BONNEVILLE POWER ADMINISTRATION
POWER BUSINESS LINE

PROPOSED CONTRACTS OR AMENDMENTS TO EXISTING CONTRACTS WITH THE REGIONAL INVESTOR-OWNED UTILITIES REGARDING THE PAYMENT OF RESIDENTIAL AND SMALL-FARM CONSUMER BENEFITS UNDER THE RESIDENTIAL EXCHANGE PROGRAM SETTLEMENT AGREEMENTS FY 2007-2011

ADMINISTRATOR'S RECORD OF DECISION

MAY 25, 2004

BONNEVILLE
POWER ADMINISTRATION

Proposed Contracts or Amendments to Existing Contracts With the Regional Investor-Owned Utilities Regarding the Payment of Residential and Small-Farm Consumer Benefits Under the Residential Exchange Program Settlement Agreements FY 2007-2011

Administrator's Record of Decision

Bonneville Power Administration
U.S. Department of Energy

May 25, 2004

INTRODUCTION

This Record of Decision (ROD) addresses the comments and issues raised with respect to BPA's proposal to offer new contracts or amendments to existing contracts (proposed contracts) to each of the region's six investor-owned utilities.[1] The proposed contracts refine the manner in which BPA provides benefits from the Federal power system to the investor-owned utilities' respective residential and small farm consumers. BPA achieves two objectives with this proposal: (1) BPA provides a level of certainty for both the investor-owned utilities and BPA regarding the manner in which benefits for their residential and small farm customers are calculated and provided in FY 2007-2011; and (2) the contracts result in a reduction in the augmentation costs contained in the Load-Based Cost Recovery Adjustment Clause (LB CRAC), thereby contributing to lower rates for a large segment of BPA's customers. This ROD first discusses the Residential Exchange Program (REP), subsequent contractual agreements, and the contract proposal, and then describes and evaluates the public comments received on the proposed contracts.

In the proposed contracts addresses several aspects of the manner in which investor-owned utility benefits are provided. First, BPA elects to provide the equivalent of 2200 aMWs entirely as financial benefits during the FY 2007-2011 period.

Second, the proposed contracts also establish a mark-to-market methodology to determine the market price forecast used in the calculation of monetary benefit levels under the utilities' REP Settlement Agreements. Currently, the monetary benefits are calculated as the difference between a forecast of market prices established in BPA's rate case and the RL rate. The proposed contracts replace the rate case price forecast with a mark-to-market methodology to determine the market price.

Third, the contracts also provide a yearly $100 million floor and a $300 million cap for the financial benefits provided to the utilities' residential and small farm consumers for the FY 2007-2011 period.

Finally, the proposed contracts provide the investor-owned utilities with additional time to pass through these monetary benefits to their residential and small farm consumers. The existing REP Settlement Agreements specify the amount of benefits the investor-owned utilities can hold. Currently, the investor-owned utilities can hold benefits equal to the greater of the benefits provided six months prior to, or expected to be provided six months after, the actual pass-through of benefits to the residential and small farm customers. The new contracts extend that period to 36 months to provide the investor-owned utilities additional time to moderate their retail rate levels during the last five years of the contracts.

[1] Puget Sound Energy, Contract No. 04PB-11467; PacifiCorp, Contract No. 04PB-11468; Avista, Amendment No. 3 to Contract No. 00PB- 12157; Portland General Electric, Amendment No. 2 to Contract No. 00PB-12161; Idaho Power Company, Amendment No. 3 to Contract No.00PB-12158; NorthWestern Energy, Amendment No. 3 to Contract No. 00PB-12160.

As a corollary to the decision to offer these contracts, BPA is proposing a clarification of Section III.C.2 of its 1998 BPA Power Subscription Strategy. Currently, the Power Subscription Strategy states that BPA will establish a market price forecast of power in a rate case, which will be used in calculating benefits for the utilities' residential and small farm customers. The proposed clarification to the Subscription Strategy allows BPA to calculate the level of monetary benefits using a market price from a mark–to-market methodology in the new contracts or, alternatively, one developed in a BPA rate case.

The proposed contracts with Puget Sound Energy, Inc. (Puget) and PacifiCorp also modify the $200 million reduction-of-risk discount contained in their Conditional Deferral Agreements (Contract Nos. 02PB-11156 and 02PB-11157, respectively). As part of the consideration for BPA's decision to offer the proposed changes to the contracts, Puget and PacifiCorp are willing to forego collection of one half of the reduction-of-risk discount payments, plus interest, and defer collection of the remaining amount until the FY2007-2011 period. The other four investor-owned utilities would provide consideration in the form of a waiver of the remaining portion of the monetary benefits due each of the utilities in their FY 2003 Deferral Agreements (Contract Nos. 03 PB-11268, Idaho Power; 03PB–11267, Portland General Electric Company; 03PB–11266, Avista Corporation; 03PB-11265, NorthWestern Energy).

The amounts deferred by Puget and PacifiCorp are anticipated to be collected as part of BPA's general revenue requirement during the FY2007-2011 period. All of BPA's power customers (including but not limited to Slice, non-Slice, investor-owned utility, and direct-service industrial) would pay the costs associated with the deferral.

BACKGROUND

BPA was created in 1937 to market electric power generated at the Bonneville Dam, and to construct and operate facilities for the transmission of power. 16 U.S.C. § 832-832l. Since that time, Congress has directed BPA to market power generated at additional facilities. 16 U.S.C. § 838f. Currently, BPA markets power generated at thirty-one Federal hydroelectric projects, and several non-Federal projects. BPA also owns and operates approximately 80 percent of the Pacific Northwest's high-voltage transmission system. In 1974, BPA became a self-financed agency that does not receive annual appropriations. *Id*. § 838i. BPA's rates must therefore produce sufficient revenues to repay all Federal investments in the power and transmission systems, and to carry out BPA's additional statutory objectives. *See* 16 U.S.C. §§ 832f, 838g, 838i, and 839e(a).

In the 1970s, forecasts of insufficient resources to meet the region's electricity demands led to passage of the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act) in 1980. 16 U.S.C. § 839, *et seq*. In that Act, Congress, among other things, directed BPA to offer new power sales contracts to its customers. *Id*. §§ 839c, 839c(g).

A. The Residential Exchange Program (REP)

Section 5(c) of the Northwest Power Act established the REP. *Id*. § 839c(c). Under the REP, a Pacific Northwest electric utility may offer to sell power to BPA at the utility's average system cost (ASC). *Id*. § 839c(c)(1). If offered, BPA purchases such power and, in exchange, sells an equivalent amount of power to the utility at BPA's PF Exchange rate. *Id*. The amount of the power exchanged equals the utility's residential and small farm load. *Id*. In past practice, no actual power deliveries have taken place. Instead, BPA provided equivalent monetary benefits to the utility based on the difference between the utility's ASC and the applicable PF Exchange rate multiplied by the utility's residential load.

