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Dear Mr. Wright:

Re: Comments on PPC Comments On BPA's Long-Term Regional Dialogue Proposal

Thank you for the opportunity to submit comments on the BPA's Long-Term Regional Dialogue Proposal. Our comments are organized as follows:

A. INTRODUCTION

The Public Power Council (PPC) is hopeful for successful resolution of the discussions regarding the long-term future of the Bonneville Power Administration (BPA.). To a noteworthy extent, BPA's Policy Proposal mirrors PPC's allocation proposal dated April 10, 2006. However, there are also some significant differences from the PPC proposal, and many critical details still need to be worked out before BPA's public power customers can determine whether the Proposal meets their needs.

Under the Policy Proposal, many key details would be determined in future processes. Yet BPA expects its customers to commit to taking power under new arrangements before some important details are resolved. PPC believes that it is critical to coordinate the timing of the various future processes with the timing of required and related customer approvals, such that carts and horses are hitched together when both are ready. That way, we are all more likely to reach the desired destination of executing mutually satisfactory long-term contracts. These comments are intended to advance that goal.

In reviewing PPC's comments, we hope that BPA will agree that most issues relating to service to publics are present regardless of whether BPA pursues Regional Dialogue "settlement" agreements or instead pursues the "fallback" process. It would therefore be reasonable to incorporate our recommendations regardless of the path BPA chooses. Similarly, PPC's comments on cost control and dispute resolution can and should be incorporated into any long-term contracts for power with preference customers.

B. SERVICE TO PUBLICS

For understandable reasons, the Policy Proposal does not address all of the details surrounding service to publics, and we expect that the Final Record of Decision (ROD) will not do so, either. BPA should ensure, however, that it strikes an appropriate balance in the ROD by providing enough high-level policy decisions to give necessary guidance to the upcoming contract negotiations without locking

itself into detailed implementation decisions that would preclude creative solutions during the negotiations.

1. Product Design

BPA needs to develop products that customers can actually use in an allocated, or tiered-rates environment. We would like to avoid the experience from the last round of contract negotiations wherein BPA developed a complex partial requirements service that no customer could be induced to take.

Even products that were relatively simple in the non-allocated world, such as full requirements service, become considerably more complex in a allocated world, where customers taking Tier 2 service from BPA will have to deal with the complexities of Tier 2 pricing and terms of service. It is possible that many current full requirements customers of BPA will elect to take all or some of their load growth from suppliers other than BPA, and BPA needs to develop a partial requirements service that works for customers. Customers who have their own resources need to have the option of a workable partial requirements service that allows customers to fully utilize their resources, and block and Slice service needs to be designed in a way that meets the needs of those customers wanting to take those services.

All current products offered by BPA should also be offered for the post-2011 period. Those products include Full and Partial Requirements, Block and Slice. These products should be viable, responsive to customers' needs and offered in their entirety at cost-based rates.

In all products, the inherent flexibility of the FBS should be available for the benefit of preference customers. As preference customers transition to providing for their own load growth, whether through Tier 2 rates or acquisition of resources independent of BPA, this flexibility will be necessary, and should be reserved for preference customers to allow integration of new resources by customers who choose to do so. As part of this flexibility, BPA should allow operational pooling by utilities for purposes of taking Tier 1 power from BPA. Allowing operational pooling will give utilities needed flexibility to be able to deal with the demands of accepting responsibility for meeting load growth.

Discussion of limitations to the availability of the Slice product appears to be premature. The availability of Slice should make it possible for a utility to meet its responsibilities in following its load. The product should provide flexibility on a "pro rata" basis comparable to the flexibility PBL has to meet non-Slice load and market surplus power (excluding dynamic scheduling).

Additionally, BPA should develop a complex Partial Requirements product that better allows the integration of resources than does the current contract. BPA's concerns regarding potential over-subscription to Slice are significantly less likely to be realized if BPA offers a more useable Partial Requirements contract.

PPC is opposed to opportunity-cost pricing for specific components of Tier 1 requirements service (such as ancillary services and capacity). Tier 1 should consist of cost-based products, and all components of Tier 1 service should be cost-based.

2. Centralia

PPC has already communicated by letter (dated August 7, 2006 with BPA on the issue of Centralia. BPA should not be using the Centralia issue as a "stick" to compel the publics to agree to other aspects of the Policy Proposal. In sum, we feel that BPA should adopt the following policy: BPA will not require former Centralia owners to continue to include Centralia in their resource exhibits or assume Centralia rights when calculating HWMs or Net Requirements.

