration and renewal of over one-hundred long-term preference customer power contracts as a business as usual transaction. This approach has injected uncertainty and concern into the consideration of tiered rates, and raised questions by preference customers about their ability to access Tier 1 power, and to receive power from non-federal Tier 2 resources.

Bonneville should recognize that the renewal of over one-hundred preference customer power contracts is not a business as usual event, and may require the adoption of special procedures and approaches to ensure orderly and fair access to the federal transmission system under the new power contracts.

In the ROD, Bonneville should include firm assurances that: (i) it will, in consultation with its customers, implement approaches to ensure that preference customer will not have to get in the queue to obtain access to federal transmission system capacity needed to serve their loads under the new power contracts regardless of the power product they select; and (ii) undertake the process with its customers to find such solutions promptly so they can be implemented well before the new power contracts are to be signed.

g. Modifications to the Slice Product

The Policy Proposal contains a section that suggests major modifications for the Slice product. It also suggests that preference customer access to the Slice product will be limited to a specific megawatt amount. (Policy Proposal, pp. 35-45) There are a number of reasons why these proposals should be reconsidered.

In the first instance, Bonneville has deferred the consideration of any revisions to its other products until later in the tiered rate implementation process. This decision appears to be based on the sound idea that it is unwise to modify its power products while large components of the tiered rate construct have yet to be developed, including the net requirement methodology and the tiered rate methodology to name two. Making modifications to the Slice product, more complete knowledge of these major elements of the tiered rate construct, runs the risk of producing a Slice product that is not only less than optimal, but one that is antithetical to the basic purposes of implementing tiered rates.

A product that is currently working successfully, such as the Slice product, should not be subjected to revisions unless they are required by the tiered rate environment. At this juncture, Bonneville has not put forward any compelling evidence that implementation of tiered rates requires any changes to the Slice product.

The proposed limit on the amount of Slice product available to preference customer should also be removed. The Policy Proposal offers not substantive reason for such a limitation, and no such limit is imposed on any other product. When the Slice product was first offered in 2001, it was a new and relatively untested concept, so Bonneville had a reasonable basis for placing a limit on its availability. That time is long since past. The Slice product has been successfully operated by preference customers large and small for the last six years, and it is no longer an "experimental" product. There is no rationale for limiting access to this product.

There is another sound reason for removing the limitation on the access to the Slice product. If the opportunity cost pricing issue that as arisen regarding the pricing of Tier 1 capacity and load variance products identified in section 3(a) of these comments is not successfully resolved, it is likely that many additional preference customers will become interested in the Slice product in order to secure cost based pricing for all Tier 1 products. Placing a limit on the amount of Slice product available may deprive preference customers of the ability to purchase viable amounts of the Slice product. This would be an unfair and unnecessary result.

It is recommended that the ROD not contain the proposed revisions to the Slice product, nor should it contain any limit on the amount of Slice product that will be made available to preference customers.

4. **Responses to Questions Posed by Bonneville**

Bonneville Question – Do customers support the Presidential proposal to require the use secondary revenues in excess of $500 million per fiscal year to prepay Treasury debt? (Policy Proposal, p. 6)

Response – The purpose of the Policy Proposal is to secure for preference customers, and the region generally, the benefits of the low-cost power from the federal power system. Agreeing to a mandatory prepayment of Bonneville's Treasury debt runs counter to this objective. Further, there is no assurance that acceding to this proposal will not inevitably lead to an ever decreasing threshold (a secondary threshold of $500 million, $400 million, $300 million) and ever increasing adverse rate impacts once the precedent for using secondary revenues in this manner is established.

There is also an inherent inequity with such a proposal. The primary use of the increased borrowing authority produced by such mandatory prepayments would be to invest in transmission system expansion. The Bonneville power customers who would suffer the consequences of this mandatory prepayment in the form of higher power rates make up less than one-half of the transmission system users. This means that power customers would in essence be subsidizing transmission system investment for transmission customers who buy no power from Bonneville.

If Bonneville needs additional borrowing authority, and such borrowing authority can be justified based on the need for additional transmission infrastructure, it should be sought through the normal Congressional appropriations process, or provided by transmission customers through revenue financing. It should *not* be obtained by increasing power rates by imposing a mandatory debt prepayment program using secondary revenues.

Bonneville Question – Should FBS power available due to preference customer loads falling short of the HWMs be used to serve Tier 2 loads? (Policy Proposal, p. 14)

Response – As a general proposition, it should be a matter of indifference to Tier 1 purchasers whether FBS power not needed to serve Tier 1 loads is used to serve Tier 2 loads or sold on the market, so long as the same price is received in both instances. In reality, employing unused Tier 1 power to serve Tier 2 loads presents a number of problems.

First, there is no facile way to reliably determine whether the price charged Tier 2 customers is in fact comparable to what would have been achieved by sales into Tier 1 power into the market. Selling Tier 1 power to Tier 2 customers will likely subject Bonneville to pressure to keep the price charge Tier 2 customers low.

Second, there is the risk that the Tier 2 customers being served with such power would develop a sense of entitlement to it, and would object to the withdrawal of such power to serve Tier 1 loads. Sales of excess Tier 1 power to Tier 2 customers would create risks that such power would not be readily available to serve Tier 1 loads when it is needed to do so.

On balance, it is probably better to obtain Tier 2 power solely from the market, and to sell excess Tier 1 power into the market, with the revenues generated from such sales being used to reduce the Tier 1 revenue requirement. This approach will be less divisive, will generate less controversy, and will reduce the pressure brought to bear on Bonneville.