The Northwest Power Act requires the investor-owned utilities to pass these monetary benefits directly to the utilities' residential and small farm consumers. *Id*. § 839c(c)(3). While REP benefits have previously been monetary, the Northwest Power Act also provides for the sale of actual power to exchanging utilities in specific circumstances. Pursuant to section 5(c)(5) of the Northwest Power Act, in lieu of purchasing any amount of electric power offered by an exchanging utility, the Administrator may acquire an equivalent amount of electric power to replace power sold to the utility as part of an exchange sale. *Id*. § 839c(c)(5). However, the cost of the acquisition must be less than the cost of purchasing the electric power offered by the utility. *Id*. In these circumstances, BPA acquires power from an in-lieu resource and sells actual power to the exchanging utility.

The REP has traditionally been implemented through Residential Purchase and Sale Agreements (RPSAs), the initial versions of which were executed in 1981.

B. Power Subscription Strategy ROD

In anticipation of the expiration of the then-current contracts and rates, the BPA Administrator issued a Power Subscription Strategy (Subscription Strategy) and accompanying Power Subscription Strategy ROD, (Subscription ROD) on December 21, 1998. These documents established the agency's direction regarding the post-2001 power sales contracts. The Subscription Strategy and Subscription ROD were the culmination of a lengthy and thorough public process that formed a framework to equitably distribute the benefits of electric power generated by the FCRPS among Pacific Northwest parties.

C. Total Amount of Investor-Owned Utility Settlement Benefits

BPA's principal goal in the Subscription Strategy was to spread the benefits of the FCRPS as broadly as possible, with special attention given to the residential and rural customers of the region. The Subscription Strategy enabled the benefits of the FCRPS to flow throughout the region, whether currently served by publicly owned or privately owned utilities.

One aspect of the Subscription Strategy involved an offer to settle disputes regarding the implementation of the REP post 2001. Over the years BPA, the investor-owned utilities and public preference customers vigorously disputed the manner in which BPA determined the level of benefits for the residential and small farm consumers of the investor-owned utilities. In addition to offering investor-owned utilities the ability to participate in the traditional REP, the proposed Subscription Strategy offered the region's six investor-owned utilities access to the equivalent of 1800 aMW of Federal power for the FY 2002-2006 period. The offer provided that at least 1000 aMW of the 1800 aMW would be served with actual BPA power deliveries. The remainder would be provided through either a financial arrangement or additional power deliveries depending on which approach was most cost-effective for BPA.

The four Pacific Northwest state utility commissions (Commissions), in a letter dated July 23, 1999, requested that BPA increase the amount of the settlement from 1800 aMW to 1900 aMW for the FY 2002-2006 period. This request was made in order for the Commissions to arrive at a joint recommendation for allocating the settlement benefits among the IOUs for both the FY 2002-2006 and FY 2007-2011 periods. The Subscription Strategy already included a proposal to increase the equivalent amount of Federal energy to 2200 aMWs for the FY 2007-2011 period.

BPA sought comment on this proposed increase in settlement benefits. After review of public comments, BPA found the arguments for increasing the investor-owned utility settlement amount by 100 aMW to be compelling. Having previously established conditions for adopting any such increase, BPA determined that it expected to satisfy all such conditions. Therefore, BPA increased the amount of total benefits for the proposed settlements of the REP with regional investor-owned utilities from 1800 aMW to 1900 aMW for FY 2002-2011, and announced the change in BPA's Supplemental Subscription ROD.

D. IOU REP Settlement Agreements

After completion of the Administrator's Supplemental Subscription ROD, BPA began the development of a prototype Residential Purchase and Sale Agreement (RPSA) and a prototype REP Settlement Agreement. The prototype REP Settlement Agreement provided power sales pursuant to a contract offered under section 5(b) of the Northwest Power Act. The prototype REP Settlement Agreement also provided for the payment of financial benefits. At the specific request of the Montana Power Company, (the predecessor to NorthWestern Energy) BPA also proposed a prototype REP Settlement Agreement that provided power sales pursuant to section 5(c) of the Northwest Power Act.

On October 4, 2000, the BPA Administrator issued a decision document entitled "Residential Exchange Program Settlement Agreements With Pacific Northwest Investor-Owned Utilities, Administrator's Record of Decision," which concluded that it was appropriate to offer the REP Settlement Agreements to regional investor-owned

utilities. The REP Settlement Agreements were then executed the same month with all of the region's investor-owned utilities.

E. Load Reduction Agreements

Beginning in the early summer of 2000 and for approximately the next 10 months, power prices on the West Coast increased to unprecedented levels. The increase in the wholesale price led a number of customers to place load on BPA above the amount BPA forecasted in its WP-02 rate case. Because BPA did not have sufficient generation to meet the original load forecast, the added load meant BPA would need to make additional purchases in the increasingly volatile wholesale market. These factors lead BPA to raise its rates by approximately forty-six percent to deal the increased expense of meeting its load obligations.

As one part of the effort to lessen the impact of these high market prices on BPA's ability to meet these firm load obligations, on April 9, 2001, the BPA Administrator asked BPA's customers to enter into agreements to reduce the load placed on BPA. These agreements would reduce the need to purchase power to meet loads under contracts negotiated pursuant to the Subscription Strategy during this period of historically high and volatile market prices of power.

BPA entered into load reduction agreements with both Puget and PacifiCorp that amended or replaced their original REP Settlement Agreements and removed BPA's obligation to deliver 619 aMWs of firm power for the first five years of those agreements (FY 2002-2006) in exchange for cash payments. BPA used the firm power not sold to Puget and PacifiCorp to meet its total firm obligations to publicly owned and cooperative customers, investor-owned utilities, and direct service industries.

Both load reduction agreements, PacifiCorp's Financial Settlement Agreement (Contract No. 01PB-10854) and Puget's Amended Settlement Agreement (Contract No. 01PB-10885), specifically provided that the respective utilities were willing to reduce the payments received under the agreements to well below then-prevailing forward market price if the respective utilities entered into settlement agreements with certain publicly owned utility and cooperative customers that waived and dismissed certain legal challenges. PacifiCorp and Puget believe there was risk associated with allowing BPA to buy the power purchases under its REP Settlement Agreement that were currently being challenged in court. As of June 2001, talks about potential settlement of litigation had been occurring between investor-owned utilities and public utility litigants. This provision was added to hold open the option for a reduced load reduction payment to Puget and PacifiCorp, in the event those talks were successful.

These payments are referred to as the "reduction-of-risk discount or payment." In order for BPA to avoid paying the reduction-of-risk discount to PacifiCorp and Puget, litigation settlements with publicly owned utility and cooperative customers had to occur by December 1, 2001. The amount of these payments for PacifiCorp and Puget combined is approximately $200 million. Absent executing the proposed contracts, the

$200 million would be recovered as a load reduction expense through BPA's wholesale power rates in the Load-Based Cost Recovery Adjustment Clause (LB CRAC).

F. Conditional Deferral Agreements

When no settlement was reached by December 1, 2001, BPA, PacifiCorp, and Puget negotiated Conditional Deferral Agreements. These agreements deferred recovery of the $200 million reduction-of-risk payments, in order to allow additional discussions to occur with regional parties that could settle pending litigation challenging BPA's REP Settlement Agreements with the investor-owned utilities. These agreements applied a negotiated interest rate to the $200 million reduction-of-risk discount payments for the period of the deferral.