3. Waiver of Customer Rights

Any settlement, including BPA's proposed long-term regional dialogue "settlement" agreements, involves the waiver of certain rights that parties might enjoy absent the settlement. We have two concerns regarding BPA's proposal: first, BPA is asking for a wavier of customer rights more extensive than should be required to accomplish the objectives of the Policy Proposal; and second, BPA wants customers to agree to waive their rights prior to settling several critical implementation details of the proposal. More fundamentally, requiring preference customers to waive one statutory right to exercise a different statutory right is unacceptably coercive. For example, the Policy Proposal would require customers to waive their rights to seek appellate review of BPA's rate methodology as a condition for being able to sign a new power sales contract.

BPA needs to reduce, to the minimum necessary, the scope of waivers that it wants from customers as part of agreeing to the "settlement" agreements, and it needs to delay when customers need to waive certain rights until customers are more certain of the details of the proposal. Customers need to know exactly what is being offered when the time comes to sign contracts.

4. Annual vs. monthly HWM

After the Policy Proposal was released, PPC learned that there was discussion within BPA on whether high water marks (HWMs) should be stated as an annual number, or as separate monthly numbers. In PPC's allocation discussions, we always envisioned that HWMs would be annual numbers. We were gratified to hear recently from BPA that BPA will indeed use the "annual HWM" approach rather than the "monthly HWM" approach.

5. Transmission Issues

BPA's proposal raises significant transmission issues, the most important of which relate to queuing and having equitable access to non-federal Tier 2 resources. We suggest these issues be resolved rapidly but resolved outside of the formal regional dialogue process.

a. Queuing For Tier 1 Power Contracts

Pursuant to BPA's Open-Access Transmission Tariff (OATT), each network transmission (NT) customer must declare in its resource exhibit all of the resources the customer will use to serve its load. When an NT customer requests a new resource be added, BPA's Transmission Services (TS) will evaluate the requested use of the system by the new resource to determine if it is an additional use of the transmission system and, if so, TS will determine whether Available Transfer Capability (ATC) is available to support that new use. In order to obtain this evaluation, and ATC if needed, the NT customer must get in the queue for new transmission service.

This places an unnecessary burden on NT customers that are continuing to take service from BPA. It can take months or years for a new service request to move through the queue. This delay and uncertainty will be compounded by the fact that several dozen NT customers may be seeking to comply with the tariff requirements for adding their new contracts as resources in their exhibits at the same time. The new power contracts, taken together or singly, are unlikely to make greater use of the system than the current power contracts.

b. Planning for Load Growth with Non-Federal and Federal Tier 2 Resources

The new power contracts, if offered as proposed, will place on the customers the onus of securing resources for load growth. Federal Tier 2 resources may have an advantage over non-federal resources in that PBL will be able to integrate those resources into the federal power system and make system sales to existing PTP and NT points of receipt on the federal system. This may ease, if not avoid, the problems with acquisition of needed transmission capacity and designation of new resources. Also, TS has stated that it will plan to expand the system to meet load growth based on the assumption that the NT customers continue to take power from their current declared NT resources to meet that load growth. TS should plan to meet preference customers' load growth from new resources, as well as from existing resources. TS and its preference customers should discuss and resolve how to accomplish this planning.

c. BPA Must Resolve These Issues With Its Customers As Soon As Possible

PPC strongly encourages BPA to explore ways to move the new Tier 1 contracts through its queue and application process that are more efficient for both BPA and its preference customers. The resolution of these issues regarding queuing for declaration of Tier 1 power contracts should comply with the following principles:

(1) there will be no diminution of current transmission service or rights for preference load service; and

(2) preference customers executing new BPA power contracts will not be required to get in the queue behind other requests for transmission service.

Similarly, BPA should resolve transmission access and system use issues presented by new federal and non-federal resources used to serve Tier 2 preference load in a manner that reasonably mitigates unfair advantages that may be enjoyed by the federal resources. PPC agrees that BPA and its customers should discuss mechanisms by which needed network transmission investments can be made by BPA and its customers; facilitation of transmission investment is a crucial activity that all parties should make significant efforts to advance.

