



Providing quality water, power and service at a competitive price that our customers value

October 31, 2006

Mr. Mark O. Gendron
Vice-President, Requirements Marketing
Bonneville Power Administration
Post Office Box 14428
Portland, OR 97293-4428

RE: BPA's Long-Term Regional Dialogue Policy Proposal

Dear Mark:

Snohomish County PUD No. 1 is pleased to submit the following comments in response to BPA's "Long-Term Regional Dialogue Policy Proposal" ("Proposal") dated July 13, 2006. We appreciate the cooperative manner in which BPA has approached the Regional Dialogue process and the extension of time for filing comments. The results of this process will be a significantly changed paradigm for the Pacific Northwest region, the Bonneville Power Administration ("BPA"), and BPA's customers. As such, it is important that we take the time to "get it right" and do not fall into the traps that have plagued so many other parts of the country that have tried to restructure the electric power industry. Power at cost, coupled with a fair allocation of federal system power benefits, should continue to be the fundamental theme for BPA and this region. The Proposal is a good first step toward that end.

In general we are supportive of the comments by the Public Power Council (PPC) and agree with the Northwest Power and Conservation Council that "the goal should be long-term contracts (20 years) both to protect the system from interventions from outside the region and to reduce uncertainty for both the customers and Bonneville."

Consistent with this long-term goal we have the following specific comments:

Snohomish PUD's support of the Proposal is predicated on resolution of the Centralia issue as proposed to BPA by the PPC Executive Committee.

A significant and important element of Snohomish PUD's willingness to support the Proposal is resolution of the Centralia issue. And it speaks volumes that the balance of Public Power is also supportive of a solution which does not require publicly owned utilities to continue to be penalized for a decision largely outside of their control. The Centralia resource was owned under a different BPA contractual relationship than currently exists; its inclusion or exclusion as a "resource" for allocation purposes is a contract dispute issue that has no place in the Regional Dialogue discussion.

As requested by BPA, those publicly-owned utilities that were previous minority owners of the Centralia coal project have submitted to BPA a compelling set of arguments for why the Administrator should decide in favor of removing the Centralia resource from their resource exhibits for the post 2011 contracts. The Administrator should move immediately to resolve the Centralia issue in favor of the publicly owned utilities, including Snohomish PUD, who owned a minority share of that project.

Snohomish PUD is supportive of the basic premise of the Proposal to allocate the Federal Base System (“FBS”) amongst BPA’s public owned utilities.

Allocation of the FBS among BPA’s public customers under long-term contracts is fundamental to the underlying goal of preserving low cost FBS power for preference customers. This is true whether it is achieved through BPA’s current proposal or through a direct allocation of power as originally proposed by the PPC. Snohomish PUD supports tiered rates in concert with an allocated system approach because it provides incentives for individual utilities to invest in conservation and renewable resources.

BPA’s proposal is more complex than a straight power allocation and its success is dependent on the specifics of rate design, coupled with the mechanics of determining individual utility High Water Marks and net requirements. We encourage BPA to continue to work out the details cooperatively with its customers. The interaction of the various elements is extremely important and can make or break the Proposal. As with most things, the “devil is in the detail.”

Historic conservation must be treated fairly in the Proposal.

Snohomish PUD has a specific concern with the way BPA has modified the Public Power Council’s proposed treatment of conservation. As currently structured, initial High Water Marks would only include credit for conservation achieved since 2007. This approach penalizes utilities that have historically made substantial conservation investments towards the region’s goals and conversely rewards utilities who have not carried their share. Utilities that have made only minimal efforts will be able to use the 2007 to 2011 time period to pick fruit left un-harvested for years. Utilities, like Snohomish PUD, who have pursued conservation aggressively for over two decades, will be challenged to achieve equivalent relative reductions. Instead of being credited for its leadership, Snohomish PUD and other utilities could find themselves punished with lower High Water Marks.

While we appreciate BPA’s inclusion of fifty percent of conservation achieved through BPA funding, Snohomish PUD has funded the lion’s share of post 2002 conservation itself. We believe all utilities should do likewise. We encourage BPA to rethink its proposal and credit conservation achieved since 2002 consistent with the original Public Power Council proposal.

Tiered rates must be designed and implemented with cost control processes that ensure costs are not transferred from Tier 2 to Tier 1.

