



October 31, 2006

Bonneville Power Administration
Public Affairs Office DKC-7
P.O. Box 14428
Portland, OR 97292-4428

Re: Benton PUD Regional Dialogue Comments

Introduction

BPA is an important business partner. Your success and our success are clearly tied. We are supportive of the Regional Dialogue (RD) goal of allocating the federal system to BPA's preference customers.

As a slice customer of BPA, we have essentially faced an allocated system since 2001 as our rights to power from BPA are fixed amounts each year. We have acquired non-federal resources to provide for growing loads and mitigate the risk of being short when market prices are high. During the July 24, 2006 heat wave, these resources kept Benton from purchasing in a triple digit market where on some hours power was not available at any cost.

The Administrator has repeatedly said that a goal of RD is to get infrastructure built in the region. To achieve this goal, the RD contracts must provide at least two assurances:

- The cost of service for load growth MUST stay out of Tier 1. This includes any cost of Tier 2 resources, meeting conservation and renewable targets, and the cost of load following customer load growth within a rate period (load variance). Utilities will only commit the large amounts of capital necessary for new resources if they are confident BPA has exited the buy and meld paradigm.
- BPA must offer products that allow customers to acquire and integrate non-federal resources. The complex partial produce needs to be retooled so it is a viable option for customers. With the settlement of the true-up litigation, the slice product needs to be reoffered with similar flexibilities as exist today (except for dynamic scheduling) and in sufficient quantities to meet customer requests and allow load following and resource integration over the 17 year period of the contracts (If a volume cap is included in the ROD, language must be added that provides for a reopener if the above exceeds the cap).

Stay the course and get this done. BPA's sense of urgency is appreciated and we share it.

Service to Publics

Introduction

BPA should implement the basic tenants of the PPC proposal, including the treatment of Centralia issues. Singling out Centralia issues in the fall back proposal is divisive among public power and keeps the region from focusing on solutions to more important issues.

Tier 1 must have a process that assures customers that only the embedded costs of the system are collected here and augmentation purchases are kept to a minimum.

We support the comments from PPC and WPUDA on service to publics.

Irrigation Mitigation

We agree with and support the recommendations on page 32 with the following clarifications:

- There should be no fixed dollar cap on future irrigation mitigation. Future dollar amounts should change proportionally to the future adjustments in the then effective summer rates.
- The current program is working well administratively and should be replicated in future business relationships between BPA and participating utilities.
- The amount of irrigation mitigation should be determined in a rate case as long as it is a mechanical implementation of program design that is decided during the Regional Dialogue process.
- The amount of irrigation mitigation available to an existing slice/block customer should be based on 100% of their eligible irrigation load (FY 2002 – 2004 three year average)
- There should not be a requirement to implement conservation. BPA's allocated system will provide the necessary incentives for investments in conservation without other contractual requirements.

Service to IOUs

We support the comments of the PPC regarding service to IOUs. In addition, we observed in the policy proposal that BPA has calculated the range of IOU benefits between \$0 and \$390M per year. We would like to point out the mid-point of this range is \$195M/year rather than the \$250M/year BPA suggested as the starting point for future benefits. We agree with using both Tier 1 and Tier 2 rates as part of the equation on future escalation of the benefit.

We support the methodology for updating the financial benefits over time. The Proxy PF should include all the resources acquired by publics to serve load growth, in addition to BPA's Tier 2 acquisitions.

Service to DSI's

All DSI benefits should end in 2011.

The President's Budget Proposal

We agree that BPA needs a mechanism to fund its capital expenditures in light of borrowing limits. The Administration's proposal to use secondary revenues above \$500M to reduce federal debt is not an appropriate mechanism and should not be a part of the RD proposal.

We do support BPA beginning a public process to explore more appropriate mechanisms for addressing funding BPA's capital program.