PPC requests that through discussions with its preference customers, BPA commit to resolve all of these issues as soon as possible but no later than July 1, 2007. PPC requests that BPA not resolve any transmission issue in its decision on the Policy Proposal but that BPA resolve them only after discussions with customers. PPC notes that BPA recently has proposed changes to its business practices regarding ATC methodology, queue management, NT contract modifications, and firm redirects. PPC is evaluating these proposed changes for their effects on the transmission issues discussed above. If the proposed changes have implications for these transmission issues, PPC will submit comments to BPA in the Technical Forum.

6. Transfer Service

PPC greatly appreciates BPA's efforts to resolve significant transfer service issues raised by the Policy Proposal. In the proposal, BPA articulates its objective of encouraging preference customers to develop and meet their load growth using non-federal resources. The ability of transfer service customers to make fair use of the transfer service agreements to import non-federal resources to serve load makes this objective achievable for these customers and promotes the ability of transfer and non-transfer customers to gain comparable access to transmission. Areas of the transfer service proposal, however, should be revised to meet the objectives more fully:

a. BPA proposes to allow the wheeling of non-federal power over a transfer service contract only if the power is wheeled also over BPA's transmission system. PPC proposes, however that if a transfer customer pays for wheeling of power to a Point of Receipt on the transferor's system, BPA should permit the transfer customer to use the GTA or OATT agreement that provides transfer contract to move that power from the POR to the customer's load so long as:

   - Doing so does not increase BPA's costs above the level that BPA would have incurred were that portion of the load by federal Tier 2 power;
   - If a new POR must be added to the contract, the transfer customer would pay all directly assigned costs associated with the new POR and integration of the power at that point;
   - BPA's obligations to pay the costs of wheeling the power would be effective whether BPA or the transfer customer holds the contract; and
   - Limiting the costs incurred by BPA to the amount BPA would have paid to wheel Tier 2 power does not mean that, if the transferor's transmission rate increases due to rolling in new facilities needed to wheel the power, BPA does not have to permit use of the contract or may pass part of that cost on to the transfer customer.

b. BPA proposes to cap the use of transfer service agreements to wheel non-federal power. PPC disagrees with that proposal. BPA should eliminate the dollar cap on providing transfer service for non-federal resources under its proposal. BPA should also eliminate the MW cap on transfer for this purpose. The dollar cap does not account for probable transmission rate increases for transfer service. BPA's obligation to provide transfer service is already capped by load growth and if an additional cap is imposed, that cap should apply to annexed load only. Moreover, the MW cap proposed by BPA does not meet the expected load growth of current transfer customers. The number of MW available under the cap in any year does not increase at a compounded rate from the year before. Instead, it is a fixed percentage increase from the start of the contract and does not follow the expected load growth of the customers. Caps, as proposed, would phase out transfer service for non-federal resources and would make them uncompetitive in relation to federal Tier 2 resources. The caps, therefore, should be removed from the proposal.

c. BPA states that "transfer service costs related to annexed loads or new public loads that are $7/MWh, or above, would be arranged and paid for by the transfer customer. Existing Subscription customers may request BPA arranged for service that is $7/MWh or above, however all costs would be assigned to the customer." (Policy Proposal, p. 69) Although cost control is a consideration, BPA should only require that costs above $7/MWh be borne by the transfer customer. The cut-off, as written, is arbitrary and punitive and does not support the objective of durable agreements because transfer service rates will inevitably rise. At some future date, $7/MWh may be a reasonable and customary rate.

d. BPA asserts simultaneously the exclusive right to decide to shift load currently served load by a GTA to BPA main grid service (where that is feasible) and the allocation to the transfer customer of stranded costs incurred by that shift. (Policy Proposal, p. 67.) To do so is inherently inequitable. If BPA wishes to make the decision to switch a transfer customer to main grid service, BPA must accept the risk of stranded investments and take that risk into account in its decisions.

7. True-ups

BPA proposes a major change in how it will design rates under its proposal. Currently, only Slice is subject to a true-up to BPA's actual costs. BPA proposes to have true-ups for all of its other requirements products, which means that all BPA customers would be liable for after-the-fact increases in the rates they pay BPA.

Whether BPA trues up all of its requirements products, or continues to use a mix of true-ups and CRACs, BPA should work to have equivalent risk mitigation devices for all requirements products, so that each product bears an equitable share of the risk associated with serving that product.