5. Comments on Other Issues Raised by the Policy Proposal

The comments on the following issues are presented in the sequence in which they appear in the Policy Proposal, and not necessarily in their order of importance.

a. Proposed Schedule for Tiered Rate Implementation

The proposed schedule for implementing tiered rates shows the tiered rate methodology development taking place from 8/06 through 1/07. (Policy Proposal, pp. 5-6) Since we are now in 11/06, with holidays to come, this leaves something like two months to do a thorough job of developing a tiered rate methodology that Bonneville and its preference customers will have to live with for the next twenty years. This is not enough time to do the kind of job that is required on this methodology, which is at the heart of the tiered rate construct.

The schedule contained in the Policy Proposal also shows that the development of the new power contracts, the net requirement methodology and the revised § 5(b)/9(c) policy will all commence in the month following the conclusion of the tiered rate methodology development (2/07). This makes sense, since it would not be constructive to commence the development of these tiered rate elements absent a fully developed tiered rate methodology. However, it is very unlikely that a carefully constructed and fully thought out tiered rate methodology will be completed by 2/07.

Bonneville should not sacrifice the quality of the tiered rate methodology that will be with us for twenty years, and implicitly the net requirement methodology, § 5(b)/9(c) policy and the new power contracts as well, by leaving insufficient time to do the quality job required on the tiered rate methodology. The desire to have an early contract execution date does not justify a truncated tiered rate methodology development period.

To provide an adequate amount of time for Bonneville and its preference customers to develop a top quality tiered rate methodology that will stand the test of time, the deadline for completing that task should be extended by ninety (90) days (to 4/07). In addition, the date for commencing the net requirement methodology and the new power contracts should be altered to commence the month after the completion of the tiered rate methodology (to 5/07). Finally, the revision of the § 5(b)/9(c) policy should be initiated *after* the net requirement methodology and the new power contracts are developed. Separating these tasks in this manner will keep the workload at a reasonable level.

There is one omission from the schedule that is troubling. The proposed schedule does not separately list nor set aside time to resolve the variety of detailed issues that will be presented in committing the various dispute resolution processes to paper. Perhaps the implicit assumption is that this work will be done as part of the contract negotiation process. This is an erroneous assumption.

As shown by the discussion of this topic in section 3(d) of these comments, dispute resolution is vitally important to the successful implementation of tiered rates, and will present complicated issues that will call for careful thought and drafting. It is not realistic to expect that this type of work can be successfully completed as an adjunct to the drafting of the new power contracts. The drafting of the dispute resolution procedures should be identified as a separate task, and it should be commenced about half way through the tiered rate methodology development process. At this point there will be sufficient information available to commence the work on the dispute resolution processes and procedures, and doing so will give this work a head-start.

b. HWM Calculation Mechanics

The Policy Proposal sets out the mechanics for calculating the HWM of individual utilities that generally comports with the proposal made by the PPC, except for the issues discussed in the following subsections. (Policy Proposal, pp. 13-15)

With regard to Bonneville's commitment to augment the FBS, it is understood that Bonneville would augment the output of the FBS to ensure that the combination of the FBS output and the augmentation power would cover the sum of the HWMs, so long as (i) the sum of the HWMs did not exceed 7400 aMW, and (ii) the amount of augmentation needed to cover the sum of the HWMs did not exceed 300 aMW. The actual amount of augmentation needed in each rate period would vary, based on whether the forecast net requirements were equal to or less than the sum of the HWMs, and the output of the FBS during the relevant period. The costs of such augmentation would be included in the costs of Tier 1 power. (Policy Proposal, p. 16) Based on this understanding, the WPAG utilities support Bonneville's commitment to augment the output of the FBS by these limited amounts.

i. Annual versus Monthly HWM

Although the Policy Proposal does not expressly discuss the trade-off between a HWM calculation that produces twelve monthly values versus one that produces a single annual value, this was a topic of great interest by preference customers during the public meetings on the Policy Proposal. It is the understanding of the WPAG utilities that after much internal discussion, Bonneville has decided to adopt the HWM approach that produces a single annual value. (Policy Proposal, p. 25) The WPAG utilities support this Bonneville decision.

Implementing the tiered rate concept is a complicated matter, and its application to actual utility loads will present many challenging issues. Using the monthly HWM would increase this complication by orders of magnitude without any substantial gain in equity or fairness. Conversely, using a single annual HWM value will provide simplicity in this area, and will increase preference customer understanding and acceptance of the tiered rate concept.

For these reasons, the WPAG utilities recommend that Bonneville memorialize its adoption of the single annual HWM value in the ROD.

ii. Treatment of PURPA Generating Resources

In the calculation of the HWM, the Policy Proposal does not distinguish between non-federal generating resources that preference customers have voluntarily developed due to the economic benefits they provide, and the output of non-federal generating resources that preference customers have been forced to acquire due to the operation of Public Utilities Regulatory Policies Act ("PURPA"). (Policy Proposal, pp. 13-16; 18) The HWM calculation should recognize the difference between these two classes of non-federal resources.

Preference customers that are currently required to purchase the output of PURPA resources do not have control over the operation of these resources, nor can they ensure that they are properly operated and maintained. As a consequence, these preference customers have no way of assuring that these resources will continue to provide power, and if so at what level of output or reliability.

It is unfair to treat PURPA resources in an identical manner to non-federal generation that preference customers own and/or control in all respects in the HWM calculation. Doing so would result in the HWM of preference customers with PURPA resources being reduced based on a resource which may be here today, and gone tomorrow, without regard to the wishes of the preference customer.

To resolve this problem, and provide equitable treatment to preference customers with PURPA resources, the HWM calculation mechanics should be revised to exclude from the HWM calculations in 2008 and 2010 the output of small PURPA resources (less than 3 MW of nameplate capacity).[8] The output of PURPA resources used to serve preference customer load should continue to be recognized in the net requirement calculation of those preference customers so long as the output is so used. However, if the PURPA resource ceases to provide power or is no longer used to serve the preference customer's load, the net requirement should reflect that change.