G. Financial Choices and the FY 2003 Deferral Agreements

During the spring and summer of 2002, BPA's financial picture deteriorated. To address BPA's financial problems, on July 2, 2002, BPA sent a letter to rate case parties and other interested entities in the region announcing the beginning of the Financial Choices public comment process. The Financial Choices process examined a variety of financial and program options for addressing BPA's Power Business Line's (PBL) FY 2003-2006 financial challenges. In this process, BPA described the financial challenges, the actions BPA already had taken to address the challenges, and the financial outlook for the remainder of the rate period. Additionally, BPA identified a variety of potential financial alternatives that, separately or in combination, could form the basis of a solution to PBL's financial situation.

As a result of the Financial Choices process, BPA made decisions to cut, eliminate, or defer certain costs and expenses. BPA issued a Financial Choices close-out letter to the region on November 22, 2002, outlining BPA's plan, in part, for meeting the agency's financial challenges. The plan took into consideration extensive public input BPA received during the Financial Choices public process.

As an outgrowth of the Financial Choices process, BPA sought to defer payment in FY 2003 of certain amounts of financial benefits under the investor-owned utilities' REP Settlement Agreements and to facilitate a relatively uniform pass-through of benefits under the agreements. BPA viewed the deferral of these financial benefits as a tool to help avoid implementing a Safety-Net Cost Recovery Adjustment Clause (SN CRAC). Under these agreements the investor-owned utilities agreed to defer a total of $55 million in financial benefits from FY 2003 until the FY 2007-2011 period. The investor-owned utilities conditioned the deferral on whether BPA implemented an SN CRAC in FY 2003. In the event BPA implemented an SN CRAC, the investor-owned utilities would use the deferred financial benefits to pay any SN CRAC adjustment applied to their rates. In early 2003, BPA contemporaneously entered into agreements under which the investor-owned utilities and BPA agreed to a deferral of payments in FY 2003 under agreements amending provisions of the REP Settlement Agreements, known as "Agreements Regarding Fiscal Year 2003 Deferral Amount" or the "FY 2003 Deferral

Agreements." These agreements include: Avista Corporation, Contract No. 03PB-11265; NorthWestern Corporation, Contract No. 03PB-11269; PacifiCorp, Contract No. 03PB-11262; Portland General Electric (PGE), Contract No. 03PB-11267; Puget Sound Energy, Inc., Contract No. 03PB-11251; and Idaho Power Company, Contract No. 03PB-11268.

PROPOSED CONTRACT OFFERS TO THE INVESTOR-OWNED UTILITIES

A. Calculation of Monetary Benefits and Forward Flat-Block Price Forecast

Under the REP Settlement Agreements, monetary benefits are determined by the difference between BPA's Forward Firm-Block Price Forecast (FBPF) and the RL rate (or lowest PF rate in appropriate circumstances) multiplied by the amount of the investor-owned utility's benefits as stated in annual aMW.[2]

The REP Settlement Agreements currently provide the FBPF is "BPA's forecast of the wholesale market price for the purchase of additional amounts of power at 100 percent annual load factor established in the same BPA *power rate case* as that which established the RL rate and for the period of the RL Rate established in a BPA power rate case Record of Decision (ROD) as finally approved by the Federal Energy Regulatory Commission and affirmed, if appealed, by the United States Court of Appeals for the Ninth Circuit." (Emphasis added) The proposed contracts replace the use of a rate case power price forecast with a mark-to-market methodology that is functionally similar yet provides a desired transparency for determining the forecast.

Rather than using a rate case forecast to determine the FBPF, the contracts use an independent survey of market prices. The survey will use the prices for a flat block of firm power delivered at the Mid-C trading hub for each contract year. The survey will be done quarterly and a mean price for this power product will be determined (after eliminating the highest and lowest prices). This mean price will serve as the FBPF for purposes of calculating the monetary benefit levels.

[2] The current allocation of aMWs for each of the investor-owned utilities, as reduced for assignment to BPA pursuant to the respective agreements, is as follows:

	FY2002-2006	FY2007-2011
Avista Corp.	90	149
Idaho Power Company	120	224
NorthWestern Energy	24	28
PacifiCorp (Total)	473.6406	586.8481
PacifiCorp (UP&L)	140	140
PacifiCorp (PP&L – WA)	80	108
PacifiCorp (UP&L – OR)	253.6406	338.8481
Portland General Electric	490	560
Puget Sound Energy (PSE)	700	648
Total	1897.6406	2195.8481

B. Qualified Third Party/Eligible Data Providers

As a first step to implement the new methodology, BPA must hire a qualified third party (QTP) to collect the necessary market data. A QTP will be selected from among the Big 4 accounting firms or from a list of entities that have expertise in the electric power industry, including expertise in financial and risk accounting for the electricity power industry. For each Contract Year, the QTP randomly selects 6 to 8 Eligible Data Providers (EDPs) to provide price information. EDPs are entities that routinely buy and sell bulk power for resale in the Pacific Northwest (PNW) and use risk accounting for reporting in the regular course of business. The list of EDPs will consist, if possible, of at least two PNW publicly owned utilities, two PNW investor-owned utilities, and two marketers among other eligible entities.

The QTP will survey the market for the price of a block of firm power delivered at Mid-C for four consecutive quarters (the first of which commences 21 months prior to the beginning of each Contract Year, and the last of which ends 9 months prior to each Contract Year) from the list of EDPs. Following the completion of each quarterly survey, the QTP excludes the highest and lowest forward prices from the EDPs surveyed during each such quarter. The QTP then calculates the arithmetic mean of the remaining Forward Price Data to determine that quarter's FBPF (the "Quarterly FBPF") for the Contract Year. Following the completion of the four Quarterly FBPFs, the QTP calculates the arithmetic mean for the Quarterly FBPFs. The result of this calculation is the FBPF that is used for the Contract Year to calculate the level of monetary benefits.

C. Additional Transparency for the FBPF

As noted previously, the current method used to calculate the FBPF is through BPA's forecast of the wholesale market price in BPA's power rate cases. Investor-owned utilities expressed concern that BPA views the investor-owned utilities' REP settlement benefits as an agency cost. Because BPA is frequently under pressure to reduce costs and therefore rates, the investor-owned utilities believed this environment could create the appearance that the Administrator would view the determination of the FBPF as a means to reduce costs. The investor-owned utilities suggested that a more transparent method of establishing the FBPF would eliminate using the calculation of the FBPF as a means to lower costs. To achieve this goal, the parties developed the methodology described above. Through this methodology, an independent QTP surveys numerous market participants in order to obtain forward price data, which is averaged to determine the FBPF. This removes any appearance of opportunity for BPA to establish an artificially low or high FBPF rate case forecast.