8. Section 5(b)/9(c) marketing impediments

BPA needs to rethink its interpretation of section 9(c) of the Regional Act in light of the new allocated world. Utilities are going to have a more complex relationship with BPA and other power suppliers, and BPA needs to have policies that allow utilities to balance their power sales and purchases without undue restriction.

9. Reliance on 2010 resource declarations

BPA proposes that utilities be required to use 2010 resource declarations when calculating high water marks, locking utilities into resource declarations made in current contracts for another sixteen years beyond the current contract period. PPC, in its April 10, 2006, allocation proposal, proposed to allow utilities to use 2012 resource declarations, in order to allow utilities to adjust their resource declarations, subject to certain conditions. PPC continues to support the use of 2012 resource declarations. If a utility is being asked to commit itself to declaring a set of resources for several decades, the utility should know at the time that the decision is made that it is making a multi-decade commitment. The utilities who made resource declarations in 1998 and 1999 did not know that they were making a multi-decade commitment, yet BPA's proposal would so commit them.

That being said, the PPC April 10, 2006, allocation proposal did suggest a way of defining what utilities would have to put into their resource declarations, and it proposed a mechanism to quickly resolve determinations of non-Federal resource capability. The allocation proposal proposed that "the firm capability of nonfederal resources that the utility has dedicated to retail load service and which is actually available to such utility in FY 2012" be included in a utility's resource declaration. Furthermore, the PPC proposal suggested that that the "rules for determining non-federal resource capability for net requirements determinations must be jointly developed by BPA and the customers" prior to performing an estimate of HWM in 2007. We feel that it is still feasible to develop rules for determining non-Federal resource capability in 2007.

10. Conservation

BPA proposed a method for crediting past conservation achievements different from the PPC proposal when calculating HWM's. Where the April 10, 2006, PPC allocation proposal proposed crediting only utility-funded conservation from 2002-2010, BPA proposed crediting not just utility-funded conservation but also 50% of BPA-funded conservation, but shortening the time-frame to 2007-2010. PPC continues to support crediting utility-funded conservation from 2002-2010. We feel that it is inequitable for utilities who funded conservation from 2002-2007 to be penalized for doing so, via a reduction in their HWM's arising from the conservation. PPC takes no position on whether BPA should provide an additional credit for BPA-funded conservation.

11. Treatment of Grant PUD and Purchasers of Priest Rapids Products

Grant PUD filed comments with BPA dated October 17, 2006, making recommendations on how future rights to purchase power from the Priest Rapids dam should affect the high water marks of Grant PUD and public purchasers from those products. PPC endorses Grant's recommendations (1) through (4) and (6) and (7).

C. THE BUSINESS RELATIONSHIP BETWEEN BPA AND ITS CUSTOMERS

Dispute resolution and cost control, are critical to determining the business relationship between BPA and its customers. Any agreement with BPA needs to deal with these two issues. Contract enforceability is important to both BPA and its customers, because both parties need an acceptable method for resolving disputes and avoiding the rancor that can occur in the absence of robust dispute resolution techniques. Cost-control is also vital. If customers are going to commit to taking power from BPA under take or pay arrangements, BPA should be under a reciprocal obligation to provide an effective mechanism enabling customers and BPA to work together to keep BPA's costs under control.

1. Dispute Resolution

Because BPA and its customers are contemplating entering into twenty-year take-or-pay contracts for the purchase of BPA power, the parties need fair, understandable, and efficient dispute resolution procedures to be determined before those contracts are signed. It is essential to the operations of both BPA and its customers that disagreements are resolved in a timely manner that is both objective and informed.

Instead of setting out specific mechanisms for resolving disputes under the twenty-year contracts, BPA sets out in its Policy Proposal various principles and criteria that it will apply in determining which dispute resolution mechanisms should be used. Although the Policy Proposal is helpful in setting forth a variety of ideas for dispute resolution under the 20-year contracts, it does not go far enough in establishing at this stage of the contract development process exactly what BPA's commitment to dispute resolution is. In other words, although it demonstrates a BPA willingness to engage in dispute resolution procedures other than traditional petitions for review to the Ninth Circuit, the general direction provided in the Policy Proposal is not concrete enough to give BPA's customers assurance that BPA will commit itself to specific alternative dispute resolution procedures. PPC believes that BPA should commit in the Regional Dialogue Record of Decision (ROD) to specific dispute resolution processes for each of the major types of disputes that are likely to arise under the twenty-year contracts and tiered rate approach, and that wherever possible BPA should agree to use neutral third-party decision makers in these processes.