Under this approach, output from PURPA resources that is used to serve preference customers load would be recognized in calculating the amount of Tier 1 power available to the utility so long as such power was available. However, if the resource sponsor elects to cease producing power or requiring the utility to purchase it, the preference

[8] Research has revealed that at the present time there are only two PURPA resources that being used to serve preference customer load, and that their total nameplate capacity is less than 3 MW.

customer would not face a permanent reduction to its HWM based on a PURPA resource over which it exercises no control

The ROD should adopt the foregoing modification to the HWM calculation.

iii. Treatment of Conservation

Preference customers that have developed non-federal generating resources in recent years, and that will develop such resources prior to the new power contract going into effect, are not required to declare them to load service under the existing power sales contract. This means that the output of such resources will *not* reduce the HWM of these preference customers. However, preference customers that have developed conservation resources have no such choice. The load reductions that they have accomplished through conservation will permanently reduce their HWM under the new power contract.

The Policy Proposal addresses this unequal treatment by proposing that one-hundred percent of the energy savings from utility funded conservation, and fifty percent of the energy savings from Bonneville funded conservation, be added back into the HWM calculation at step four of that process, which is after the sum of the HWMs has been established. (Policy Proposal, p. 13-16) This is a good start at equalizing the treatment of generating and conservation resources, but it does not go far enough.

First, it is unclear why there is differential treatment of utility funded and Bonneville funded conservation. At the end of the day, all of the money used to fund Bonneville conservation programs comes from its preference customers. As a result, all Bonneville conservation is “utility funded”. All of the verified conservation savings, whether funded by the utility directly, or funded by the utility indirectly through Bonneville, should be recognized in the crediting process.

Second, by crediting the conservation savings at step four of the HWM calculation, the Policy Proposal does not provide a full credit for conservation savings achieved because it merely reshuffles the capped HWM amount between preference customers. This is not equivalent to the treatment of generating resources, and inappropriately penalizes preference customers that have engaged in conservation. Preference customers should not be penalized under the HWM calculation for doing conservation that has benefited the utility, Bonneville and the region.

The ROD should modify the proposed HWM calculation to recognize one-hundred percent of verifiable conservation savings achieved by preference customers, and should do so in steps 2 and 3 of the HWM calculation.

iv. Changes to Individual HWMs

This section of the Policy Proposal states that amounts of load that are annexed by a public utility from an existing preference customer would receive a portion of the HWM of the existing preference customer proportional to the load they have annexed. (Policy

Proposal, p. 16-17) While this rule seems simple on its face, it may create perverse incentives that will cause controversy where none now exists.

Currently, when one preference customer annexes a portion of the load of another preference customer, the annexing utility accrues no power supply cost advantage by doing so. This is because both of the preference customers are eligible at some point to receive their power supply from Bonneville at melded Priority Firm rate. However, under the tiered rates construct, and under the proposal described above, this would not necessarily be the case. A simple example will illustrate this issue.

Presume that there are two neighboring preference customers, one that is experiencing substantial load growth and as a result has a load that exceeds its HWM, and a second that is growing slowly and has a load that is less than its HWM. Under the Policy Proposal, the first utility would have an incentive to annex a portion of the second utility's load *if* by so doing it received a portion of the second utility's unused HWM. In such a case, the first utility would gain additional HWM with which to serve its growing loads (other than those annexed) at a lower cost. This would be detrimental to the customers of the second utility which had been husbanding its HWM for future growth.

The tiered rates construct should be implemented in a way that does not create power cost incentives for load annexations between preference customers. There are two changes that should be made to this part of the Policy Proposal to avoid such an outcome. First, the amount of HWM assigned to a preference customer that is annexing a portion of another preference customer's load should be limited to the HWM being used to serve such annexed load, and should not include unused HWM of the utility whose load is being annexed. And second, the amount of HWM transferred to the annexing utility should be limited to one-half of the amount of load being annexed. This will ensure that annexations between preference customers for the sole purpose gaining additional HWM will not occur.

v. <u>Adjustments to HWMs</u>

The Policy Proposal indicates that adjustments to the initial HWMs would be made in subsequent rate cases. (Policy Proposal, p. 16) Hopefully, this statement is the result of inartful drafting.

Something as important to the benefits preference customers expect from tiered rates as the HWM should not be subject to change in the Bonneville rate process. The calculation of the HWM must have permanence. This can only be achieved by memorializing the HWM, and the method for calculating any change to it, in the new power contract. Placing this important calculation in the rate case would introduce uncertainty, and would cause preference customers to have significant concerns about whether they could rely on the HWM to guarantee their access to Tier 1 power over the term of the new power contract.

The ROD should clearly indicate that the initial HWM, and the method for calculating any revisions to it, will be set out in the new power contract, and will not be subject to override by the Bonneville rate process.

c. Treatment of the Centralia Generating Project

The PPC proposal recommended that the portions of the Centralia Plant that four preference customers have been required to retain in their Exhibits C should be removed for purposes of calculating the HWMs of these utilities, and should not be include in their Firm Resource Exhibits under the new power contract. This treatment was an integral part of the compromise that allowed the PPC executive committee to unanimously support the PPC proposal.

The Policy Proposal withholds its approval of this portion of the PPC proposal, and holds it hostage to a successful resolution of the unrelated issue of the level of financial benefits to be paid IOU residential and small farm customers. (Policy Proposal, p. 18) This is inappropriate, and ignores the PPC recommendation that stated explicitly that the proposal was a package from which Bonneville could not pick and choose.