D. Floors and Caps

A separate concern involved the potential that the mark-to-market methodology could result in very high or very low benefit levels for the residential and small farm customers depending upon the differential between the market price and the RL rate. As a result, BPA and the investor-owned utilities included provisions that both guaranteed a

minimum level of benefits and at the same time capped the upper level of monetary benefits. The proposed contract establishes a floor of $100 million per year for investor-owned utility benefits, and a cap of $300 million per year for investor-owned utility benefits. Through the floor, BPA ensures the residential and small farm customers of the region's investor-owned utilities receive a specified minimum level of benefits. Similarly, through the cap, BPA's other customers are assured that investor-owned utility benefits will not exceed a specified amount.

E. Election of All Monetary Benefits for Investor-Owned Utilities

The REP Settlement Agreements provide BPA with the option to elect the actual amount of power and monetary benefits for the FY 2007-2011 period by October 1, 2005, one year prior to the beginning of the next rate period. This option has introduced a great deal of uncertainty for the investor-owned utilities in their resource planning process. To address this uncertainty, the proposed contracts provide that BPA will make the decision now to provide all of the benefits as monetary benefits.

In the proposed contracts, BPA agrees it will provide no firm power under the REP Settlement Agreements for the FY 2007-2011 period. As a consequence, the proposed contracts will reduce the loads served by BPA, and thus reduce BPA's need to rely on power purchases from the sometimes volatile and unpredictable wholesale power market to serve its loads.

Thus, the proposed contracts provide the investor-owned utilities with the needed information to assist them with their resource planning during the final five years of their contracts.

F. Pass-Through of Benefits to Residential and Small Farm Consumers

An additional aspect of the proposed contracts involves the pass-through of benefits to the investor-owned utilities' residential and small farm consumers. Under the proposed contracts, the investor-owned utilities are given an extended period of time to pass through the benefits to these consumers. Under the existing agreements, as amended by the FY 2003 Deferral Agreements, the investor-owned utilities can hold benefits equal to the greater of benefits received six months prior to the pass-through or benefits expected six months after the pass-through before they must pass the benefits to the residential and small farm consumers. Under the proposed contracts, periods before and after the pass-through are extended to thirty-six months. This change is designed to allow the investor-owned utilities to spread the payment of the benefits to allow them to moderate the potential variations in rates for their residential and small farm consumers.

G. Clarification of Subscription Strategy

As part of the decision to offer the proposed contracts to the investor-owned utilities, BPA is also proposing to clarify Section III.C.2 of its 1998 BPA Power Subscription Strategy. The Power Subscription Strategy as currently written, states:

> For the amount of subscription sales not made through physical power deliveries, BPA will provide a cash payment that reflects the difference between the market *price of power forecast in the rate case* and the rate used to make such subscription sales.

(Emphasis added). It further provides:

> Under the 10-year contract, BPA will guarantee 1,800 aMW of power or financial benefits for the 2002-2006 period and 2,200 aMW for the 2007-2011 period. BPA intends for this 2,200 aMW to be all power deliveries. If BPA is unable to deliver all power for the 2007-2011 period, a mechanism similar to that described above will be used for determining the financial component payment.

As noted above, BPA and the investor-owned utilities agree through the proposed contracts that the benefits for the FY 2007-2011 period will be entirely financial benefits. There is also agreement to use a mark-to-market methodology to calculate the financial benefits. While BPA intended to provide these benefits entirely in the form of power deliveries, changes in BPA's loads and in the wholesale market since BPA's 1998 decision no longer make this practical. BPA's loads increased significantly over the levels assumed at the time BPA issued the Subscription ROD. This unforeseen increase in loads forced BPA to purchase more power in the wholesale market to make up the difference between its own generation and its load obligations. In addition, the wholesale power market has been marked by dramatic price swings in recent years. By opting to provide the investor-owned utilities only financial benefits, BPA can limit its exposure to the sometimes volatile wholesale market.

The Subscription Strategy also provides that the investor-owned utilities' financial benefits would be based on the difference between the market price and the rate paid for power (FBPF and the RL rate in the REP Settlement Agreement). The Subscription Strategy further provides that if BPA provides financial benefits in the FY 2007-2011 period, it will use a "mechanism similar" to the rate case price forecast. BPA believes the mark-to-market methodology outlined in the proposed contracts is a similar mechanism. The mark-to-market methodology does not materially change the manner in which the financial benefits are calculated. It does, however, provide all parties with a more transparent method for calculating the market price used in the formula. While BPA believes this proposal merely clarifies the Subscription Strategy, BPA nevertheless put this matter out for public comment.

H. Challenges to Investor-Owned Utility Benefits

There are a number of lawsuits pending before the Ninth Circuit Court of Appeals challenging the manner in which BPA is providing benefits to the investor-owned utilities. The current contracts are not contingent upon the dismissal of any pending litigation. While the proposed contracts do not require dismissal of any pending litigation, the contracts recognize that the outcome of pending litigation could impact the

parties' bargained for consideration. As previously noted, the financial benefits are currently determined by a formula based on the difference between BPA's rate case market price forecast (the FBPF) and the RL rate (or lowest PF rate in appropriate circumstances) multiplied by the amount of the investor-owned utility's benefits as stated in annual aMW. The FBPF and benefit levels are impacted by the proposed contracts. The proposed contracts reflect the basic formula for calculating benefits contained in the REP Settlement Agreements as they currently exist. The caps, floors and mark-to-market methodology all relate back to the manner in which BPA calculates the financial benefits for the investor-owned utilities as established in the REP Settlement Agreements. If the courts strike down the manner in which BPA provides benefits under the REP Settlement Agreements, the foundation for the proposed contracts disappears. As a result, if the court were to invalidate the REP Settlement Agreements, BPA and the investor-owned utilities have agreed that the proposed contracts would be void *ab initio* since the foundation for calculating benefits in the REP Settlement Agreement would no longer exist. If the proposed contracts are voided, the parties would revert back to the existing agreements to the extent applicable.

I. Consideration for Amendments to REP Settlement Agreements

The proposed contracts with Puget and PacifiCorp include modification of the $200 million reduction-of-risk discount contained in their Conditional Deferral Agreements (Contract Nos. PB02-11156 and PB02-11157, respectively). As part of the consideration for BPA's decision to offer the proposed changes to Puget and PacifiCorp's contracts with BPA, they are willing to forego collection of one half of the reduction-of-risk discount payments, plus interest, and defer collection of the remaining amount until the FY2007-2011 period. The other four investor-owned utilities would provide consideration in the form of a waiver of the remaining portion of the monetary benefits due each of the utilities in their FY2003 Deferral Agreements. (*See* Contract Nos. 03PB-11268, Idaho Power; 03PB-11267 Portland General Electric Company; 03PB-11266, Avista Corp.; 03PB-11265, NorthWestern Energy.)

J. Payment of Deferred Amounts to PacifiCorp and Puget

Under the proposed contracts, the amounts deferred by PacifiCorp and Puget amounts to just over $100 million. BPA currently envisions these deferred reduction-of-risk payments will be part of BPA's general revenue requirement during the FY 2007-2011 period. As a result, BPA customers will not see reduction-of-risk dollars as part of their rates during the current rate period, but will see these dollars as part of their power rates during the FY 2007-2011 period.

