

ISSUES SUMMARY

Long-Term Regional Dialogue Policy Proposal

July 2006

The Bonneville Power Administration has released for public discussion a “Long-Term Regional Dialogue Policy Proposal” (Policy Proposal). The Policy Proposal defines how BPA proposes to serve the region’s power needs post-2011, after current power sales (Subscription) contracts expire.

This summary is intended to be a broad overview of the issues covered in the Policy Proposal and should not be construed as a definitive statement on the various issues. Those wishing to comment on any or all of the issues should go to the full Policy Proposal, which is available at www.bpa.gov/power/pl/regionaldialogue/07-2006_policy_proposal.pdf. As with the Policy Proposal itself, the policies described below are all proposals. The Policy Proposal remains a draft and is open to comment.

A backgrounder on the Long-Term Regional Dialogue Policy Proposal that provides overall context for the Regional Dialogue is available at www.bpa.gov/corporate/pubs/backgrounder/06/bg071206.pdf.

The issues in this summary generally follow the sequence in the full Policy Proposal.

The New Paradigm

BPA is proposing to implement a decision it made in February 2005 to limit the firm power it sells after 2011 at its lowest cost-based rates to an amount approximately equal to the firm capability of the existing federal system. This would be known as Tier 1 power and would be available to BPA’s existing preference customers (Northwest public entities such as public utilities, cooperatives and municipalities) at the lowest cost-based rates. This is intended to ensure the benefits of the low-cost federal system are not diluted by melding higher cost power purchases or additional resources into the system.

Preference customers would be given a high water mark (HWM) that defines their access to Tier 1 power. HWMs are a rate construct. BPA will distribute HWMs among public customers that add up to the firm energy output of the existing federal system, using critical water to calculate the firm power.

Consistent with BPA’s statutory obligation to serve, public customers may turn to BPA for additional power, and, while BPA would make every effort to meet their needs cost-effectively, the agency would charge a rate for such power sufficient to cover the costs of securing the



additional power. This would be known as Tier 2 power. BPA would set rates to fully recover the costs from those customers who request Tier 2 service.

The amount of power a customer could purchase in any particular year would be limited to its net requirements. A utility's net requirement is the amount of power it is entitled to purchase from BPA under the Northwest Power Act. The HWM simply establishes an upper limit on how much of the net requirement is met at the Tier 1 rate. The tiering structure should send appropriate, marginal cost-based price signals to customers to meet load growth beyond their HWM.

Loads and resources post FY 2011

BPA currently estimates the firm output of the Federal Columbia River Power System (FCRPS) for fiscal year 2012, net of all pre-existing firm system obligations, at approximately 7,100 average megawatts. There is uncertainty, however, around whether or not regional net requirements load will exceed the firm capability of the FCRPS in fiscal year 2012. A sum-of-utilities forecast of expected loads indicates that BPA's firm load obligations will be about 7,275 average megawatts in fiscal year 2012, assuming medium load growth. BPA proposes to augment the Federal Base System by up to 300 average megawatts if needed to meet existing public utility net requirements loads as calculated in 2011 based on 2010 actual loads. Information about these forecasts is presented more fully in the Policy Proposal.

Service to publics

Each preference customer's HWM would be based on the calculation of the difference between its actual 2010 firm regional consumer loads and the amount of resources dedicated to serve its consumer load during that year, under current Subscription contracts.

If customers want to purchase power above their HWM, they would be charged the Tier 2 rate, which would be priced at the marginal cost of BPA acquiring or purchasing power to serve their load above their HWM. BPA would offer several alternatives that reflect the full underlying costs of the new resources or market purchases. Examples of the kind of resources BPA is considering to serve customers at Tier 2 rates include new renewable resources and short and long-term market purchases. Contracts would be designed to allow for a default product for those customers who do not affirmatively choose a different Tier 2 pricing approach or who do not commit to meet their future load growth with nonfederal resources.

Contracts will set forth the Federal Base System resources and the initial firm capability that will be used to establish initial HWMs. They also will set forth the data and the process that will be used to periodically adjust resource capabilities and HWMs. Other than for changes in Federal Base System capability or utility service territory annexations, there would be no other changes in HWMs for the duration of the contract.