Dispute Resolution

RD has been characterized as a settlement where each of the parties must make compromises and sign contracts implementing these compromises and giving up some rights for judicial review. BPA must be part of this settlement and put some "skin" into the game. Dispute resolution is an opportunity for BPA. BPA needs to "push the envelope" by allowing third party arbitration in as many areas as it can. For areas where there is a crystal clear constitutional prohibition, BPA should use the Dispute Resolution methodology laid out in the recent Slice settlement documents.

Cost Control

BPA should utilize the Regional Cost Review (RCR) process for vetting and establishing O&M and capital budgets. The process must include a requirement that the Administrator and senior BPA and Resource Management partner staff meet with stakeholder CEO's as often as requested by the stakeholder CEO's for purposes of attempting to resolve budget level disagreements between technical staffs. This process should be included in the long term contracts.

There will be an opportunity in 2011 to align all customers' rates for Tier 1. We support using true-ups for the difference between forecasted costs and actual costs. This will keep pressure on the agency to manage actual costs within the budgets developed in the PFR process. However, we are open to other mechanisms that will align all customers' rates.

BPA should also commit in its policy document to continue to meet monthly with interested stakeholders to review actual costs. Senior BPA staff should meet with customers to review results on a quarterly basis and explain any forecasted budget overruns.

Conservation and Renewables

The credit of energy from BPA funded conservation to HWM should be increased from 50% to 75%.

BPA's allocated system will provided the incentives and price signals for their customers to make appropriate investments in C&R. Therefore, BPA should not include any funding in Tier 1 for these programs.

If it is necessary for BPA to provide a conservation back stop to meets its statutory obligations, then these expenditures should be directly assigned to these under performing customers.

Slice

Summary

The current Slice product provides important benefits to the region, not the least of which is spreading the risk inherent in a hydropower-based system. In the future, a viable Slice product will be important to the success of the broader objectives of the Regional Dialogue Policy. Our comments will give background on the success of the current product and then touch upon reasons why some of the changes to the Slice product proposed in the Regional Dialogue Proposal are unnecessary and would be harmful to the region's long term goals.

In light of the lack of detail in the Regional Dialogue Policy regarding other BPA power sales products, we question whether this policy document is the place for BPA to provide a detailed description of the Slice product features. Instead we believe that, rather than locking in specific product design features for this or other products in the Regional Dialogue Record of Decision, the Administrator should preserve his flexibility for later cooperative contract design discussions and negotiation with customers between now and signing of contracts. However, if such a product description is to be made at this time regarding Slice, we have several specific and important suggestions in our comments.

Slice Product Performance

Slice customers have worked alongside BPA staff for almost a decade in order to create and then implement a viable Slice product. It is a credit to the staff, both at BPA and at the utilities, that this effort has been a success in creating a functioning product that meets the intended goals. The Slice purchasers agree with some of the changes that can make the product work even better. And, we look forward to working with BPA staff to continue to hone implementation of the product in many ways.

However, it should be clear that the recent "review" of the product did not create a consensus on all of the new directions and principles that BPA has proposed for the Slice

product. BPA has not provided information or arguments that would support several significant changes appearing in the proposal.

In its current form the product fully meets the five original principles: (1) No risk or cost shift to other customers; (2) No risk or cost shift to taxpayers; (3) No avoidance of fish costs; (4) No interference with operations; and (5) No changes in law required.

In fact, the product has shifted risk away from BPA and its other customers just as originally intended. It has created the four advantages to the agency that BPA envisioned when it first offered the product for contracts beginning in October, 2001: (1) Risk mitigation in moving risk of variable hydro conditions to Slice purchasers; (2) Reducing the need for BPA to reshape federal system output to the shape of customers' loads; (3) Longer-term fish funding stability; and (4) Responsiveness to public customer needs (see BPA Congressional Testimony, <http://resourcescommittee.house.gov/archives/106cong/water/00apr06/norman.htm>).

For the future, a viable Slice product (i.e., one that has not been detrimentally modified) would meet many of BPA's key objectives while maintaining the objective of avoiding any negative impact upon other customer groups.