Currently, reduction-of-risk dollars are collected as part of the LB CRAC and rates are adjusted accordingly. However, not all of BPA's customers are obligated to pay the LB CRAC. Customers who signed pre-Subscription contracts are not obligated to pay the LB CRAC.

In its next rate case, BPA anticipates it will propose these deferred amounts will be included as part of its general revenue requirement. By doing so, all BPA customers, Slice, non-Slice, investor-owned utilities and direct service industries, would pay a portion of these deferred dollars. However, any actual decision regard the rate treatment of these costs will be resolved in those future 7(i) proceedings.

RESPONSE TO PUBLIC COMMENTS

On April 16, 2004, BPA sent a letter to interested parties in the region informing them of the proposed contracts and asking for public comments. The public comment period ended on May 14, 2004. BPA received a total of 42 comments as a result of the letter.

***Issue 1*:** *Whether the proposed contracts provide near-term rate relief for BPA's customers.*

Comments: The City of Ashland, Clark Public Utilities, Cowlitz County Public Utility District, Emerald People's Utility District, Flathead Electric Cooperative, Idaho Public Utility Commission, Midstate Electric Cooperative, Inc., Northern Wasco People's Utility District, Seattle City Light, Public Utility District No. 1 of Skamania County, Springfield Utility Board, Tillamook People's Utility District, Wells Rural Electric Company and Western Montana Electric Generating and Transmission Cooperative, all submitted written comments in favor of the proposed contracts. The comments focused primarily on the rate relief afforded these customers that would result from the cost reductions and deferrals in the proposed contracts.

The Superintendent of Seattle City Light stated "[t]he effort to restructure the terms, is from my point of view, clearly beneficial to the region's publicly owned utilities, including Seattle City Light. I understand that the restructured contracts may allow you to avoid a near-term rate increase that many utilities would be forced to pass along to their retail customers." The City of Ashland also stated that it supported going forward with the proposal due to the near-term rate relief it afforded the City. The City of Tacoma viewed the proposed contracts as an opportunity to "reduce BPA's near term costs and provide a real opportunity to deliver rate relief." Clark, Emerald, Flathead, Midstate, Skamania PUD, Springfield, Tillamook, and Wells all submitted similar comments regarding the positive benefits of the near-term rate relief afforded by the proposed contracts.

Western Montana expressed some reservations regarding deferring costs until the next rate period, but nevertheless concluded that the overall benefits of near-term rate relief outweighed their concerns regarding the deferral.

Cowlitz PUD also noted that even though it did not endorse the payment of the underlying reduction-of-risk dollars, it nevertheless believes that the proposed contracts are "a crucial part of BPA's rate reduction efforts" and encouraged BPA to go forward with the proposed contracts.

Northwest Requirements Utilities (NRU) submitted comments on behalf of a majority of its members that viewed the proposed contracts as a necessary part of an overall strategy for rate relief in the region. NRU commented that the contracts, in combination with seeking a reduction in summer spill and a pledge by the Administrator to seek $100 million in cost cuts and revenue enhancements, provide a meaningful opportunity for near-term rate relief. NRU also viewed the ability to continue with litigation challenges as an important part of the overall strategy.

Northern Wasco PUD submitted comments similar to NRU's. Northern Wasco PUD also supported the proposal and viewed it as part of an overall strategy for rate relief that included the continued efforts of the Sounding Board to achieve cost reductions and revenue enhancements, as well as getting approval to reduce summer spill.

Alcoa submitted comments that noted the proposed cost deferrals are not a substitute for cost reductions. Alcoa expressed a concern that BPA must not consider the $100 million in deferrals as a cost reduction and must continue its efforts to obtain real and permanent cost reductions.

In addition, a number of employees of aluminum smelters in the region submitted comments generally in favor of the proposed contracts because of the favorable impact it would have on the price of power. However, some of the comments submitted by other aluminum workers conditioned their support upon obtaining assurance from BPA that rates for power in the next rate period would not exceed $30/MWh.

Evaluation: BPA believes the proposed contracts present an opportunity to offer significant near-term rate relief to all of BPA's customers that pay the LB CRAC. The proposed contracts with Puget and PacifiCorp include modification of the $200 million reduction-of-risk discount contained in their Conditional Deferral Agreements (Contract Nos. 02PB-11156 and 02PB-11157, respectively). As part of the proposed contracts, Puget and PacifiCorp forego collection of one-half of the reduction-of-risk discount payments, plus interest, and defer collection of the remaining amount until the FY2007-2011 period. Absent executing the proposed contracts, the $200 million would be recovered as a load reduction expense through BPA's wholesale power rates in the Load-Based Cost Recovery Adjustment Clause (LB CRAC) in FY 2005-2006.

It should be noted that, removing $200 million from BPA's power costs for FY 2005-2006 would make power rates about 6 percent lower in those two years than absent the proposed contracts. The actual level of BPA's power rates in FY 2005-2006 depends on many factors, including the success of the Sounding Board's efforts to reduce BPA's costs, the National Oceanic and Atmospheric Administration Fisheries' decision regarding the summer spill proposal, the amount and timing of this year's runoff, and market prices.

BPA agrees with the comments submitted by NRU, Northern Wasco, and others that view the proposed contracts as a constructive part of an overall strategy to reduce

BPA rates. The fallout from the 2000-2001 west coast energy crisis is still felt by the region. While the proposed contracts help address some of the impact, it is only one piece of a larger strategy to reduce BPA's costs and enhance its revenues. Alcoa is correct in noting that the deferral of the $100 million is not a cost reduction and that to achieve significant rate reductions in the future BPA, must continue efforts in the Sounding Board, and elsewhere, to cut costs where possible.

A number of aluminum workers conditioned their support for the proposal on BPA assuring that its rates in the FY 2007-2011 period will not exceed $30/MWh. BPA, however, cannot provide such assurance in the context of this ROD without violating applicable statutory provisions regarding BPA ratemaking. BPA's rates for the FY 2007-2011 period must be set in a future rate case consistent with section 7(i) of the Northwest Power Act. If BPA were to provide the requested assurance, BPA would be predeciding ratemaking issues that can only be made in a section 7(i) rate hearing based on the record developed in that hearing. While the proposed amendments will have a limited upward pressure on rates for the next rate period (currently forecasted to result in approximately a 1 percent increase on rates) many other factors will have a significantly greater influence on determining BPA's power rates during that period.

***Decision*:** The proposed contracts provide meaningful near term rate relief for customers subject to the LB CRAC by removing approximately $200 million in load reduction expenses from BPA's power costs from the LB CRAC for the FY 2005-2006 period. While the current proposal assists in reducing rates, it is only a part of the efforts BPA is undertaking to reduce its costs and enhance its revenues over the coming months and years.

***Issue 2*:** *Whether the deferral of $100 million in reduction-of-risk payments to the FY 2007-2011 period is consistent with the rate lock provisions in BPA's pre-Subscription contracts.*

Comments: Columbia Rural Electric Association, Kootenai Electric Cooperative and Modern Electric Water Co. submitted similar comments objecting to the proposed contracts. The crux of their collective concern involves the proposal to defer $100 million associated with the reduction-of-risk payments to the FY 2007-2011 period. Although the arguments are structured slightly differently, these utilities contend that this decision breaches their respective pre-Subscription contracts with BPA.