One of the most important elements of the Proposal is to ensure the segregation of costs between Tier 2 and Tier 1. Tier 1 must reflect only the costs of maintaining and operating the existing FBS plus funding of fish and wildlife and other mitigation costs associated with operation of the FBS. Unless the proposal successfully maintains this segregation over time the tiered rate structure will not properly function to incent resource development.

Tier 1 should not include the costs of acquiring new conservation or renewable resources. Under the changed paradigm, funding new conservation and renewable resources is the responsibility of individual utilities whether they choose to do so through their own actions or through BPA Tier 2 purchases. There will be appropriate incentives in the tiered rate structure, coupled with likely federal and/or state mandates, to ensure conservation and renewable development. If, despite these incentives, it can be shown that a utility is not making a good faith effort to invest prudently in these resources, then Snohomish PUD supports the consideration of a mechanism for surcharging utilities who do not contribute toward regional targets.

With regard to market transformation efforts, however, we believe BPA could continue to play a role. The costs associated with these activities can be reasonably included in Tier 1 rates, because the benefits accrue to all utilities by reducing electric loads region-wide.

The BPA Tier 2 product must not be advantaged over individual utility resource acquisitions. For that reason, Tier 1 should not be burdened with resources acquired by BPA to meet reliability, resource integration, load regulation and other functions associated with load growth placed on BPA. The FBS is currently capable of providing those functions for its existing customer load and any additional acquisition should be deemed to be for purposes of load growth. A utility that chooses to provide for its own load growth will need to provide those services for itself. BPA should not relieve Tier 2 purchasers of those costs and thus advantage Tier 2 purchasers by burying those costs in Tier 1.

Rates for Tier 1 power products should be based on the cost of operating the federal system in aggregate and not on “opportunity cost” constructs. BPA suggests that prices for load-shaping and load-following services would be based on the opportunity cost of buying and selling secondary energy to shape FBS power. Snohomish PUD finds this approach problematic for two reasons. First, the proposal is at odds with the basic premise of the Regional Dialogue -- that the benefits of the federal system should be allocated to Publics to produce the lowest possible cost-based rates. Market rates do not represent BPA’s costs, because BPA uses its own resources – not the market – to provide ancillary services. While BPA has suggested it would use revenues from shaping services to reduce base energy rates, such an adjustment would simply create winners and losers among public utilities, without furthering any particular allocation goal.

Second, as a dominant participant in northwest energy markets, BPA heavily influences near-term energy prices. BPA cannot legitimately use the market to value its services, when the market itself is largely driven by the timing and volume of BPA transactions.

We agree that rates under a new tiered structure need to be transparent and meaningful to customers, with price signals that encourage resource development and minimize the dilution of the existing Federal system. Creating rates that meet these objectives will take focused and thoughtful work. The Record of Decision should leave open all avenues of inquiry and give both BPA staff and customers the flexibility to explore creative solutions.

It is critical that BPA provide a robust set of product options that meet the needs of their customers and customers should be free to choose among those products without arbitrary limits or artificial product constraints.

We strongly believe that publicly-owned utilities should be free to choose products from a robust product menu that includes workable block, partial requirements, full requirements, and Slice options. Products should be developed cooperatively with customers and include features that allow utilities to meet their load requirements and successfully integrate future resource choices. The Record of Decision should not contain statements that constrain the Administrator in terms of the design or quantities of products offered. Rather than locking in any particular product design or quantity, such as with Slice, the Administrator should preserve flexibility for later contract design discussions and contract negotiations.

Snohomish PUD may or may not continue to purchase the Slice product; however, Slice should not be singled out for any decisions at this time, if any are in fact needed. From Snohomish PUD's perspective, Slice provides an option that does not disadvantage or harm other utility customers, provides risk management and other benefits to BPA, and facilitates the integration of new resource choices by utilities in concert with BPA's stated goals.

BPA should establish policy objectives for the future role its transmission system.

For the Proposal to succeed, public utilities must be able to move power to load centers. From discussions that have occurred since the Proposal was issued, it has become clear that BPA's current processes for selling transmission rights are not well aligned with Regional Dialogue concepts.

While Snohomish PUD recognizes and is encouraged by BPA's commitment to address these issues, we believe it important at this juncture for BPA to outline its overarching policy objectives with respect to its transmission assets. Those objectives should include an affirmation that access to an allocated share of the federal power system carries with it equivalent access to federal transmission capacity. In addition, Tier 2 resources should not, by virtue of BPA's ownership of transmission, enjoy a competitive advantage over resources developed by others. We believe these two statements are consistent with the

premise of the Proposal and will ensure an even playing field exists for all future resource development.