Nature of the Slice product and Role in the Region's Future

From its inception, the Slice product has been based on two complementary principles that are fundamental to its success:

1. Slice purchasers pay a fixed percentage of BPA's actual costs, and in return receive the same, pro rata percentage of federal power system output and services (such as storage) as and when available on the Federal system.
2. Slice purchasers accept the risk of fluctuations in actual federal system output and accept responsibility for managing their percentage share of the federal system output to serve their loads. In return, they have access to the same federal system flexibilities available to BPA in order to fulfill their load-following obligations.

It is this fundamental tradeoff of risk and benefit that makes Slice beneficial not only to customers, but to BPA. It fits the needs of customers who require the capability to follow their own loads, and who may want or need to develop and integrate non-federal resources. Slice is particularly well suited for helping utilities integrate intermittent renewable resources, which may soon become required under renewable portfolio standards. Contrary to some perceptions, the Slice product fits the needs of BPA and its load-following customers as described above by having Slice purchasers take on the risk of water and market conditions, the task of shaping the federal system output to loads, and their proportionate share of actual costs including fish and wildlife obligations. Since it was a

newly offered option in 2001, Slice has proven to be a product that meets all of these expectations.

Inherent in the future construct proposed in the Regional Dialogue are three objectives: (1) BPA's role as a regional power supplier is reduced over time as is its need to rely on short term power purchases from the market; (2) BPA's customers will receive accurate price signals as they face actual costs for the power products offered; (3) Customers will be encouraged to develop or acquire needed regional infrastructure, particularly non-federal generating resources to serve regional load growth and to satisfy renewable resource needs, rather than relying on BPA for such development.

The Slice product already accomplishes, with Slice purchasers, all of the objectives that BPA is attempting to accomplish for its other customers. A viable Slice product would be ideally suited to accomplishing these key objectives for the future: (1) By changing the major responsibility of shaping system output to the Slice purchaser, it materially reduces BPA's reliance on the market; (2) By charging customers for BPA's actual costs, it gives the most accurate price signal possible; (3) By providing access to the output and delivery flexibility of the federal system, the Slice product is ideal for encouraging development and integration of all types of non-federal resources.

Concerns with the Regional Dialogue Proposal

As noted above, it is not the position of Slice customers that the product should remain exactly the same forever. Certainly, there are some changes that all involved have agreed upon. We look forward to working together to continue to enhance product implementation. Further, we appreciate that BPA staff's original intent described in the power sales contracts was to renew the Slice agreement on the same terms and conditions set forth in those documents.

Unfortunately, the Long Term Regional Dialogue Policy Proposal ("the Proposal") proposes changes that will materially alter the nature of the product, will reduce its attractiveness in the future business paradigm, and will make the product less useful to customers who want to develop and integrate new, non-federal resources. In light of the product's success, these fundamental changes appear to be trying to "fix" elements of the product that are not broken.

In general, the most significant concern is BPA's departure from the two fundamental principles mentioned above that make the Slice product viable and successful. Again, these fundamental principles involve true access to the same federal system flexibilities available to BPA in exchange for payment of actual cost of that system and acceptance of the risk inherent in that system. It should be noted that this access does not include "off the top" obligations that BPA must provide for fish flows, flood control and other important regional uses.

We have provided three sections below to more fully describe the meaning behind these principles and the threat to them represented by BPA's proposed changes. These sections will be presented as questions involving three aspects of BPA's proposal: (1) Departure from the basic nature of the product and corresponding reduction of the flexibility of the Slice product; (2) Disallowing self-supply of ancillary services associated with the product; and (3) Inserting a strict and arbitrary cap on the volume of the product offering.

Question 1: Should BPA depart from the basic concept that the Slice product is a contracted percentage of system capability in exchange for a payment of the same percentage of system costs?

The answer is no. Slice customers are very concerned over BPA's failure to reaffirm the two fundamental principles upon which the Slice product has been based, and which have made it a success.

Principle 1. Slice purchasers currently pay fixed percentages of BPA's actual costs as incurred by BPA, and in return receive the same percentage of Federal power system output and services (such as storage) as and when available on the Federal system. This arrangement satisfies the Federal Power Act's requirement that BPA must offer cost-based power rates to its preference customers.