This approach is also illogical. In essence, it holds fair treatment of the resource portfolio of four preference customers hostage to a decision that they do not control, and on which all of public power must come together. By the time the current Bonneville power contract has run its course, these utilities will have replaced the output of the Centralia Plant for over a decade at an enormous cost to their ratepayers, and at an enormous benefit to the region. This is more than the time period required under the 1981 Bonneville Power Sales Contract to remove this resource from retail load service.

Regardless of the outcome of the discussions over the level of benefits preference customers will provide to IOU residential and small farm customers during the term of the new power contract, it is time for the Firm Resource Exhibits of these four preference customers to reflect only those resources which are actually being used to serve their retail load. The ROD should state that the HWMs of preference customers who were Centralia Plant owners will not be reduced to reflect their former ownership shares, and that Centralia Plant will not be included in their Firm Resource Exhibit under the new power contract, regardless of the status of discussions over the IOUs benefit levels.

d. Removal of Resources from Retail Load Service

The Policy Proposal suggests that Bonneville will offer a limited right to preference customers to remove existing non-federal resources from load service due to load loss experienced within the rate period, measured as the difference between retail load forecasted at the start of each rate period and actual load during that rate period. With regard to new non-federal resources, the Policy Proposal states that preference customers will have an additional right to remove such resources from load service. (Policy Proposal, p. 18) The Policy Proposal is silent on how these two resource removal rights will differ.

With regard to the resource removal right for existing non-federal resources, the WPAG utilities understand that Bonneville is proposing to perform the net requirement determination for each preference customer annually. (Policy Proposal, p. 17) If this determination is the source of the forecast on which removal rights for existing non-federal resources will be based, it will create a mismatch between the annual utility load forecast generated by the net requirement determination and the two year rate period during which the removal right for existing non-federal resources would be available.

To resolve this apparent conflict, and to make the resource removal right for existing non-federal resources useful, it is suggested that the net requirement determination used to forecast the utility's retail load for purposes of determining resource removal rights be done for each two year rate period. This would make the periods for the retail load forecast and the resource removal right correspond, and provide some degree of planning certainty to preference customers. Doing so would not require Bonneville to abandon its decision to perform the net requirement determination annually, but instead would supplement that determination with a two-year retail load forecast to establish the resource removal right for existing non-federal resources for each rate period.

With regard to the removal right that will be available for new non-federal resources, it is recommended that such removal right not be linked to retail load loss. Rather, such removal right should be available to the preference customer (after reasonable notice to Bonneville) without regard to the reasons prompting such action. Under the tiered rates construct, granting such a right should have no adverse financial impacts on Bonneville or other preference customers. The disposition of the output of the new non-federal resource so removed would still be subject to the requirement of § 9(c). Such a resource removal right would provide genuine flexibility to new resource sponsors, and would help overcome the challenges presented by new resource development.

e. <u>Mandatory Waiver of Legal Rights</u>

While in a some places the Policy Proposal uses permissive language ("would expect") and other places mandatory language ("would require"), the overall tenor of this document is that customers will be *required* to waive statutory rights granted to them in the Regional Act, including the right to challenge the tiered rate methodology, participate in the residential exchange program and apply for billing credits. (Policy Proposal, pp. 19-20; 29; 30) Preference customers may decide to voluntarily waive some or all of these statutory rights, and nothing should stand in the way of their doing so.

However, it is quite a different matter for Bonneville to propose that preference customers *must* waive a statutory right (such as the right to pursue a legal challenge) in order to receive the power supply to which they are statutorily entitled. It is beyond Bonneville's authority to condition the receipt of one statutory right on the waiver of another statutory right. Suggesting that such a waiver will be required indicates Bonneville's concern over the legal vulnerability of the tiered rate proposal.

In the ROD, Bonneville should abandon this effort to require preference customers to waive their statutory rights in order to obtain the federal power supply to which they are statutorily entitled, and rely on their good judgment and benefits of its tiered rate proposal to produce voluntarily the waivers it seeks.

f. Treatment of New Preference Customers

The Policy Proposal includes a detailed proposal for making up to 250 aMW of power available to new preference customers that form after the implementation of the new power contracts at the Tier 1 rate. The power needed to make this supply available would be acquired by Bonneville through augmentation, and the costs of such augmentation would be included in the Tier 1 revenue requirement. (Policy Proposal, pp. 20-22)

This is a realistic amount of power given the history of preference customer formation. And while making this power available to new preference customers will increase the Tier 1 revenue requirement, doing so is a reasonable accommodation of new preference utilities. It will also likely minimize collateral legal attacks on the tiered rate construct by newly formed preference customers.

There is, however, one aspect of this proposal that warrants further consideration. As currently structured, the proposal contains no limits on the percentage of the new preference customer's load that would be served at Tier 1. If the new preference customer forms some years into the new power contract term, this may result in the new preference customer having all of its load served at Tier 1, while pre-existing preference customers may have only enough HWM remaining to some lesser portion of their load. This will create perverse incentives and may lead to efforts by new preference customers to take over service areas of pre-existing preference customers. This will cause unnecessary strife and contention.