New publics that form and meet standards for service in time to sign Regional Dialogue contracts will be treated the same as existing public utilities, including having the same access to the residential exchange and, subject to notice periods, the right to purchase firm power from BPA to serve their entire net requirement load at PF rates. BPA proposes to earmark 250 aMW for the Regional Dialogue contracts for new publics formed after Regional Dialogue contracts are signed. Their HWM additions will be limited to 50 aMW each rate period to strike a balance between providing new publics significant access to lowest-cost BPA power and limiting costs that would dilute benefits to existing purchasers at Tier 1 rates. The Policy Proposal describes when deliveries would begin and how the 250 aMW would be spread so that it is not used solely by one large new public. Other considerations for new publics also are covered in the Policy Proposal.

Products for requirements customers

BPA will continue to offer an array of products comparable to those currently offered. The starting point for setting Tier 1 rates for all products would be the same, a fraction of the costs of the existing system with additional costs added as necessary to create each product.

BPA proposes to continue offering products that follow a customer's loads, similar to the current Full and Partial Service Load-Following Products. Regional Dialogue contracts will provide a single load-following product with specified rules for existing or added resources to ensure they do not create costs for other BPA customers. Load-following products reshape the firm power of the FBS into the variable shape of the customer's net requirement load. Rules for establishing the annual predefined shape of purchases subject to the Tier 2 rate will be the subject of additional discussions. As a starting point, they are presented in the Policy Proposal as a flat annual block.

BPA proposes to continue offering products that allow customers to supply their own load-following service such as the Block product and possibly a Slice product (see below). These customers would receive an amount of power based on a forecast of their net requirement load and would be responsible for integrating their BPA power purchase with their own resources to follow their actual consumer loads throughout the year.

Pricing and rates for PF service

Specific decisions on rates would be made in each rate case, consistent with the long-term tiered rates methodology.

Tier 1 rates: Tier 1 would include the cost of the existing FBS and other costs, such as the Residential Exchange Program (REP); public benefits (e.g., fish and wildlife program); acquisition of BPA's share of conservation; facilitation of renewables; power purchases up to 300 aMW of augmentation; and costs for actions, such as capacity purchases from new resources to ensure Tier 1 service complies with resource adequacy standards. They also would include augmentation to serve limited amounts of new public load, transfer service costs allocated to BPA power loads, direct-service industry service costs, recovery of Low-Density Discount lost revenue and Irrigation Rate Mitigation.

Tier 2 rates: Tier 2 would cover PF power to meet a customer's net firm power requirements loads beyond its HWM. BPA would structure rates to fully recover the costs from those customers who request Tier 2 service within the year the power is delivered. It would be priced at BPA's marginal cost of power. If BPA's secondary power is used to meet the load at the Tier 2 rate, the excess value above the average Federal Base System cost would be credited back to Tier 1 rates. Customers will have choices about the types of products they choose for service at the Tier 2 rate. BPA will not subsidize Tier 2 rates to create a financial advantage for a customer to make a choice to buy from BPA instead of the market.

To avoid diluting the benefits of Tier 1 power, Regional Dialogue contracts would require existing publics to settle their rights to the residential exchange for the term of the contract.

To meet load needs, the shape of the FBS under critical water must be transformed to a more load-friendly and useful shape. For each rate case, BPA would design rates for these shaping services so that the projected reshaping costs are borne by the customers using the services.

Other service-to-publics issues

Low Density Discount: BPA proposes to continue to review and possibly revise its Low Density Discount in future rate case proceedings, including implementation details relating to eligibility, the discount level and applicable rate.

Irrigation Rate Mitigation: Beginning with the FY 2012 rate period, BPA would offer irrigation rate mitigation in the form of a fixed mills-per-kWh discount in the PF rate schedule and not as a separate product. BPA also proposes requiring participating customers to implement cost-effective conservation measures on irrigation systems in their service territories.

New Large Single Loads: Based on efforts to promote and develop renewable resources in the region, BPA has reconsidered its current policy that allows a consumer to reduce its load behind the meter by purchasing and delivering either renewable resources or on-site cogeneration to reduce its NLSL to fewer than 10 aMW served by the utility. BPA now proposes to sunset its off-site renewable option effective Dec. 31, 2006. Once service has commenced, the consumer load behind the meter must be less than 10 aMW to receive the benefit of PF rate service under the terms established in the February 2005 policy for each month.

Transmission considerations: BPA will work with its transmission customers prior to offering Regional Dialogue contracts to ensure the requirements for requesting modifications under BPA's Open Access Transmission Tariff service are met and customers understand the transmission implications of their resource choices.

Slice product

A Slice Product Review Team that included BPA and utility staff spent several months reviewing the past four-plus years of experience with Slice and discussing the future direction of the product. Although consensus was not reached about the product's future, there was good progress.