BPA's Policy Proposal sets forth key elements of the tiered rates construct, around which disputes are likely to occur. Those elements include: 1) the Tiered Rates Methodology, 2) Net Requirement Determinations, 3) High Water Mark (HWM) calculations, and 4) Federal Base System (FBS) capability determinations. PPC has reviewed the comments of the Western Public Agencies Group (WPAG) and, as outlined below, supports WPAG's approach of specifying specific dispute resolution procedures that BPA should adopt for disputes surrounding each of these key elements.

a. Regarding the Tiered Rates Methodology

The one place in the policy proposal where BPA sets forth a specific instance in which it might use a third-party neutral to resolve a dispute is where it states that "BPA proposes that it could empower the rate case hearing officer in specified cases to make a determination as to whether any BPA-proposed rate change is a contractually prohibited change."1 PPC supports this step, and believes that BPA should expressly agree to implement it in its Regional Dialogue ROD. PPC also believes this is an appropriate procedure where it is claimed that proposed rate changes in a rate case are prohibited by the rate methodology or where proposed changes to the methodology are allegedly prohibited by contract.

BPA's policy proposal recognizes that in some instances disputes regarding the Tiered Rates Methodology will center on alleged changes to the methodology, and in other instances they will center on alleged improper interpretations of it. In section 8 of its policy proposal, BPA states,

> A topic discussed at some length has been what happens when the Administrator proposes a change to the rate methodology or some element of it. What will more likely occur is the situation when the Administrator proposes to take an action pursuant to the methodology and one or more customers asserts it is contrary to the rate methodology. *In such a case, there is no proposed change to the methodology, but rather a difference in interpretation regarding what the methodology permits or requires.* Because implementation of the methodology affects all customers, resolution should be done in an open administrative process."2

[1] Policy Proposal, p. 79 (emphasis added).
[2] Policy Proposal, p. 87 (emphasis added).

PPC is concerned by this part of the Policy Proposal since BPA appears to assume that an administrative determination is the most appropriate method for resolving disputes where one or even many customers allege that BPA is proposing to take an action that is contrary to the rate methodology. In other words, the Policy Proposal seems to set a default assumption that complaints that BPA is acting contrary to the rate methodology are most accurately characterized as differences regarding interpretation, and that they are thus best determined by the Administrator.

In the event that such claims arise, however, the heart of the dispute may be whether BPA's actions are in fact differences over interpretation or actual deviations from the methodology. By setting a default position that such disputes will be characterized as disputes over interpretation, subject to resolution only by administrative determination, BPA is precluding the use of alternative dispute resolution where its use would be appropriate. PPC therefore urges BPA to empower the hearing officer (if the dispute occurs within a rate case) or other neutral third-party decision-maker (if the dispute occurs outside a rate case) to determine whether such disputes involve an interpretation or an actual change to the methodology. The decision-maker's determination should be binding on the parties. PPC assumes that if disputes are determined to be over changes to the Tiered Rates Methodology, that such disputes can only be resolved in a rate case proceeding.

Where disputes are determined to be disputes over interpretation of the rate methodology, BPA should commit to refer the matter for decision to the rate case officer (if within a rate case) or a neutral third-party decision-maker (if outside of a rate case). In such a process, the decision-maker would be required to issue a timely decision, within a short number of days. If the dispute arises during a rate case and is referred to the hearing officer, the hearing officer's determination should be final and binding on all parties, since the rate proceeding is the forum in which rate determinations are made. The finality of the decision would be subject only to situations where BPA can demonstrate that the decision would prevent revenue recovery or compliance with court orders.3

[3] *See* Regional Dialogue, p. 79, where BPA explains the necessity for such an exception.

If the dispute arises outside of a rate case and is referred to another third-party neutral decision-maker, that decision should be binding on the parties subject only to rejection by the Administrator within a specified time limit. Parties may have the right to raise an appeal to the Ninth Circuit, and the record in the Ninth Circuit proceeding should include the record developed in the third-party neutral process, including the third-party neutral's decision. This process would mirror to a large extent the process recently agreed to in the Slice Settlement litigation.

