SLICE OF THE SYSTEM
SUPPLEMENTARY ISSUE PAPER
REVIEW AND COMMENT
DECEMBER 10, 1999 – JANUARY 14, 2000

The product description for the Slice of the system was last updated on October 8, 1999 and can be found on the web at http://www.bpa.gov/power/PSP/products/slice/sliceproddesc.shtml In its simplest form the product provides purchasers with a percentage of the output of the federal power system, including WNP 2, in exchange for the same percentage payment of specified federal power system costs. Thus the term "Slice Of The System" refers to the percentage Slice the purchaser receives.

This is a completely new way for BPA to sell requirements service to public power customers and a new way of doing business. Customer staff and representatives have worked for well over a year to resolve the technical and public policy issues associated with this new approach. They have been remarkably successful. Certainly there is more to do from the technical side and the experts on the project are well prepared to continue that work. The public policy issues are drawing to a close with the completion of the draft prototype Slice sales contract.

We are concerned that certain public policy issues may have missed the attention of reviewers. The specific issues of interest are:

1. The sales volume of the product, as with other subscription products, is unlimited. Thus, BPA could sell several thousand average-megawatts (aMW) of the Slice product. In fact, the last dry run of the technical provisions of the product had prospective customers and dry run participants simulating 2745 aMW of Slice. Since then we have had several more customers express interest.

2. The term of the agreement is consistent with all other subscription power products, up to 20 years. **Note**: The Slice of the system must be purchased for at least 10 years.

3. Slice purchasers generally will pay a proportional share of BPA's actual costs. During the second 5 years of the contract period (2006-2011), Slice purchasers will pay only their portion of BPA net costs of supplementing the Federal Base System to serve subscription sales to investor-owned utilities (IOUs) and direct service industries (DSIs) up to a specified maximum amount. If the threshold is exceeded, a Slice customer could exercise a yet-to-be-defined contractual option to convert its service to another Requirements product. In addition, the contract removes any limits for the period beginning 2012.

The following pages explore these issues in more detail. While the entire prototype contract should be reviewed in detail we want to be sure to call your attention to these policy issues as well.

The deadline for commenting on the Slice contract and policy issues is January 14, 2000. If you have questions or comments, we encourage you to contact your Account Executive, Tribal Liaison, or Constituent Account Executive. Please mail your written comments to:

Slice Comments
Bonneville Power Administration
P.O. Box 12999
Portland, Oregon 97232

You may also send comments electronically to: slicecomments@bpa.gov

Issue 1

The sales volume of the product, as with other subscription products, is unlimited. Thus, BPA could sell several thousand average-megawatts (aMW) of the Slice product. In fact, the last dry run of the technical provisions of the product had prospective customers and dry run participants simulating 2745 aMW of Slice. Since then we have had several more customers express interest.

Several years ago, a few large generating customers asked BPA to develop a product that has become the Slice of the System. This small group of customers that own their own hydro and non-hydro resources has been joined by a number other customers. In the last dry run (where the technical experts test the Slice operating procedures without involving actual power) there were 32 customers participating. There are now generating and non-generating customers following the Slice contract and technical development and there is a growing interest among heretofore full requirements customers.

The expanded interest in Slice is stimulated by a variety of inter-related events. Customers with their own generation realize that, at current prices, the federal power system will not be able to provide the operating flexibility currently available via the 1981 power sales contract. The actual partial products available in the subscription power products catalog requires customers to dedicate their resources to their own loads first and foremost with charges if the resources are used elsewhere. The Slice product provides them significant flexibility in resource management.

Several experienced power management companies are working with utilities to help them understand and mitigate the considerable risks associated with the Slice product. These companies are expanding their customer base and intensifying their efforts as more and more utilities consider their subscription purchases. In addition, utilities are being offered a variety of risk mitigation products such as weather or "run-off" insurance that would allow them to reduce their risk exposure inherent with Slice.