Columbia contends its pre-Subscription contract prohibits BPA from adjusting its rates during the FY 2002-2006 period. According to Columbia, this means that BPA cannot adjust Columbia's rate for the LB CRAC. Based on this, Columbia believes BPA is effectively violating this rate lock by deferring the reduction-of-risk payments to the FY 2007-2011 period when these costs will be incorporated into the rate charged Columbia and others with pre-Subscription contracts.

Evaluation: The proposed contracts defer approximately $100 million plus interest due PacifiCorp and Puget under the reduction-of-risk provisions to the FY 2007-2011 period. By deferring the payments until the next rate period, Columbia, Kootenai and Modern, along with all other customers, will likely have these dollars included in their rates during the FY 2007-2011 period. However, the decision on whether to include these dollars as part of BPA's general revenue requirement will ultimately be made in a future 7(i) hearing.

Columbia correctly notes that BPA's pre-Subscription contracts lock the rates under those contracts for the FY 2002-2006 period. As a result of the rate lock, the rates charged Columbia, Kootenai and Modern, as well as all the other pre-Subscription contract holders, are not upwardly adjusted for any of the CRACs (LB, FB or SN) during FY 2002-2006. The LB CRAC is designed to capture additional costs associated with augmenting BPA's system. These augmentation costs include the load reduction agreements with PacifiCorp and Puget, which include the reduction-of-risk payments. Because Columbia, Kootenai and Modern do not pay the LB CRAC, each has avoided any obligation to pay the additional costs associated with augmenting Federal power, including the reduction-of-risk payments associated with PacifiCorp and Puget's load reduction agreements. These costs, it should be noted, were largely incurred after the pre-Subscription contracts were entered into.

Contrary to Columbia, Kootenai and Modern's contentions, the pre-Subscription contracts are not violated by the deferral of the reduction-of-risk payments. BPA's rate lock promise applies only to the FY 2002-2006 period. There are no assurances in their contracts with regard to fixed rates for the FY 2007-2011 period. The proposed contracts do not impact the current rate charged under pre-Subscription contracts, so there is no violation of the rate lock. In addition, BPA has not "effectively" violated the rate lock promise by deferring these dollars to the FY 2007-2011 period as argued by Columbia. The pre-Subscription contracts do not contain any assurance about how or when BPA will recover its costs. Additionally, the pre-Subscription contracts do not provide any shield against paying augmentation costs. The pre-Subscription contracts merely provide the utilities with an assurance that their rates will not change during the first five years of the contracts (FY 2002-2006). There is nothing in the proposed contracts that changes the rates paid under those agreements during this period.

Columbia's argument also assumes that the pre-Subscription contracts require BPA to contract for the sale of power and collect rates in a specified manner. BPA does not agree that its decision to sell a specified amount of power at a fixed price under the pre-Subscription agreements impacts its ratemaking either during the current rate period or for subsequent rate periods. BPA's ratemaking directives require it to recover its total costs.

BPA also believes pre-Subscription customers obtain a benefit from the proposed contracts. The proposed contracts include a cap on the amount of benefits that BPA will provide to the investor-owned-utilities during the FY 2007-2011 period. BPA believes that proposing these costs be included as part of the general revenue requirement in the

next rate proceeding is appropriate given the benefit provided by the cap. It should be noted that any decisions regarding the allocation of these costs among customer classes will ultimately be made in a future section 7(i) rate proceeding.

Finally, providing rate relief during this rate period is of utmost importance to BPA. The proposed contracts will allow BPA to avoid over $100 million in costs and will defer approximately $100 million from the current rate period. Providing near term rate relief to BPA's other customers is of paramount importance and outweighs the costs pre-Subscription customers will be exposed to in the FY 2007-2011 period.

***Decision*:** The proposed contracts, by deferring the reduction-of-risk payments to FY 2007-2011, do not violate the rate lock provisions of pre-Subscription contracts. The proposed contracts do not impact the rates currently charged to pre-Subscription contract holders. Similarly, BPA does not "effectively" violate the agreement by deferring the costs because the pre-Subscription contracts do not contain any provisions limiting the manner in which BPA recovers its costs.

***Issue 3*:** *Whether the deferral of the reduction-of-risk payments to FY 2007-2011 violates BPA's rate directives or established regulatory policy.*

Comments: Columbia believes that deferring the reduction-of-risk costs into future rate periods violates BPA's statutory obligation to set rates to adequately recover its costs. Columbia contends that BPA will fail to set its rates high enough to recover its costs if it defers payment of the reduction-of-risk discount and does not use the LB CRAC to recover the associated costs during the current rate period.

Columbia also maintains that the deferral violates established regulatory policy. It maintains that Federal regulatory law follows the "matching principle" that requires costs to be assigned to the periods in which the benefits are expected and rates are to be paid. Columbia cites *American Electric Power Service Corp.*, 104 FERC ¶ 61,013 (2003) ("*American Electric*") in support of this proposition.

Evaluation: BPA's rate directives are not violated by the proposed deferral. While BPA's rate directives require BPA to recover its total system costs, the deferral of costs does not violate those directives. As noted above, PacifiCorp and Puget will provide BPA with a notice terminating the deferral and asking for payments to begin October 1, 2006. By such notice, the payment obligation associated with the reduction-of-risk discount will not arise during the current rate period. As a result, BPA will not fail to recover its costs during the current rate period, as Columbia suggests, but rather, the payment obligation associated with the cost will arise and be paid during the next rate period.

Additionally, Columbia's reliance on Federal regulatory law and *American Electric* case are misplaced. *American Electric* was based on the Federal Power Act. The Federal Power Act does not apply to BPA's wholesale power ratemaking. BPA's

wholesale power ratemaking is conducted pursuant to the Northwest Power Act and BPA's organic legislation.

Columbia's reliance on the *American Electric* is misplaced for additional reasons. *American Electric* involved a request to defer certain costs associated with the start-up of a Regional Transmission Organization (RTO) until those costs could be recovered through rates. The applicability to this matter is questionable on several fronts. First, as noted previously, it involves FERC regulation of a utility under the Federal Power Act, which does not apply to BPA's power sales or ratemaking. Second, the Commission allowed American Electric Power to defer the start-up costs and collect them in a future period. This is directly contrary to the position argued by Columbia. Finally, *American Electric* involved issues surrounding the costs associated with the establishment of an RTO and has nothing to do with wholesale power rates.

***Decision*:** The deferral of the reduction-of-risk payments does not violate BPA's rate directives or applicable Federal regulatory law.

***Issue 4*:** *Whether the reduction-of-risk discount is unenforceable and unlawful.*

Comment: Canby argues that it has the right to appeal BPA's final actions to the United States Court of Appeals for the Ninth Circuit. 16 USC § 839f(e)(5). Canby contends that the reduction-of-risk discount interferes with those rights by penalizing public power utilities for not dismissing their petitions. Canby believes that the reduction-of-risk discount implicates fundamental rights under the United States Constitution, including the First Amendment right to petition the government for redress of grievances.