Assuming successful resolution of the ongoing Slice litigation, BPA proposes offering an amount of Slice capped at 25 percent of the existing federal system. It also would reduce certain uses of the Slice product, such as ancillary services self supply, in return for pro rata sharing of actual revenues BPA receives for use of system capacity for regional reliability and other public purpose functions. If a Slice product is offered post-2011, a set of principles, contained in the Policy Proposal, will set the context for product design and contract negotiations.

Residential exchange benefits

Under the Northwest Power Act, BPA provides a benefit to investor-owned utility residential and small-farm consumers and high cost public agencies that effectively lowers their rates. This cost is paid by other BPA customers. Currently, there is existing litigation brought by several public agencies that challenges BPA's authority to offer a comprehensive settlement of Residential Exchange Program disputes. BPA is seeking to settle disputes regarding implementation of the REP that provides an equitable level of benefits while ensuring BPA's lowest firm power rate reflects the cost of the undiluted existing federal system. Different REP settlement proposals have been proposed, with no regional consensus around any particular proposal.

BPA proposes a long-term financial settlement of the Residential Exchange Program that is based on its estimate of the reasonable range of future benefits to investor-owned utility customers. The proposed levels and distribution of benefits in the settlement offer are roughly equivalent to the forecast benefits that would come out of implementing the REP. Settlement will bring greater long-term certainty to a category of costs that historically has been a large driver of BPA costs and rates.

Under BPA's proposal, as a condition of receiving the REP settlement, all exchanging utilities would agree not to challenge the long-term tiered rates methodology or other REP settlements. If the settlement offer is rejected, BPA will update its policies to implement the traditional REP. BPA's first step would be to release for review a proposed policy for acquiring in-lieu resources.

Investor-owned utilities: BPA proposes providing benefits to IOUs of \$250 million in FY 2012 with a rate period adjustment described in the Policy Proposal. BPA believes this settlement reasonably reflects actual payments BPA would make if it were to implement the REP. BPA's proposal is based on an estimate of the reasonable range of future benefits to IOU residential and small-farm consumers based on interpretations of existing statutes. It is also near the center of the range of actual residential exchange benefits over the 1981-2011 period. BPA proposes that the benefits be allocated primarily to IOUs with high average system costs, but is open to alternative allocation proposals.

Public agencies: Existing public agencies with existing high cost resources would be eligible for a REP settlement comparable to the settlement offered to IOUs. BPA's Regional Dialogue contracts would require that existing public customers agree to settle their rights to the REP during the term of the contract, with only nominal consideration for most customers and with potentially higher consideration for customers who already meet some of their own high-cost resources.

Service to direct-service industries

BPA has signed contracts with three aluminum DSIs and one non-aluminum company for the fiscal year 2007-2011 period. These contracts provide a maximum of 577 aMW, or the financial equivalent, with a cap of \$59 million per year for the aluminum portion (560 aMW). The question now is what, if any, service BPA will offer to these companies for the post-2011 period. Because there has been very little public discussion for this question to date, BPA is not making a DSI service proposal, but instead lays out a range of possible approaches for regional discussion. Alternatives under consideration include extending monetary benefits similar to those offered in 2007-2010 contracts, ending benefits or providing limited physical power.

To help the region focus on the DSI issue, BPA intends to conduct at least one public meeting that centers on post-2011 DSI benefits. BPA also has commissioned a study to explore both the economic benefits of regional support for DSI jobs through BPA service and the economic impact of rate increases that result from that support.

Conservation

BPA proposes continuing to pursue all cost-effective conservation in the load it serves and would recover costs of achieving this conservation in Tier 1 rates. BPA proposes two primary actions to meet its conservation goal. The first action is to ensure that tiered rates create an economic incentive for customers to pursue conservation. The second is to provide a set of conservation programs to build on those incentives to ensure conservation targets are met at least cost.

Renewable resources

BPA proposes that the goal for its renewable resource program be a percentage of the Council's regional target based on public power customers' share of regional load growth, which is about 40 percent. This equates to a goal of 100 MW a year. This percentage will have to be adjusted over time for actual load growth. BPA proposes to apply this target to all renewable resources, not just wind.

BPA proposes to achieve this goal at the least possible cost. To the extent necessary, BPA would provide up to a net \$21 million a year (plus annual escalation) on a range of facilitation activities with its public power customers. BPA will not use any of this \$21 million to reduce its Tier 2 rates to create a financial advantage for Tier 2 over buying from the market. Any costs associated with these renewables facilitation activities will be recovered in Tier 1 rates. The spending limit is above and beyond the energy costs of BPA's existing renewable projects (not including the geothermal project) that are, and will continue to be, included in existing rates.