The ROD section dealing with new publics can resolve this problem. It should do so by creating a limitation that states that the percentage of load of newly formed preference utilities served at Tier 1 will not exceed the average percentage of Tier 1service received by pre-existing preference customers who purchase power under the same product (full requirements, partial requirement, block or Slice). Such a rule will avoid differential treatment of new and pre-existing preference customers when making Tier 1 power available to newly formed preference utilities.

g. Reductions in FBS Capability During Rate Periods

The Policy Proposal states that changes to the FBS capability forecast during or before a rate case that exceed Bonneville's augmentation commitment will impact preference customers' HWMs. It also proposes that if there are reductions to FBS capability within a rate period that were not forecast to occur, Bonneville will take the necessary actions (such as augmentation) to cover such loss of FBS capability without changing the HWMs until the next rate case. (Policy Proposal, p. 22)

This is a sound proposal for a number of reasons. As a practical matter, the vast majority of preference customers are not equipped to respond to abrupt changes to the level of their Bonneville power supply. Further, trying to apportion to over one-hundred preference customers fluctuations in FBS capability in a timely fashion would present Bonneville with insuperable administrative difficulties. Additionally, and perhaps most importantly, it is Bonneville that is best positioned to supplement the FBS on short notice when such action is needed, and is most likely to do so at the least cost to its preference customers.

Based on the foregoing, it is recommended that this proposal be included in the ROD.

h. <u>Product Availability for Preference Customers</u>

The Policy Proposal anticipates that all of the power products currently available will be offered to preference customers under the tiered rate construct. (Policy Proposal, pp. 23-28) This is a sound decision that should be reaffirmed in the ROD.

It is important to the acceptability of tiered rates, and to accomplishing Bonneville's stated goal of shifting to preference customers the responsibility for new resource development, that the power products offered under tiered rates be configured to be as congenial as possible to resource development. It is not certain that Bonneville has accepted the importance of this proposition.

During the Subscription process, Bonneville constructed a complex partial power product that was so restrictive that no preference customer would sign on. More recently, Bonneville has proposed substantial revisions to the Slice product that could reduce its utility in developing and integrating new resources. And the Slice product is considered by many to be the Bonneville power product that is the most conducive to resource development.

Bonneville must do more than pay lip service to the notion of encouraging preference customers to develop new resources. It should take affirmative actions to build into all power products that will be available under the new power contracts, including full and partial requirements, block and Slice, sufficient operational flexibility to encourage preference customers to take on the very difficult task of developing new generating resources. Bonneville should do so even if it comes at the cost of increased revenue uncertainty, and decreased secondary power marketing flexibility for Bonneville. Without such flexibility, preference customers are unlikely to develop new generating resources.

There are two specific things that Bonneville can do in this regard in the ROD. First, it should acknowledge that resources change from year to year, and that they produce different levels of output that cannot always be predicted with complete accuracy. The new power contracts should recognize this fact, and should not impose unduly rigid requirements with regard to new resource output. Second, as customers develop new generating resources over time, they may find that the power product that they selected initially no longer serves their needs adequately. Under prior contracts, preference customers were permitted, with proper notice, to change the power product under which they bought power from Bonneville. The ROD should recognize and establish that preference customers will be able, with proper notice, to change the power product under which they buy power from Bonneville.

i. The Relationship of HWM, Tier 1 and Tier 2 Products

There appears to be some confusion in the Policy Proposal regarding the relationship between preference customers' HWM, Tier 1 and Tier 2 purchases. At certain points, the Policy Proposal seems to indicate that Tier 2 purchases will be held constant, and any load loss will result in reduced Tier 1 deliveries. (Policy Proposal, pp. 19; 27) This would mean that load loss would reduce the least costly portion of a preference customer's power supply. However, at other points the Policy Proposal appears to state that the new power contract will contain mechanisms for the resale of Tier 2 power that cannot be taken, inferring that load loss will come out of Tier 2. (Policy Proposal, p. 28)

The treatment of power in excess of a preference customer's load, and the flow of revenues from the sale of such excess power, should depend on the circumstance under which such excess occurs. The following treatment is recommended:

- If the utility is only purchasing Tier 1 power, and its forecast load is less than its HWM, the utility should only pay for Tier 1 power equal to its forecast load and the excess power should be sold and the revenues used to reduce the Tier 1 revenue requirement

- If the utility is purchasing Tier 1 and Tier 2 power, and its forecast load is less than the sum of its HWM and its Tier 2 purchase obligation, it should have the choice of reducing either its Tier 1 or its Tier 2 purchases to fit its purchases to its loads. If the utility elects to reduce its Tier 1 purchases and to take its full Tier 2 amount, then the utility should pay only for the reduced Tier 1 amount and the excess Tier 1 power should be sold and the revenues used to reduce the Tier 1 revenue requirement. If the utility elects to reduce its Tier 2 amount, then the utility would continue to pay for the full Tier 2 amount, and the excess Tier 2 power should be sold with the revenues being credited back to the utility.

Such an approach will provide each preference customer with some choice in how to manage purchase obligations in excess of load without imposing any financial risk on Bonneville.

j. Low Density Discount

The Policy Proposal expressly reserves the right to redefine the qualifications for and the benefits provided by the Low Density Discount ("LDD") over the term of the new power contract. (Policy Proposal, p. 31-32) This suggestion should be reconsidered.

Bonneville has in the recent past presented proposals to redefine the qualifications and benefits of the LDD, and each time it has done so it has provoked consternation among the preference customers and substantial controversy. Resolving these controversies has required the time and the resources of both Bonneville and the preference customers.

Perpetuating such uncertainty for the preference customers that rely on the LDD program to mitigate the expenses of their low system density does not seem like an especially good policy choice. It also compares unfavorably with the certainty that Bonneville is seeking to establish for the benefits provided to IOU residential and small farm customers.

The Policy Proposal should be proposing solutions that reduce the amount of controversy, rather than perpetuating it. It is recommended that the ROD reaffirm the existing qualification standards and benefit levels available under the LDD. It should further establish periodic re-openers, such as every six years, to examine in a predictable manner whether the qualification criteria and/or the benefit levels need to be revised based on then current circumstances. And between such periodic re-openers, the LDD should be left in peace.

k. <u>Annual True-Up for Actual Costs</u>

During the discussion of the fact that the Slice product is the only Bonneville product that has an annual true-up to actual costs, the Policy Proposal indicated that after internal policy discussions Bonneville staff preferred an annual true-up to actual costs. (Policy Proposal, p. 39) When queried on this during the workshop sessions, Bonneville staff indicated that this comment was not limited to only the Slice product, but that the true-up to actual costs was an approach they favored for all Bonneville products, including full and partial requirements and block service. This suggestion has raised serious concerns among Bonneville's preference customers.