Industrial Customers of Northwest Utilities (ICNU) also asks about the circumstances under which BPA is legally obligated to pay the reduction-of-risk discounts.

Evaluation: BPA agrees that parties have the right to file *timely* challenges to BPA's final actions in the Ninth Circuit. Canby's comments, however, relate solely to the initial establishment of the reduction-of-risk discounts, not to the deferral of the existing discounts. The establishment of the reduction-of-risk provisions is not at issue in this proceeding. The reduction-of-risk discounts were established in BPA's Load Reduction Agreements with PacifiCorp and Puget, which were executed on May 23, 2001, and June 11, 2001, respectively. Under the Northwest Power Act, challenges to the Load Reduction Agreements were required to have been filed within 90 days of the execution of such Agreements. 16 U.S.C. § 839f(e)(5); *Bell v. Bonneville Power Admin.*, 340 F.3d 945, 948 (9th Cir. 2003). The issue presented in the instant case is simply whether BPA should offer the proposed contracts to the investor-owned utilities. Furthermore, questions regarding the legality of the Load Reduction Agreements are the subject of pending litigation. In summary, challenges to the original establishment of the reduction-of-risk discounts are outside the scope of this proceeding.

***Decision*:** The legality of the previously negotiated reduction-of-risk discounts is outside the scope of this proceeding and will not be addressed here.

***Issue 5*:** *Whether the mark-to-market methodology for calculating monetary benefits for the investor-owned utilities in the proposed contracts is consistent with the section 7(b)(2) rate test.*

Comments: Canby and ICNU pose questions to BPA about how it will perform the section 7(b)(2) rate test using the mark-to-market methodology in BPA's next wholesale power rate case. Neither Canby nor ICNU provide any substantive comment on this issue, but rather merely ask BPA to speculate on how it will handle this matter in BPA's next rate proceeding.

Canby asked the following set of questions:

1. Does BPA propose to implement the 7(b)(2) rate test under the new investor-owned utility methodology? If so, how?
2. If the rate test "triggers," will BPA adjust the level of investor-owned utility benefits?
3. If BPA will not adjust the level of investor-owned utility benefits, then who pays for the protection afforded to public power under the Northwest Power Act? Will those costs be shifted to DSI rates?
4. If the DSIs do not buy a sufficient amount of power from BPA, then who is left to pay for the cost of protecting public power from the triggering of the 7(b)(2) test?
5. What happens to the Residential Exchange Program for public power utilities? Can they still participate in the REP after October 1, 2006? If so, will BPA apply the 7(b)(2) rate test to their benefits?

ICNU similarly asked:

1. Whether the Agreements will impact BPA's statutory obligation to ensure that rates of preference customers are no higher than if the Administrator did not provide financial benefits to the investor-owned utilities. Northwest Power Act, 16 USC §839e(b)(2). For example, will any of the financial benefits provided to the investor owned utilities under the agreements be subject to the rate ceiling test under Section 7(b)(2) of the Northwest Power Act.

Evaluation: Pursuant to section 7(i) of the Northwest Power Act, BPA can only resolve issues regarding BPA's ratemaking in formal evidentiary hearings conducted in accordance with that section. All issues regarding the implementation of section 7(b)(2) of the Northwest Power Act and the allocation of BPA's costs will be resolved in future BPA section 7(i) hearings.

Similarly, Canby has inquired about BPA's plans for implementing the REP with BPA's public agency customers. The current proceeding only concerns the proposed contracts to eliminate a portion of the reduction-of-risk discount, defer an additional portion, and establish a FBPF for use in calculating future monetary benefits. Issues regarding BPA's implementation of the REP are outside the scope of this proceeding.

***Decision*:** Issues regarding BPA's future ratemaking can only be decided in a formal evidentiary section 7(i) hearing. Such issues are outside the scope of this proceeding. Similarly, issues regarding implementation of the REP are outside the scope of this proceeding. In any case, the questions regarding the 7(b)(2) rate test exist with or without BPA deciding to go forward with the proposed contracts.

***Issue 6*:** *Whether BPA should delay the issuance of this ROD and make the proposed contracts part of the Regional Dialogue process*.

Comments: Canby requests that BPA move its decision regarding the proposed contracts into the Regional Dialogue forum. Canby notes that BPA informed interested parties in February 2004 that it would consider the REP and related issues in the Regional Dialogue process. Rather than following its announced process, Canby argues BPA has developed this separate expedited proceeding. Canby believes that this will fragment the Regional Dialogue's decision making process.

Evaluation: BPA does not believe it is appropriate to move the decisions on the proposed contracts to the Regional Dialogue forum because the timing of the Regional Dialogue conflicts with the need to make timely decisions regarding the proposed contracts.

The Regional Dialogue is a forum where a number of issues related to BPA's future obligations and role in the region are being discussed. Under the current plan, the Regional Dialogue will culminate in a decision document in the coming months on a wide range of issues. This timetable conflicts with the decision timetable for the reduction-of-risk payments. The Conditional Deferral Agreement requires PacifiCorp and Puget to elect by June 3, 2004 whether they intend to terminate the existing deferral and thereby begin to receive payments in the next fiscal year. BPA's preferred option is to execute the proposed contracts with PacifiCorp and Puget prior to June 3, 2004.

BPA prefers this option because it avoids the possibility of unnecessarily increasing the LB CRAC. The LB CRAC for the October 1, 2004 to March 31, 2005, period is set in mid-June. BPA fully anticipates receiving notices from PacifiCorp and Puget terminating the deferral. This belief is based upon an order from the Oregon Public Utilities Commission directing PacifiCorp to terminate the deferral and representations by Puget that it intends to do the same. Absent execution of the proposed contracts by the investor-owned utilities, BPA fully expects PacifiCorp and Puget to seek payment of the full $200 million plus interest.

If PacifiCorp and Puget terminate the existing deferral, it is possible that each could ask for the payments to begin as soon as possible. The reduction-of-risk payments will be collected through an upward adjustment to the LB CRAC. If BPA waits until the Regional Dialogue has concluded to make a decision regarding the proposed contracts, the LB CRAC set in mid-June could include dollars for the reduction-of-risk payments.

To avoid this problem, BPA placed this decision on a different timetable. By negotiating a contract with the investor-owned utilities and putting it out for comment prior to the LB CRAC decision date, BPA provided Canby and others the ability to comment on the proposed changes and not run the risk of unnecessarily raising the LB CRAC.

The issues raised by these proposed contracts do not fully address the issues surrounding the provision of benefits to the investor-owned utilities. Regional Dialogue is addressing a variety of issues regarding the future of its relationship with the region's investor-owned utilities. Those issues will still need to be addressed in that forum. By resolving the issues surrounding the decision to offer these contracts in this ROD, BPA is not precluding Canby or others from presenting its opinion on the other investor-owned utility issues that are still being discussed in Regional Dialogue.

***Decision*:** BPA's decision regarding the proposed contracts will be made in this ROD and not shifted to the Regional Dialogue.