BPA proposes facilitation activities with its public power customers to meet the renewables target at the least cost. This portfolio includes cost-effective renewable acquisition for Tier 2, using the flexibility of the FCRPS to provide integration products for wind projects serving requirements load, and coordinated planning with the Council, utilities, developers and other regional organizations to promote long-term resource planning and to minimize costs. BPA

intends to continue providing a limited amount of financial support for research and development. It may also target financial support for public customers' efforts to foster renewables if BPA concludes that the target will not otherwise be met.

Transfer service

Often it is more economical for BPA to contract with other transmission owners to deliver federal power over their facilities rather than build duplicate facilities. In 2005, BPA signed 20-year contracts titled Agreement Regarding Transfer Service (ARTS) with transfer service customers. These agreements require BPA to: (1) continue to arrange for transfer service with third-party transmission owners for the delivery of federal power; (2) continue to be financially responsible for specified costs of the transfer service; and (3) propose in its initial rate proposal to continue rolling specified costs of transfer service into either power or transmission rates.

During the last several months, BPA's transfer customers and other interested parties have worked to resolve several issues not covered by the ARTS. Consequently, BPA proposes to resolve the following issues, which are discussed more fully in the Policy Proposal: (1) direct assignment guidelines, including low voltage services; (2) quality of service; (3) administrative roles and responsibilities; (4) ancillary service costs; (5) nonfederal power deliveries; (6) transfer service to annexed load (and by extension to new public customers); and (7) transfer service for Block and Slice power sales agreements.

Resource adequacy

If BPA reduces its role in acquiring new resources or power purchases, its customers must have a common understanding of what constitutes resource adequacy and must procure adequate resources to meet their load not served by BPA. BPA and the Northwest Power and Conservation Council initiated the Regional Resource Adequacy Forum to help the region be aggressive in developing and implementing a resource adequacy standard. The forum has adopted a resource adequacy energy metric and has agreed in principle on a capacity metric. Discussions continue on how to ensure adequacy standards will actually be met, without treading on the prerogatives of utilities or states.

The Policy Proposal outlines a phased approach the forum is exploring. Assuming this effort has progressed sufficiently by the time contracts are signed, BPA proposes that customers would contractually agree to provide data on a confidential basis to a neutral third party to assess adequacy.

Long-term cost control

While BPA will not delegate decision-making authority on costs and programs to third parties, it can make its decision-making and cost information open and transparent with ample opportunity for input. Customers want an approach that provides good information about costs before decisions on cost levels are made and that creates strong accountability for BPA and its partners to manage to established cost levels. They also want some recourse in the event BPA staff disagrees.

Three alternatives for a cost-management process attracted the most support: (1) a regional cost review (RCR) process that would be an enhancement of the Power Function Review process and other agencywide processes, (2) a Cost Management Group (CMG), and (3) inclusion of costs in BPA's rate proceedings. All three alternatives go well beyond cost reviews BPA has done in the past. The Policy Proposal outlines each approach, including the advantages and disadvantages of each.

Subject to further comment, BPA believes the Regional Cost Review would be the best cost control process. While embracing many of the successful aspects of recent agency-wide cost review processes, such as the Power Function Review and Programs in Review, it also expands the process to include ongoing and long-term components and opportunities to debate areas of disagreement in front of the administrator. BPA also proposes to continue providing frequent additional opportunities for stakeholders to review BPA's ongoing financial performance.

Dispute resolution

It is BPA's intent to approach disputes in good faith and to engage in resolution processes that provide the maximum simplicity, clarity and equity while still respecting BPA's statutes and the administrator's legal responsibilities.

Although many customers would like a specific and known dispute resolution process that applies uniformly, BPA does not believe a single process can be used to resolve all disputes. Disputes vary in nature ranging from debates over interpretation of facts to disputes of judgment or interpretation of intent. Some involve policy judgments, issues of law, or factual or technical determinations. The scope can range from narrow and discrete issues affecting a small set of parties to hugely complex and judgmental issues affecting many parties. Some issues will create precedent, while others will not.

Because of these huge variations, a one-size-fits-all dispute resolution process would not be workable or likely legally enforceable. If it is to be effective and equitable, dispute resolution should be tailored to the type of dispute, the issues and parties involved. There are, however, principles, criteria and factors that BPA has laid out in the Policy Proposal that will help define a clearer direction for future dispute resolution.