One of the primary benefits provided to preference customers by Bonneville is power supply cost stability during each rate period. For virtually all of these utilities, power supply is the largest single cost item in their budget, making stability in this area very valuable. Aside for the occasional operation of a cost recovery adjustment clause, the costs of power from Bonneville remain stable for each rate period. And while there is a price for this stability in the form of paying higher rates to provide Bonneville with the reserves needed to cover fluctuations in its own costs, this additional increment of cost provides preference customers a stable cost base on which to do their financial planning. It also permits them to offer their customers retail rates that are not subject to continual change.

There is nothing inherent in the tiered rates construct that would compel Bonneville to make such a material change to the manner in which it collects its costs from preference customers. In fact, the take or pay nature of the tiered rate construct makes the case for such a change less compelling. Finally, the suggestion by some Slice customers to find a way to put the Slice product on the same risk basis as other products (such as cost recovery adjustment clauses) should not be used as an opportunity to change all of Bonneville's other power products.

Given the substantial benefits that accrue from the current approach, the WPAG utilities urge Bonneville to retain the existing revenue and risk approach for non-Slice products, and to not impose a true-up to actual costs approach for the non-Slice products.

l. Benefits to IOU Residential and Small Farm Customers

The Policy Proposal suggests that the financial benefits available to the residential and small farm customers of IOUs should be initially set at $250 million per year. This initial amount would be escalated over the term of the new power contract at the difference in the relative escalation rates of the Priority Firm rate and the weighted average of the IOU's average system costs ("ASC"). These financial benefits would be distributed among the IOUs based on their relative ASCs. The ASCs would not be based on filings made by the IOUs, but would be calculated by Bonneville using its "cookbook" approach. (Policy Proposal, pp. 46-53)

The Policy Proposal indicates that the initial benefit level is based on the analysis of the estimated benefits the IOUs might receive if Bonneville were to implement the statutory residential exchange program and the § 7(b)(2) rate ceiling. It suggests that the initial benefit level of $250 million per year is a reasonable settlement of this obligation. It does not appear that Bonneville's analysis supports this amount.

Of the twenty-four scenarios that Bonneville analyzed, seven showed no financial benefits to the IOUs. The average benefit to the IOUs under all of these scenarios was about $162 million per year. These results were based on an assumption that Bonneville would modify the inputs it has used in its last two wholesale power rate cases to calculate the § 7(b)(2) rate ceiling in a manner that materially increases the benefits Bonneville is permitted to pay the IOUs.

In the over forty settlements of its payment obligation under the statutory residential exchange program that Bonneville implemented with preference and IOU customers prior to the Subscription process, it calculated its potential payment liability based on the ASC and § 7(b)(2) rate ceiling methodologies in place at the time the settlement was negotiated. Bonneville did not calculate this liability based on the assumption that it would make material revisions to existing methodologies to increase the benefits. When the scenarios that Bonneville analyzed using current methodologies and assumptions are assessed, the average annual benefit payment to the IOUs is about $33 million per year.

Lastly, Bonneville's assessment of the appropriate benefit level for IOU residential and small farm customers does not take into account the existing payment liability that certain of the IOUs owe to Bonneville, and indirectly to its preference customers, in the form of unpaid deemer account balances. These are amounts that accrued as a result of the ASCs of certain IOUs falling below the Priority Firm rate during periods when these IOUs were participating in the statutory residential exchange program. Rather than making an immediate payment of these sums to Bonneville when they accrued, which would have lowered costs to Bonneville and its preference customers, these IOUs accrued a payment obligation which they contractually committed to pay, and which survived the expiration of their residential exchange program contracts. This unpaid liability presently amounts to over $300 million, and does not appear to be accounted for in the Policy Proposal.

The level of benefits Bonneville is contemplating paying the IOUs in settlement of its residential exchange program liability exceeds what the IOUs would be entitled to receive under the statutory residential exchange program and the § 7(b)(2) rate ceiling as currently applied. Such a proposed payment level, in combination with a proposed payment methodology that departs from the method set out in statute, makes this proposal legally vulnerable. It appears that Bonneville is attempting to revise this statutory benefit payment program without aid of legislation.

Presently, representatives of preference customers and the IOUs are working diligently to find a consensual resolution of this difficult issue. These efforts, in which WPAG is participating, may produce a settlement proposal that the WPAG utilities will support. If this occurs, the willingness of the WPAG utilities to accept such a settlement and forego their right to seek legal review of the IOU benefit portion of the Policy Proposal will ultimately depend on the degree to which Bonneville responds with positive solutions in the ROD, and in the subsequent contract, rate and net requirement methodology processes, to the concerns raised in these and other comments by preference customers on the components of the tiered rates construct, other than the IOU benefit issue, that are important to these customers.

m. <u>Preference Customer Residential Exchange Benefits</u>

Preference customers have been eligible to participate in the statutory residential exchange program, and have done so since the passage of the Regional Act. The Policy Proposal recognizes this fact by proposing to settle Bonneville's residential exchange program liability with these customers as well. (Policy Proposal, pp. 19-20)

However, the Policy Proposal speaks in terms of *requiring* preference customers to waive their right to participate in the residential exchange program as a precondition to signing a new power contract with Bonneville. (Policy Proposal, p. 30) As stated earlier in these comments at section 4(e), Bonneville cannot condition the exercise of one statutory right (the purchase of federal power) on the waiver of another statutory right (participation in the residential exchange program).