Principle 2. Slice purchasers currently accept the risk of fluctuations in actual Federal system output and responsibility for managing their percentage share of the Federal system output to serve their loads, and in return have access to the same Federal system flexibilities available to BPA to fulfill this obligation.

After five years of experience implementing the current product, it is clear that the current Slice product meets the original principles as laid out by BPA. And, it does so while maintaining the two fundamental principles listed above. BPA proposes to move away from these key elements without offering justification beyond wanting to "simplify the product offering." The unintended result might be a more complex new product that creates a whole new set of conflicts and disputes over implementation questions that have already been settled with the current Slice product.

It is worth repeating that the Slice purchasers have worked diligently at the technical level to reach agreements on some changes that can make the product work even better. Further, they are ready and willing to work with BPA staff to continue to address any issues that arise with implementation of the product.

Clearly, Slice customers have never advocated having actual ownership or control over the federal system. All of the mandated needs for non-power obligations and for system reliability are preserved in the current version of the Slice product. But, inherent in the product is the need for Slice customers to have contractual, operational access to their share of system capability and to appropriate information utilized by BPA staff.

Discussions and descriptions of the “Alternative 2” Regional Dialogue proposal show several departures from the basic concept that Slice is a contracted percentage of the available system capability in exchange for a payment of the same percentage of system costs. The following are some examples.

Off the Top Obligation Buffer-- The proposal appears to allow BPA to reserve capacity on a subjective basis without demonstration that the need for the capacity is equally shared between the paying Slice customers and BPA. Without proper care, BPA could generate uncertainty with its own power marketing activities and then take capacity from Slice customers through the use of these subjective buffers. It is essential that any capacity reserved by BPA tie back to system capability in an objective manner.

Real-time limits subject to BPA’s and customers’ aggregate pre-schedule election and “other operating criteria as determined by the BPA hydro scheduler”-- Again, a Slice customer’s system limits should not be a function of the other customers’ or BPA’s schedules, but of their share of the actual capability of the system. The use of subjective adjustments by the BPA hydro scheduler is a break from the current practice of objectively linking contract limits to system capabilities.

In BPA’s Regional Dialogue proposal, the statement defining Slice as “a system sale of Requirements and surplus power indexed to the variable FCRPS energy and storage capability...” should be clearly understood as providing both the available energy and capacity of the system to the Slice customers on an apportioned basis. In addition, to address concerns raised earlier by BPA, the Slice customers have made it clear that they accept BPA’s proposal to remove the right to dynamically schedule FCRPS energy and capacity.

BPA’s new proposals are unwarranted wherever they cause constraints on design and flexibility of the product. That is because they would make unwieldy a Slice product that already allows BPA to set conservative limits that can disadvantage Slice customers. Examples demonstrating BPA’s current ability in this regard are many; here are a few:

- In March of 2002, after repeated warnings from Slice customers that the system was at risk of drafting out the bottom of the Slice storage limits, BPA was discovered to be well below the limit while the Slice customers had minimized their generation to stay in compliance with the limit.
- In June of 2005, BPA’s real-time marketer blocked in sales for the day and shortly afterward discovered that the Federal System lacked generating capability to supply the sales and that the cost of purchasing to meet the obligations was very high. In response, BPA brought on 200 MW of additional generating capability from Hungry Horse, Libby and the Willamette Projects. But, the Slice limits were never updated with this generating capability, effectively allowing BPA to unilaterally use the capacity to minimize their own purchasing.