We encourage BPA to continue to work with its customers, in an open fashion, to ensure that adequate transmission capacity is available to serve northwest loads.

BPA should provide Residential Exchange benefits that reflect the intent of the Regional Act.

BPA should provide financial benefits to residential and small-farm consumers of investor-owned utilities consistent with the Northwest Power Act Residential Exchange Provisions. BPA should not, as the state Public Utility Commissions have suggested, substitute a “share the benefits” formula based upon the market. The original concept behind the regional exchange was to provide parity between the wholesale costs of publicly owned and investor owned utilities, not to share benefits as measured by the difference between BPA costs and market prices. While conditions have changed, wholesale parity should continue to be the focus and a solution should be sought that bases residential exchange benefits on that premise.

While the amount of Residential Exchange benefits for investor-owned utilities continues to be a matter of intense negotiation, Snohomish PUD believes BPA’s proposed methodology provides satisfactory long-term certainty -- by not escalating the initial amount until 2012 and then applying the relative escalation rates of investor-owned utility average system costs and combined Tier 1/Tier 2 rates.

BPA should continue to work with its customers to improve cost transparency, implement cost control mechanisms, and provide enforceable dispute resolution mechanisms.

Cost Transparency and Control

Snohomish agrees with previous PPC statements that “meaningful, long-term mechanisms for controlling all of BPA’s costs must be developed in tandem with an allocation method.” BPA has made progress in working with its customers to establish better cost controls, such as outlined in the Process Improvement Program report prepared by KEMA. BPA should continue efforts to capture the potential savings the KEMA report outlined and to establish cost control mechanisms that go beyond simple transparency. Meaningful customer involvement in BPA’s decision-making process – involvement that includes discussions about the variety of options BPA might pursue – is one avenue for avoiding the controversies of the past. We are committed to working closely with BPA on all issues it faces.

In order to enable customers to sign long-term contracts, there must be institutionalized and enforceable contract provisions for cost control with meaningful dispute resolution mechanisms and governance reforms. It is unlikely that a “y’all come” cost control process as proposed in Regional Dialogue will achieve that end. There are fundamentally two groups in such a process: 1) those that pay the bills, and 2) those that spend the money. There is little incentive for the latter to be concerned with the cost-effectiveness of actions taken to carry out BPA statutory obligations. In fact, history would tend to

suggest the opposite. Agencies, tribes and public interests groups already have significant forums for determining money to be provided them. Customers should similarly have their own forum where they can examine available alternatives for achieving statutory objectives and to provide BPA separate input that reflects their responsibility as the bill payer.

Dispute Resolution

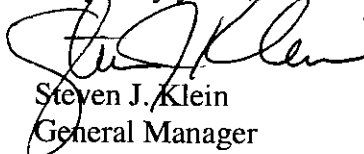
Likewise, while BPA's discussions of possible dispute resolution mechanisms are useful, they fall short of a specific proposal. Fair methods of dispute resolution are imperative to the creation of contracts that are durable and binding upon both parties. BPA and its customers will need to devote significant time to develop methods that will stand up over time. A good starting point may be the resolutions reached in the Slice product mediation process.

The Proposal should not mention or reference the President's Budget Proposal.

The misguided notion that the region should send a portion of secondary energy sales revenue to the Treasury should not be given credence by specific reference in the Proposal. BPA's customers have stepped forward consistently to cover BPA's costs when secondary sales revenues were below those budgeted. In turn, they should reap the benefits when secondary revenues are higher than forecasted. To do otherwise places a lopsided risk upon your customers and places them in a "lose, lose" position. They lose if revenues are below those budgeted and they lose if revenues are significantly above. We, as a region, have always met our Treasury repayment obligations and in doing so have paid for the regional power system. We should not be asked to pay more than what is owed.

Snohomish PUD appreciates the efforts that you, the Administrator and all the other BPA staff have put in to make this a cooperative process and one designed to achieve the goal we all share – to preserve the cost-based benefits of the FBS for the citizens of the Northwest. We look forward to continuing to work closely with BPA in sorting through the myriad of detailed issues that will arise as we move forward. Thank you very much for your continuing efforts in this regard.

Very truly yours,



Steven J. Klein
General Manager

Snohomish County PUD No. 1