New long-term contracts

Reaching agreement on contract terms and signing contracts as early as possible is critical to the goal of enabling nonfederal resource development. BPA explored this issue in the technical workshops held between October 2005 and February 2006. Workshop participants supported signing new contracts as soon as possible but suggested the schedule be adjusted to have power service begin for all Regional Dialogue contracts on Oct. 1, 2011. BPA agrees.

The Policy proposes 20-year contracts, which have the dual advantage of providing certainty to customers on their rights to purchase BPA power and providing BPA certainty of cost recovery for the actual FBS costs, regardless of the vagaries of market prices. Such contracts promote

regional electric infrastructure development, reduce the federal role in the region and promote the private sector role, provide market-based pricing of incremental BPA power sales, and enhance BPA stability and assurance of making payments to Treasury.

BPA proposes to create standardized Regional Dialogue power sales contracts with limited bilateral negotiations. The process would be similar to that used for developing standardized Subscription contracts in 1999-2000.

Fallback policy proposal

BPA has worked hard toward regional consensus on the issues in this Policy Proposal. Consensus is important because it will allow the region to move forward to address infrastructure development and other challenges without distraction of ongoing disputes over BPA rates and contracts. BPA hopes the region will use this Policy Proposal as the opportunity to complete the task of reaching alignment on outstanding key issues by coming to consensus either on BPA's Policy Proposal or on a regionally acceptable variation. This will require tough compromise on all sides, but absent that compromise and alignment, the region will have a hard time meeting its key goals.

While there is a great deal of alignment on issues presented in the Policy Proposal, there also are areas where there is little or no regional consensus. Several features in this Policy Proposal tend to increase rates somewhat and/or delay certainty about load obligations. They were included because they were important to some participants and, therefore, helped create consensus.

BPA intends to continue to work toward consensus on the remaining areas of regional disagreement during the comment period. In the event consensus cannot be reached on these remaining issues during the comment period, BPA plans to move forward with a policy that omits the features that drive up rates and delay certainty and that are most subject to legal challenge. Features that would be omitted in the fallback approach include:

- Settlements of residential exchange benefits for either IOU or public customers
- True-ups of high water marks in 2010.
- Augmentation of the existing system for both existing and new public customers
- Changes in the treatment of shares of the Centralia Coal Plant
- Resource removal rights for load loss during a rate period
- Special provisions for new public customers.

Environmental analysis

At this point it appears implementation of the various aspects of this Policy Proposal, taken either individually or collectively, would not result in significantly different environmental impacts from those examined in the Business Plan Environmental Impact Statement completed in June 1995. Therefore, BPA expects the proposed Long-Term Regional Dialogue Policy will fall

within the scope of the Market-Driven Alternative evaluated in the Business Plan EIS and adopted in the Business Plan Record of Decision. As part of the Administrator's record of decision that will be prepared for the Long-Term Regional Dialogue Policy, BPA may tie its decision under the National Environmental Policy Act to the Business Plan ROD. However, depending on the ongoing environmental review, BPA may instead issue another appropriate NEPA document.

President's budget proposal

Consistent with sound business practices required under BPA's statutes, the President's fiscal year 2007 budget provides that BPA will use any surplus power sales (net secondary) revenues it earns in any given year above its historical high level of \$500 million to make early payments on its federal bond debt to the U.S. Treasury in order to provide BPA with needed financial flexibility to invest back into energy infrastructure, conservation, and fish and wildlife protection programs. Absent this action, BPA projects that it will run out of borrowing authority from the U.S. Treasury by 2011. Long-term power and transmission customers benefit from this action through lower long-term power rates than would otherwise be the case, and through improved and upgraded capital facilities. Given the importance of this action for the post-2011 period, BPA seeks public comment and discussion of this action in conjunction with the discussion about BPA's Long-Term Regional Dialogue Policy Proposal.

Schedule

The BPA administrator intends to make final policy decisions and sign a Record of Decision in December. Updated information will continue to be posted at www.bpa.gov/power/regionaldialogue.

- Formal BPA Policy Proposal released – July 2006
- Public comment on Policy Proposal and discussions seeking consensus – July to September 2006.
- Publish BPA Regional Dialogue Policy and ROD on long-term issues – January 2007
- Negotiate and develop new contract prototypes based on policy and ROD – February to December 2007
- Limited bilateral negotiations – January to April 2008
- BPA and customers sign new long-term contracts – April 2008
- Service and rates under new contracts begin – October 2011