That being said, it makes sense for both Bonneville and preference customers to agree to settlements of Bonneville's liability to preference customers under the statutory residential exchange program. But this should be done in a voluntary manner and at settlement levels that both parties find reasonable, not under the threat of being deprived of statutory rights.

Two additional changes are suggested to this portion of the Policy Proposal. First, it may make sense to negotiate residential exchange benefit settlements with preference customers for terms of less than the full term of the new power contract. Although settlements that cover the entire contract period may be optimal from Bonneville's perspective, preference customers may be unwilling or unable to commit to settlements of that duration.

Second, there are a number of public utilities that participated in generating resources in response to Bonneville's Notice of Insufficiency, and that have sold the output of these resources outside the region for an extended period. The Boardman Plant is a good example of this. Requiring preference customers who participated in such resources to waive their residential exchange benefits before the output of these resources is returned to the region is unreasonable. It would require them to waive a right before they have any understanding of its value. For the handful of utilities in this situation, it is suggested that they not be required to negotiate a settlement of their residential exchange rights until the resource on which such settlement would be based returns to the region.

n. Benefits for the Direct Service Industrial Customers

The Policy Proposal solicits comments on whether Bonneville should continue to provide federal system benefits, in the form of either power or money, to the remaining direct service industrial ("DSI") customers. It makes reference to the 2005 Concept Paper proposal of making about 560 aMW of power or benefits available to the DSI for the term of the new power contract. (Policy Proposal, pp. 54-55) For the reasons stated below, continuation of this subsidy program at the expense of the preference customers is not warranted.

Under the tiered rate construct, all of the available power from the FBS will be dedicated to serving the loads of preference customers, meaning that any power provided to the DSIs must come from the market. If there were any likelihood that the DSIs would pay the actual costs that Bonneville would incur to supply them, there would be less resistance to meeting their power needs by preference customers.

However, the history of Bonneville service to the DSIs is replete with instances where once the right to supply is established, the DSIs apply political pressure to reduce the price they pay for that supply to ensure their operations. The most recent example of this pattern was the offer of $40 million in financial benefits, which ultimately ballooned to a $59 million subsidy payment paid by preference customers. Bonneville has had an understandably difficult time resisting the political pressure the DSIs bring to bear for price reductions, and there is no reason to expect that this will change in the future. Small concessions to the DSIs turn into large subsidies over time.

The notion of selling power to the DSIs at the statutory rate also makes little sense in the tiered rates construct. The DSI rate directive contained in § 7(c) of the Regional Act keys the DSI rate off of the Priority Firm ("PF") rate and the typical industrial margin of preference customers. This rate directive was predicated on an environment in which

Bonneville was the primary (if not exclusive) source of load growth service to preference customers, and such service was provided under a melded PF rate as required by §7(b). The tiered rates proposal will eliminate the melded PF rate, and will reduce or eliminate Bonneville's role as the primary source of load growth service to preference customers. It would be unfair, and a legally dubious proposition as well, to provide power to the DSIs based on a rate directive when all of the other statutory provisions on which such rate directive relies have been set aside under the tiered rate construct.

There is yet another risk of selling power to the DSIs based on the §7(c) rate directive. Application of this rate directive in circumstances it was neither intended nor designed to operate in, such as the tiered rate environment, could produce a DSI rate that is not only lower than the Tier 2 rate paid by preference customers, but potentially lower than the Tier 1 rate as well. Either of these results would cause preference customer support for tiered rates to evaporate.

It is time for the region to acknowledge that while many of the DSIs have been long-standing customers of Bonneville, preference customers can no longer afford to provide the subsidy necessary to provide them with a power supply at a price lower than market. It is time for the DSIs to make their way, as so many other Northwest industries have been forced to do, without a subsidy extracted by Bonneville from preference customers.

o. Treatment of Conservation and Renewables under Tiered Rates

The Policy Proposal suggests that Bonneville should continue to conduct conservation and renewable activities under tiered rates in a manner essentially unchanged from its current approach under melded rates. (Policy Proposal, pp. 56-62) There are some good reasons for re-examining this approach.

The one of the primary purposes for implementing tiered rates is to give preference customers both an incentive to develop incremental resources, including conservation and renewables. The tiered rate regime should give preference customers more than sufficient incentives to pursue conservation and renewable resources, particularly in light of the cost-effectiveness compared with other resources. This makes continuation Bonneville's current conservation and renewable programs under the new power contracts seem unnecessary.

This conclusion is reinforced by the likely implementation of resource portfolio standards in Oregon and Washington, which will mandate a significant level of conservation and/or renewable resource development by most preference customers. With such obligations in the offing, continuation of the Bonneville programs to encourage conservation and renewable development is difficult to justify.

Lastly, while the Policy Proposal disclaims any intention of subsidizing Tier 2 service out of the Tier 1 revenue requirement, in fact that is what is being proposed with regard to the conservation and renewable programs. The Policy Proposal would place the costs of Bonneville's conservation and renewables programs in the Tier 1 revenue requirement, and justify such action on the basis of avoiding or minimizing customers' exposure to Tier 2 costs.

It is the case that recent history contains instances where, when left to their own devices, some preference customers did not pursue conservation and renewable resources at the level that was expected. While these instances can be explained on the basis of extraordinarily low market prices and the absence of appropriate incentives (such as tiered rates and mandatory resource portfolio standard), skepticism regarding a "trust us" approach is understandable. It is also important to note that while some preference customers performed at levels below expectations, many other pursued conservation and renewable at levels that exceeded expectations.