This approach to dispute resolution would allow customers to rely on third-party neutral determinations to a great extent, while not compromising the Administrator's duty to reserve ultimate decision-making authority to him or herself on certain issues. All affected parties should be able to participate in the process, and would have an opportunity to file briefs and make oral argument.

Notwithstanding the above, PPC believes that there may be a need for a process through which BPA and its customers could seek to revise the Tiered Rates Methodology in order to fix any unintended consequences or to accommodate changed circumstances. PPC hopes that BPA will commit to working on this challenge with customers, so that a tailored, fair, and predictable process can be created, which will be acceptable to both BPA and customers.

b. Net Requirement Determinations

In its Policy Proposal, BPA commits that prior to signing new contracts it will "conduct a public process that establishes a consistent, simple and transparent approach that would be used to establish net requirements for and during the contracts, consistent with BPA's 5(b)9(c) Policy."[4] A transparent and consistent methodology will hopefully prevent many disputes surrounding net requirement determinations.

Where disputes arise, however, they should be finally determined by neutral third-party decision makers. In its Policy Proposal, BPA recognizes that many of the details of net requirement determinations are highly factual, and are therefore good candidates for determination by third-party neutrals when disputed. Participation in such proceedings should be open to all customers affected, and should be limited to only those affected.

[4] Policy Proposal, p. 14.

c. High Water Mark Calculations

Under its Policy Proposal, BPA's rates will refer to each customer's contract for an initial value that establishes that utility's High Water Mark (HWM). Customers could then be assured that the amount of Tier 1 power they are entitled to will not be changed in the rate-setting process, and will only fluctuate depending on variability in the output of the FBS, and other limited circumstances, such as possibly the creation of new publics entitled to a HWM.

Disputes over any change to a customer's HWM will be diminished to the extent that BPA can make clear how those changes are to be calculated. As discussed below, changes to the capability of the FBS should be determined from an independent source, and mathematical calculations for redetermining HWM entitlements should be clear and understandable. To the extent disputes regarding these calculations occur, they should be subject to binding third-party arbitration, which is appropriate for such disputes.5

d. FBS Capability Determinations

Because the output of the FBS determines the amount of Tier 1 power BPA's customers will be able to receive under their long-term contracts, customers will have an intense interest in the calculation of that number. Like WPAG, PPC recommends that BPA utilize a trusted independent source of information for determining this value. This will eliminate concerns that the size of customers' Tier 1 power entitlement are subject to considerations other than technical determinations.

e. Other Considerations

WPAG in its comments expresses concern that BPA in recent times has excluded certain evidence from its rate proceedings through limitations in its Federal Register Notice. This practice could ostensibly lead to a situation where customers would be prevented from introducing evidence that would counter a BPA determination in the rate case that the customer is entitled to something other than what is specified in its contract. In order to alleviate these concerns, BPA should expressly determine in its Regional Dialogue ROD that it will not place limitations on customers' ability to introduce outside evidence of their contractual or statutory entitlements to power or services in BPA rate proceedings.

[5] *See* Policy Proposal, p. 85 ("In the case of disputes of a mathematical nature, third-party resolution would be appropriate.").

Also, PPC understands that BPA may disagree with some of PPC's above statements on when disputes can be finally resolved by third-party neutrals and when they must be determined by the Administrator with recourse exclusively in the Ninth Circuit. Because of the importance of timely and objective dispute resolution under the twenty-year contracts, PPC urges BPA to employ third-party neutral decision-making on a binding basis wherever possible, and at least on a non-binding basis where BPA believes that disputes are ultimately subject to administrative decision.

In sum, PPC is hopeful that the collaborative approach of the Policy Proposal will foster alternative dispute resolution procedures that will allow efficient and informed resolution of disputes under the contracts. PPC hopes that BPA will expressly commit in its Regional Dialogue ROD to the dispute resolution procedures described above, and to an ongoing commitment to work out the details of those processes. At this time, it is vital that customers receive assurance that BPA is willing to bind itself to appropriate dispute resolution procedures that will inspire confidence in customers' ability to enforce their contractual rights.

2. Cost-Control

In its issue paper, BPA identifies three possible cost-control alternatives: (1) a Regional cost review (RCR) process that would be an enhancement of the power function review process; (2) a Cost Management group, which would serve as an advisory panel to the Administrator on cost-related issues, with the Administrator retaining ultimate decision-making power, and (3) inclusion of cost levels in BPA rate cases.