Being interested in Slice is relatively easy while signing a 10 year Slice contract is much more difficult and final. Many customers who have expressed an interest may simply choose other products when they compare Slice to the risks, benefits and costs of the wide array of subscription products. In addition, the power management and risk mitigation insurance/measures will come at a cost. Combining those costs on top of the Slice product price may limit the financial incentives sufficiently that some customers will choose a portfolio of subscription products that have fewer additional costs. Equally important is the availability of the block product. Customers can buy a portion of their net requirements via the Priority Firm (PF) priced block and the remainder via Slice. This would provide a better balance of risk and benefits than a stand-alone Slice product.

Things to consider

Possible Slice sales are estimated at between 3000 aMW and 4000 aMW, far exceeding the original expectation of 1000 aMW. This could represent one-third to one-half of BPA's total firm power sales although a number of factors could limit sales to under 3000 aMW despite the growing interest. Additionally, the possibility of over 30 Slice customers including non-generating customers increases the potential complexity of the procedures for implementing the Slice of the System creating greater technical challenges than originally anticipated. We anticipate that it would be more difficult and time-consuming to fine tune a product that has a large number of customers and involved a significant percentage of our inventory.

BPA would like to know if you are concerned about the volume of Slice sales and if so, what volume seems reasonable. Is there a sales volume that would be too high? If so, why and how should it be limited?

Alternatives to consider:

- The volume of Slice sales may not, in fact, be an issue. The sales volume will likely be modest given the gap between PF and the market, the considerable risks inherent in Slice and the interest of most customers to purchase products that are simple to operate and cost certain (non-Slice products can be purchased for only 5 years with known prices).

- A few thousand average-megawatts of Slice sales might be good for the federal system. The risk profile resulting from Slice is positive for the federal system and will help during the uncertainty of the next decade. Rather than a concern, should it be a goal to get a strong level of Slice sales?

- Slice sales should be limited via contract so that only 1000 – 1500 aMW are sold. This level is appropriate given the unique nature of the product and the need to learn about how the product and purchasers react with the rest of the federal system and market. This limit could mean that only utilities with variable output resources would be able to purchase Slice since their product choices are more limited than those of other customers.

- Commenters may have other views or ideas they would like to suggest.

Issue 2

*The term of the agreement is consistent with all other subscription power products, up to 20 years. **Note**: The Slice of the system must be purchased for at least 10 years.*

BPA is empowered by statute to enter into power sales contracts for up to 20 years. The subscription strategy, December 1998, provided for sales of all power products up to 20 years. The Slice product description and contract are consistent with that feature. We wish to provide all customers product choices that, while differing in specific features, afford the same basic rights whenever reasonable. Term appeared to be one area of reasonable consistency between products.

Slice is a unique, untested product with which we have no operating or administrative experience. In December 1998 we estimated there would be a modest interest in Slice of between 1000 aMW and 1500 aMW. The 20 year term seemed reasonable despite the new approach and new systems we would need to develop, test, operate and refine in order to deliver the product. A modest sales volume with relatively few customers seemed to afford an opportunity do something creative, make changes as we learned, and share the benefits of the product. We remain confident that the 10 year minimum term is necessary in order to assure that the benefits of the product are shared appropriately between BPA and purchasers.

Things to consider

A 10- to 20-year term presents potentially difficult challenges to our ability to anticipate changes in the industry and the hydrosystem. The possibility of federal legislation giving rise to basic industry change could raise difficult issues in administering a large Slice product of 3000 aMW to 4000 aMW to a relatively large number of Slice customers. It is essential that the Slice product have sufficient inherent flexibility to allow BPA and the Slice purchasers to adjust appropriately to unanticipated change.

We would like your thoughts on whether the 10-20 year term appears reasonable. What alternative(s) would you suggest?

Alternatives to consider:

- The Slice product, while different from other products, should be offered for the same 20-year term. This is especially true if the volume is limited and there are no post-2011 cost limits. Purchasers willing to assume these risks should be allowed to do so.

- The 10 year term is adequate for a new product that has so many unique features embedded. A 10-year limit would allow for a reasonable chance for all parties to share the risks and benefits of year to year water and weather shifts and limit any unforeseen adverse consequences that cannot be mitigated during the 10 years.

- Commenters may have other views or ideas they would like to suggest.