- In May of 2006, BPA started operation to 360 kcfs discharge at The Dalles to move water out of the system in anticipation of high flows during a warm spell. Slice customers were given exact daily generation levels to maintain in order to operate to the 360 kcfs flow. For May 19-21 (the weekend) the generation levels given to the Slice customers were overstated by an energy amount equal to 1,426 MW *every hour* for 3 days. Despite contract provisions requiring BPA to update the customer's limits for deviations this large, no update over the weekend was given and it was only on Monday that BPA made a sizable reduction to the customer's generation levels. Compensating adjustments for the weekend were made starting on Wednesday. In order to meet the higher generation requirements, some customers sold during the weekend for as low as \$3/MWh. The subsequent reduction on Monday resulted in customer purchases at prices up to \$50/MWh. Interestingly BPA was selling to some of these customers on Monday at \$47/MWh.

These examples are presented not so much to complain about these instances, but to illustrate that BPA still maintains ultimate control of the federal system, contrary to misconceptions on that point. On a positive note, BPA staff and Slice customers have professionally and respectfully worked through these and many other issues, and the Slice customers have paid for many improvements to BPA's operating methods. This collaborative approach has created a viable current version of the Slice product. We will continue to work with BPA on Slice system enhancements through the current contract term, which will create an even more refined Slice product by 2011. Further constraints on flexibility that move away from the fundamental notion of paying a percentage of the costs in order to receive a percentage of the system output and risks can only create a less level playing field. On the other hand, keeping the product in a form that is viable for customers will preserve alignment and the many benefits to the region mentioned in the introduction.

Question 2: Should BPA remove the ability to self-supply ancillary services such as operating reserves (OR) and energy imbalance (EI) in the future Slice product as proffered under Regional Dialogue?

BPA has proposed the following principle: *The Slice product will not include within-hour load-following, dynamic scheduling or ancillary services. Generating capacity and energy provided from the FCRPS to TBL for Interconnected Operating Services will come "off the top," and revenues PBL receives from TBL for those generating inputs will be shared on a proportional basis.*

The customers accept that the future Slice product will not include within-hour load-following or dynamic scheduling. However, the Slice Customers believe the future Slice product should continue to incorporate the as-is ability to self-supply ancillary services (operating reserves and energy imbalance). The current Slice contract has included this right during the initial 5 years of the agreement, and this right will continue during the next 5 years under the existing agreement. BPA has not promulgated a compelling argument to withdraw the right to self-supply ancillary services in the next Slice contract.

It is nearly impossible for a Slice customer to perfectly forecast net load requirements for the upcoming hour. To be clear, Energy Imbalance is a TBL product provided to all scheduling customers (i.e., non-load following customers) within the TBL control area that provides for and absorbs the hourly energy due to the difference between actual load and the load forecasted by BPA for that customer. Using the Non-Slice capacity of the FCRPS, PBL provides this service to load following customers and essentially self-supplies this service as it does not face charges/credits from TBL. Analogous to PBL, many of the Slice customers in the TBL control area use the capacity of the FCRPS to self-supply this service from Slice. BPA limits the amounts of capacity that can be dedicated for this service each hour so imbalances greater than the self-supply amount still are provided by TBL. TBL and the Slice Customers developed a business practice and implementation procedures (see <http://www.transmission.bpa.gov/includes/get.cfm?ID=420>) for this self-supply service and the implementation has been smooth and non-controversial since it began, from October 2001 up to the present time. TBL views this product as revenue neutral so there are no revenues received by PBL to “be shared on a proportional basis.”

All bulk power systems need generating capacity set aside to balance the grid when a generator or transmission line unexpectedly fails. Operating Reserves are a TBL service provided to all customers based on usage of the TBL transmission network. All customers have the option to either: 1) purchase these ancillary services from TBL; 2) self-supply these services; or 3) purchase these services from a third party (such as Seattle City Light). Many of the Slice customers have elected to self-supply this service from their hourly Slice capacity. TBL has developed business practices and implementation procedures for this self-supply service. Implementation began October 2001 and has been smooth and non-controversial from the TBL perspective since it began (see <http://www.transmission.bpa.gov/includes/get.cfm?ID=746>).

The Slice product includes, among other things, access to hourly capacity of the FCRPS. The FCRPS is an energy-constrained system, however, there are many hours during the year when the system and individual Slice customers have surplus capacity after serving their native loads and marketing any surplus energy at that time. Two ways to utilize this capacity are to set it aside for operating reserves or energy imbalance. Slice customers are asking that BPA continue to allow customer choice in this regard as many prefer to use this capacity for the self-supply of ancillary services.