BPA recommends the strengthened regional cost review process. We agree that the dissemination of information through the regional cost review and related processes has been quite beneficial, and we would like it to continue. However, we think that BPA should not lock itself into a specific cost-control approach for the entire contract period, since as we gain more experience with an allocation approach to BPA's requirements service, we may discover that some other cost control approach works better. We recommend that BPA's cost-control mechanism should be subject to periodic review (say, once every five years), so we can determine whether a different approach is warranted.

One new cost-control issue that must be addressed under allocation is how to control possible "leakage" of costs from Tier 2 to Tier 1—that is, how to keep the costs associated in Tier 2 solely assigned to Tier 2 sales, and how to keep only costs associated with Tier 1 assigned to Tier 1 sales.

BPA acknowledges that this is a concern, but then also warns that in some circumstances, cost migration between the two tiers may occur.6 Because BPA's proposal contemplates a mechanism by which BPA's Tier 2 costs could migrate back into Tier 1, PPC believes that customers are entitled to more specifics both on how BPA will keep Tier 2 costs segregated in Tier 2, and on how it will keep the risks associated with Tier 2 service in Tier 2. BPA should not implicitly use the Tier 1 cost pool as the guarantor of risks BPA incurs to provide Tier 2 service.

D. PRESIDENT'S BUDGET PROPOSAL

BPA should not be required to send secondary revenue to prepay U.S. Treasury obligations. Due to the energy crisis, BPA imposed surcharges of 35-50% on its base rates from 2001-2006, imposing hundreds of millions of dollars of additional costs on BPA's customers. To the extent that BPA enjoys additional secondary revenue in the future, using that revenue to reduce BPA's rates will likely repay only a portion of the additional costs that BPA's customers were forced to incur during the energy crisis. Moreover, advance allocation of revenue to an otherwise discretionary purpose precludes uses that might be more compelling at the time the revenues are received.

E. SERVICE TO IOUs

BPA proposed a benefit level of $250 million, with an adjustment mechanism linked to the ratio of the IOUs average system costs to the proxy PF rate. Although many in public power feel that BPA's proposal offers too much money to the IOUs, we think that BPA is moving in the right direction in its proposal, and we feel that the ratio approach as an adjustment mechanism is an important part of any settlement of IOU benefits.

We have seen materials disseminated by a number of parties implying that the current IOU benefit level of $300 million/year (plus a $23 million/year in deferral of prior benefits) is now somehow a natural entitlement of the IOUs, and that BPA should be precluded from reducing benefits below that level. In our view, the current high level of benefits paid to the IOUs is an artifact of the energy crisis, as well as a consequence of an IOU benefits system that we believe to be unlawful, and that is currently under judicial review.

[6] Policy Proposal, p. 85-86.

Maintenance of IOU benefits at the current level would perpetuate the perverse practice of taking money from residential ratepayers of public utilities, and giving it to neighboring investor-owned utilities whose residential ratepayers consequently pay a rate significantly *lower* than the residential rate of the public utility paying for the subsidy. This situation is common across the entire Pacific Northwest. There is no sound basis in law or policy for such a subsidy, and reducing benefit levels to IOUs is a necessary first step toward ending this practice.

Related to this point, BPA should not award a gross amount to all IOUs and then delegate to the state public utility commissions how to allocate those benefits among the various IOUs. The purpose of providing benefits to the IOUs (subject to the protections of the Regional Act) is not to provide a generalized subsidy pool to be divvied up among the IOUs, but rather to assist the residential ratepayers of high-cost IOUs. To the extent BPA provides IOU benefits, they should go to the ratepayers who most need them, and not be diverted elsewhere.

BPA fails to address in its proposal the important issue of "deemer" accounts. The purpose of the Residential Exchange is to bring wholesale power costs attributable to IOUs' residential and small-farm customers closer to the wholesale power costs of customers served with BPA power (subject certain important protections of the Regional Act). This dynamic was not intended to be a one-way ratchet, where power costs would be re-distributed only when beneficial to the IOUs. Rather, BPA established "deemer" accounts, in order to capture the amounts when the wholesale costs of some investor-owned utilities fell below BPA's wholesale power costs. These deemer accounts had to be repaid by the IOUs before they could once again receive payments under the Residential Exchange from BPA.