Issue 3

Slice purchasers generally will pay a proportional share of BPA's actual costs. During the second 5 years of the contract period (2006-2011), Slice purchasers will pay only their portion of BPA net costs of supplementing the Federal Base System to serve subscription sales to investor-owned utilities (IOUs) and direct service industries (DSIs) up to a specified maximum amount. If the threshold is exceeded, a Slice customer could exercise a yet-to-be-defined contractual option to convert its service to another Requirements product. In addition, the contract removes any limits for the period beginning 2012.

Slice purchasers will pay a percentage of BPA's actual costs except those associated with benefits they do not receive. The amount of the costs will be trued up at the end of each contract year at which time Slice purchasers will pay BPA the difference between the costs identified in the rate case and BPA's actual expenses. The exceptions are costs related to short-term power purchases and planned net revenues for risk since slice purchasers will arrange their own short-term power purchases and will assume the risk in proportion to their Slice of the System.

BPA intends to include a threshold in the Slice contract product that will limit the purchasers' cost exposure. If the threshold were exceeded, the Slice customer could exercise a yet-to-be-defined contractual option to convert their service to another Requirements product.

The Slice product has a minimum term of 10 years. This will allow a more reasonable sharing of risks and benefits between BPA and purchasers. However, the current power rates will be in effect for only 5 years. Slice purchasers, reasonably, sought clarification on what costs they would be exposed to in the period between 2006-2011. Of particular interest is the cost associated with providing power to the IOUs and DSIs. When the Slice product was first requested there was no resolution to those issues.

The Subscription Strategy, published in December 1998, called for service to IOUs of 2200 aMW for the period 2006-2011. The Strategy did not address a specific service level for DSIs; the current rate case is considering 990 aMW for the 2001-2005 period.

The prototype contract calls for the Slice purchasers to pay costs associated with subscription service to IOUs up to 2200 aMW and DSIs up to 990 aMW depending on results of the 2006 rate case. BPA's initial 2006 rate proposal will include the costs associated with these amounts. If at the conclusion of the 2006 rate case the Federal Energy Regulatory Commission approves rates with costs for more than these amounts, then the Slice purchasers will be able to exercise the contract conversion.

We believe these limits are reasonable because we think the Slice purchasers should have some level of certainty on their post 2006 costs. We are requiring that they purchase Slice for 10 years and there are few areas where they have cost certainty post-2006. In addition, these limits reflect the subscription strategy (for the IOUs) and the currently planned service to the DSIs. Others may have different opinions. We would like to hear those opinions.

The current term for Slice is up to 20 years. Slice purchasers have asked for the same level of certainty about costs after 2011. BPA is unwilling to provide that certainty and the contract does not have limits for costs after 2011. Again, some may have opinions about the desirability of longer term Slice contracts and the fact that providing some cost certainty post-2011 would provide incentive to customers to purchase Slice long term. We would welcome hearing those views.

Things to consider

While most of the focus in developing the Slice product has been on designing and implementing a product that meets the needs of potential Slice customers and BPA, there is a broader policy issue that deserves mention. Should BPA sign Slice contracts that would prevent BPA from recovering 2006-2011 costs associated with selling more than specified amounts of power to the IOUs or DSIs? In this case, any action to reallocate FCRPS power, beyond the specified limits, to the IOUs and DSIs could result in conversion of the Slice contracts to some other Requirements products.

Another consideration is whether or not BPA's Subscription Strategy will prove as durable as we believe it is. Since the Slice product is predicated on the Strategy, the need for adjustments to the Strategy after 2006 could have unanticipated consequences for the Slice product.

Alternatives to consider:

- The agreements among the various parties (BPA, PUCs, utilities, etc.) and reflected in the Subscription Strategy should be included in Slice contracts. The strategy was designed around those agreements and providing or anticipating parties backing out is unnecessary and inappropriate. The DSI compromise was not explicit about the term. However, metals market data, especially that provided by DSI rate case parties, implies that the current compromise should be adequate, as a maximum, for an extended number of years.

- There should be no limits in the 2006-2011 period. There are too many changes possible and any limits now will remove possibilities for too long a period.

- Commenters may have other views or ideas they would like to suggest.