Lastly, BPA PBL also states in their policy proposal that “The removal of the right to dynamically schedule FCRPS energy and to self-supply ancillary services makes it clear that this product does not provide the purchaser with any ownership type, operational right to a percentage share of the system.” As already stated at the onset of this document, all Slice customers agree with BPA’s proposal to remove the right to dynamically schedule FCRPS energy. We also agree that Slice does not provide an implied or explicit ownership of the FCRPS. This argument by BPA does not require the removal of self-supply of these important services to sustain the validity of its assertions.

PBL has not established nor communicated to the region a legal or operational justification for removing the self-supply of these services and should restore these contract principles in the description of the Slice product in the Regional Dialogue policy proposal.

Question 3: Should BPA limit the availability of the Slice product to a specific percentage amount for the next contract period as proposed in the Regional Dialogue?

The answer is no. BPA proposes offering an amount of Slice capped at 25 percent of the existing FCRPS. However, BPA states no rationale for this limitation, nor does the Regional Dialogue proposal describe how this seemingly arbitrary limitation meets any of BPA's original or newly proposed principles for the Slice product.

Rather than providing support for this arbitrary limit, the BPA proposal purports to respond to the needs of Slice customers by stating that the interest in the product is not expected to exceed 25 percent. They cite the current level of participation as evidence of this. But BPA's assertion that there is little new interest in the product cannot be known at this time, and could have the effect of a self-fulfilling prophecy as the proposal itself limits possible interest.

The customers do not see the need to set a specific limit at this time when it is too early to know whether there will be a new, larger demand for the product. The better direction to take in the final Regional Dialogue proposal would be for the Administrator to retain discretion to revisit the issue once demand is better known.

The reason customers are concerned about the overall limit on the amount of the Slice product offered is that the product becomes less and less viable as it becomes a smaller portion of the power portfolio of a customer. Typically, Slice makes up 50 to 66 percent of a customer's portfolio. As that percentage drops, the product becomes less useful for following loads and integrating intermittent renewable generation, and less economically viable.

Even in the original offering of the product in 2001, BPA offered to sell up to 28 percent of the federal system as Slice. The basis for this original limitation was that the product was new and unknown to BPA, though similar products have been sold for many years by other hydropower producers. However, for 2011, the product will not be new. After five years of experience with the product, there is no longer a basis for limiting the product volume for fear of unforeseen situations.

In other communications, BPA has implied that the proposed 25% volume limit on Slice would provide them assurance regarding the need for flexibility to manage operational complexities. Again, successful implementation of the current product shows that this concern is not valid. Slice customers take on a portion of system risk and have the same non-power obligations and follow the same rules that BPA is obligated to follow. The version of the product currently in effect would provide plenty of flexibility to BPA for

operational purposes. This issue was discussed further under the section on BPA's new proposals to downgrade the flexibility offered in the Slice product.

Conclusion

In spreading the risk of variation in the federal power system output, the Slice product benefits BPA, its customers, and all of those to whom the federal system has an obligation. The product is working well. BPA staff and customer staff have worked well together in order to achieve these results. The proposed changes to the product are not necessary. If detailed product descriptions are to appear in the final Record of Decision for the Regional Dialogue Policy, then the Slice product description should reflect the fundamental principles that have made it successful. Taking on a percentage of the system costs and risks should warrant receipt of a percentage of the system output. Proposals to restrict product flexibility, to disallow self-supply of ancillary services, and to arbitrarily restrict the volume of the product offered could undermine a power product that is serving customers well, avoiding negative impacts on other customers, and meeting key objectives of the agency.

Thank you for the opportunity to comment.

Very truly yours,

A handwritten signature in cursive script, appearing to read "James W. Sanders". The signature is written in black ink and is positioned above the printed name and title.

James W. Sanders
General Manager