Some IOUs still have substantial obligations in their deemer accounts, and these amounts need to be repaid, with interest, before they can receive any benefits from BPA, post-2011. Also, BPA needs to work out an equivalent deemer mechanism for use after 2011 to address the circumstance when an IOU's ASC falls below BPA's proxy PF rate.

Despite our concerns, we still hope to reach a reasonable settlement agreement with the IOUs. We need to emphasize, however, the importance of a mechanism like BPA's proposed ratio method to reaching a settlement. The Residential Exchange uses the difference between ASC and PF to make the initial calculation of the level of benefits, but those benefits are constrained by the 7(b)(2) rate test to keep the costs from escalating to excessive levels, i.e. preference power costs greater than if the Regional Act had not been enacted. The 7(b)(2) test is every bit as much a part of the statutory formula as the initial calculation. The "yin" and the "yang" go together. If we are going to settle the level of IOU benefits, we need a mechanism that reflects changes in IOU ASCs and the proxy PF rate, but does so with low variance, in order to provide protection commensurate with the Residential Exchange and its 7(b)(2) test. The proposed ratio method provides that protection.

F. SERVICE TO DSIs

BPA should not provide any benefits to the DSIs after 2011. PPC realizes that not offering benefits to the DSIs after 2011 may mean that some individuals could lose their jobs at the smelters, in the event that the operation of the smelters is deemed uneconomical by one or more of the companies. Loss of local employment is always regrettable, but our recommendation is based on what PPC believes is best for the regional economy and ratepayer-citizens.

It is unfortunate that the dialogue concerning BPA's service to the DSIs has been viewed as a struggle between public power and the smelters. PPC believes the issue is more accurately characterized as a struggle of the smelters (including their corporate interests) as they make choices within the larger economy. Alcoa, for example, has earned record profits this year,7 nearly $2 billion as of its third quarter.8 Alcoa could choose to use those profits to preserve jobs in the Northwest by offsetting any losses incurred by regional smelters under current market conditions. A determination by Alcoa not to do so, however, should not transfer the burden of resulting hardships to public power. In essence, the smelters are asking the Northwest's citizens to do what the smelters are not willing to do

[7] *See, e.g., Alcoa Announces Highest Quarterly Income and Revenue in Company History* (July 10, 2006), *available at* http://www.alcoa.com/global/en/news/news_detail.asp?pageID=20060710005953en&detailType=invest&newsYear=2006 ("Alcoa (NYSE:AA) today announced second quarter 2006 income from continuing operations of $752 million, or $0.86 per diluted share, the highest quarterly profit in the company's more than 115-year history.").

[8] Alcoa presentation, 3rd Quarter 2006 Analyst Conference p. 4, *available at* http://www.alcoa.com/global/en/investment/pdfs/3Q06_Analyst_Presentation_Web_and_Print.pdf.

themselves, because they deem it to be against their shareholder and corporate interests.

PPC does not believe that the regional economy, through electricity rates, should be required to shoulder the costs of the smelters' operations under circumstances where the economics do not support that operation. Given the direct correlation between higher electrical rates and regional job loss, it is not good policy to raise rates in order to make the smelters' operations "economical" so that the smelters' shareholders can avoid the costs of their regional plants.

Providing power, as distinct from dollars, to the DSIs is particularly problematic. By buying power on the market for the DSIs and providing it to the DSIs at a Tier 1 rate, BPA transfers the risks of the power market from the DSIs to BPA. In the event of a recurrence of the energy crisis, BPA would once again be exposed to enormous risks and costs as a result of providing service to the DSIs.

Finally, in a tiered rates world, providing benefits to the DSIs at any rate below Tier 2 rates has the dual negative effects of both raising Tier 1 rates for preference customers, and providing benefits to the DSIs at lower rates than the Tier 2 rates that preference customers will pay to meet their growing loads. Thus, the DSIs, who have no statutory right to power or other benefits from BPA, would be treated preferentially compared to preference customers, who do have a right to power, at cost, but who will be required to pay Tier 2 prices in the future to serve their new load.

G. CONCLUSION

Thank you for the opportunity to submit these comments. We look forward to continuing to work with BPA and others in the region toward the goal of achieving a durable future for Bonneville.

Sincerely,

Marilyn Showalter
Executive Director