In these circumstances, a good compromise would be to implement the conservation and renewable approach contained in the Policy Proposal, but place a sunset on its continuation at the end of the third year of operations under the new power contracts. By that time, there should be a good track record of performance (or lack thereof) in the development of conservation and renewable resources under the tiered rate construct. This would permit an assessment of whether the institutional incentives are sufficient to ensure development of conservation and renewable resources, or whether continuation of a more active Bonneville role in this area is warranted.

The WPAG utilities recognize the difficulties Bonneville will face in eliminating a bureaucracy that has been in operation for decades, which has developed constituencies that are invested in its continuation, and that has enjoyed some success in developing conservation and renewable resources. However, this challenge to Bonneville is no more difficult than the political and economic challenges faced by preference customers in accepting responsibility for developing new resources and facing market prices for their load growth service.

This issue presents a litmus test that will show whether Bonneville has the will to change not only aspects of how its preference customers conduct their business with Bonneville, but to also make the changes to its business that are necessitated by the implementation of tiered rates.

p. <u>Transfer Service for Preference Customers</u>

Working collaboratively with its preference customers, Bonneville has made considerable progress in resolving many difficult issues presented by transfer service arrangements. Bonneville is commended for these efforts. The WPAG utilities look forward to continuing to work with Bonneville to resolve remaining transfer service issues so that the goal of equivalence of treatment between preference customers directly connected to the federal transmission system, and those connected through transfer agreements, can be realized.

The Policy Proposal recommends that funding be provided to ensure that transfer service customers are not materially disadvantaged when it comes to wheeling non-federal Tier 2 resources to serve their retail load. This is a necessary accommodation in order to ensure that transfer service customers can access non-federal Tier 2 resources on a relatively even footing with other preference customers. The Policy Proposal also suggests dollar and quantity limits on the amount of transfer service that will be provided for non-federal Tier 2 resources. (Policy Proposal, pp. 63-70) It is not clear why such limits are needed, or whether such limits will deprive transfer service customers of necessary opportunities to access non-federal Tier 2 resources. It is recommended that Bonneville reconsider whether such limits are really needed.

The Policy Proposal also recommends that transfer service customers be given the opportunity to hold their own transfer agreements, in lieu of Bonneville holding these agreements. (Policy Proposal, p. 67) This is a good option to provide transfer service customers and could materially reduce the administrative burden providing the service imposes on Bonneville.

q. <u>Resource Adequacy and the New Power Contract</u>

The Policy Proposal contains a default service provision under which Bonneville will serve preference customers that do not otherwise take action to serve their load in excess of their HWM under its Tier 2 rate. It also indicates that Bonneville will not include in the new power contract mandatory provisions resource adequacy provisions. (Policy Proposal, pp. 71-73) The WPAG utilities concur with both of these recommendations.

It is questionable whether Bonneville has the legal authority to condition access to federal power that preference customers have a statutory right to purchase on the development of non-federal resources. But on a more practical level, it is simply a bad idea from both the policy and administrative standpoint for Bonneville to assume the role as the regional resource development policeman. It is far wiser from all perspectives to rely on the incentives inherent in the tiered rate construct to motivate preference customers to develop new resources, and to provide power products and new power contracts that facilitate these activities.

r. <u>The Fallback Proposal</u>

The fallback contained in the Policy Proposal is the program that Bonneville asserts it will implement if the preference customers and IOUs do not reach agreement on the level of and method for providing financial benefits to the residential and small farm customers of the IOUs. (Policy Proposal, pp. 92-93) This is apparently an attempt by Bonneville to motivate preference customers and the IOUs to reach agreement. It is the "stick" to encourage consensus on this difficult issue, and as such it warrants serious examination since at this juncture there is no assurance that such an agreement will be reached.

The fallback is a mixture of applying statutory provisions as currently administered, while completely supplanting other statutory provisions. For example, the fallback suggests that the residential exchange program and the § 7(b)(2) rate ceiling will be administered as contemplated by the Regional Act. In contrast, it also suggests that the rate directives contained in § 7(b) of the Regional Act that require the melding of new and existing resource costs will be jettisoned, and that Bonneville will implement tiered rates in a manner that will be repugnant to preference customers. Under this approach, HWMs will be determined in 2007 without a subsequent true-up, there will be no augmentation to avoid Tier 1 deficits in the first year or to serve new publics, and the phantom generating resources in the Exhibits C of certain preference customers will not be removed.

Implicit in the fallback is assumption that Bonneville can implement tiered rates not only without the support of preference customers, but in a manner that preference customers find objectionable. This is a dubious assumption, because the tiered rate construct described in the fallback essentially repeals without aid of legislation the statutory rate directives intended by Congress to govern the allocation and collection of Bonneville's resource costs from preference customers. The fallback proposal is not a realistic solution to any identifiable problem, but an approach that would incite litigation on all of these matters.

What will most likely occur if the other recommendations in the Policy Proposal are not implemented is not tiered rates and the residential exchange program being administered in the least acceptable manner possible to all customers. Rather, it is conducting business under the provisions of the Regional Act for the determination of residential exchange benefits for IOUs and preference customers, preference customers purchasing power from Bonneville at melded rates, and obtaining service for their load growth either from Bonneville or from non-federal resources as they determine to be most prudent.

Rather than spending time on what Bonneville will attempt to do in the absence of consensus, Bonneville, its preference and IOU customers would be better served focusing their energies on finding consensual solutions to the issues presented by the implementation of tiered rates.

6. <u>Conclusion</u>

The WPAG utilities urge Bonneville to give serious consideration to the foregoing comments, and they look forward to working collaboratively with Bonneville to seek out mutually beneficial solutions to the difficult issues that Bonneville and its preference customers currently confront.