***Issue 7*:** *Whether BPA is obligated under certain circumstances to pay PacifiCorp and Puget the entire $200 million reduction of risk payment under the proposed contracts.*

Comments: Canby contends that there is an inconsistency between BPA's April 16, 2004, letter that sought public comment and the proposed contracts. Canby contends that the letter states that PacifiCorp and Puget will waive $100 million of the reduction of risk discount and defer collection of the other $100 million until the FY 2007-2011 period. Canby further notes that the contract "suggests that BPA may be required to pay the full amount under certain circumstances." To resolve the inconsistency, Canby posits the following questions:

1. Under what circumstances do PacifiCorp and Puget have the right to the full reduction of risk payment?
2. Why would a ruling invalidating the REP Settlement Agreement also not invalidate the reduction of risk payment?

ICNU also asks about the circumstances when BPA would be obligated to pay PacifiCorp and Puget the full reduction of risk payments.

Evaluation: BPA's letter and the proposed contracts are consistent. Canby's concern appears to be with section 4(c) of the proposed contracts. Section 4(c) provides that if section 4(c) of the REP Settlement Agreement is void, unenforceable or unlawful, then the proposed contracts that are the subject of this ROD shall likewise be rendered void *ab initio.* Section 4(c) of the REP Settlement Agreements with PacifiCorp and Puget involves the determination of benefits for the respective investor-owned utilities. The proposed contracts modify that section to include the caps and floors along with the new methodology for calculating the FBPF. The insertion of the language in section 4(c) of the proposed agreements is designed to deal with the situation that would arise if the court strikes the underlying formula in the REP Settlement Agreement. The proposed modifications to include a cap, floor as well as the new FBPF methodology all relate to the formula for calculating monetary benefits (i.e., FBPF-RL rate) and the proposed contracts become meaningless if there is no formula to which to apply the cap, floor or new methodology.

Voiding the proposed contracts does not mean that PacifiCorp or Puget will automatically be entitled to payment of the full $200 million as Canby's second question assumes. Any court order invalidating the REP Settlement Agreement formula may or may not impact BPA's obligations to make the reduction of risk payments. Attempting to speculate about the form of the court's order is a fruitless exercise. This agreement only returns parties to their positions prior to the execution of the proposed contracts. The court will ultimately resolve any question regarding the extent of BPA's obligation to make a reduction of risk payment or a payment under the FY 2003 Deferral Agreements.

BPA believes the benefits of near term rate relief outweigh any impact caused by litigation voiding the application of the proposed contracts. Regardless of the application of section 4(c), BPA's customers will receive near term rate relief. BPA will not face any higher costs from the application of section 4(c) than the costs BPA would face if the proposed contracts were not offered.

***Decision*:** Whether BPA will be obligated to pay PacifiCorp and Puget the entire $200 million reduction of risk payment if a court order results in voiding the proposed contracts is impossible to determine at this time without such court order. Regardless of the outcome of the litigation, BPA' customer's will receive the important benefit of near term rate relief.

Issue 8: *Whether the proposed contracts are consistent with REP statutory provisions.*

Comments: ICNU asks whether BPA believes the proposed contracts are consistent with the REP statutory provisions and what the investor-owned utilities might be entitled to under a traditional REP.

Evaluation: The consistency of REP Settlement benefits with the REP is an issue that was previously addressed by BPA in the establishment of the REP Settlements. *See* "Residential Exchange Program Settlement Agreements With Pacific Northwest Investor-Owned Utilities, Administrator's Record of Decision." Because this issue was previously decided, it is not being revisited in this proceeding. Also, BPA's previous decision is the subject of pending litigation.

***Decision*:** The consistency of REP Settlement benefits with REP benefits was previously addressed by BPA in a separate forum and will not be revisited in this proceeding.

***Issue 9*:** *What is the impact of the proposed contracts on BPA's rates?*

Comments: ICNU asks what the rate impact of the proposed contract would be.

Evaluation: BPA's April 16, 2004, letter, which sought public comments on the proposed contract, stated:

> Removing $200 million from BPA's power costs for FY 2005-06 would make power rates about 6 percent lower in these two years with this agreement than without it. This year's dry spell is tending to push rates in the other direction, and could overwhelm the impacts of this and other successes at reducing costs. The actual level of power rates in FY 2005-06 depends on many factors, including the success of the Sounding Board efforts, National Oceanic and Atmospheric Administration Fisheries' decision regarding the summer spill proposal and this year's runoff and market prices. We won't know the final results for FY 2005 rates until August 2004.
>
> Assuming BPA receives approval from its auditors, the $100 million would be deferred to FY 2007-2011 and would add $20 million plus interest to BPA's general revenue requirement for each of these five years. All of BPA's power customers (Slice, non-Slice, investor-owned utility, and direct-service industrial) would pay these additional costs. This deferral would make power rates in FY 2007-2011 about 1 percent higher with this proposal than without it.

***Decision*:** Assuming the proposed contracts are executed, BPA's customers will see a 6 percent decrease in rates from what they would otherwise be during the FY 2005-2006 period and a possible 1 percent increase in the FY 2007-2011 period.

***Issue 10*:** *What consideration does Avista, Idaho Power, Portland General and NorthWestern provide to BPA for their proposed amendments?*

Evaluation: BPA's April 16, 2004, letter and this ROD have explained that Avista, Idaho Power, PGE and NorthWestern provide consideration for the amendments in the

form of a waiver of the remaining dollars they deferred under the FY 2003 Deferral Agreements. This amounts to a total of approximately $3.5 million for all four investor-owned utilities.

BPA believes this is adequate consideration under the circumstances. If one considers the total contribution from PacifiCorp and Puget as well as the others, there is more than $103 million in reductions in BPA's payments to these utilities, plus more than $100 million deferred into the FY2007-2011 period. BPA believes, in total, this constitutes adequate consideration for offering the proposed contracts. It should be noted, however, that in the event PacifiCorp and/or Puget were to elect not to sign a proposed contract, BPA has informed all of the investor-owned utilities that it will not go forward with the transaction.

***Decision*:** Avista, Idaho Power, PGE and NorthWestern provide consideration for the amendments in the form of a waiver of the $3.5 million remaining of amounts deferred under the FY 2003 Deferral. This amount, when taken together with the amounts contributed by PacifiCorp and Puget, provides sufficient consideration for offering the proposed contracts.

***Issue 11*:** *Whether BPA should provide the investor-owned utilities with power or monetary benefits during the FY 2007-2011 period.*

Comments: ICNU asks why BPA elected to provide the investor-owned utilities with only monetary benefits in the FY 2007-2011 period.

Evaluation: ICNU seeks an explanation for why BPA is electing to provide the investor-owned utilities monetary benefits as opposed to power deliveries. As previously explained, BPA elects to provide only monetary benefits under the proposed contracts for the FY 2007-2011 period. Given BPA's current load-resource balance, BPA believes it is reasonable to reduce its overall risk in the market by making this decision. Electing to provide only monetary benefits allows BPA to reduce the amount of power it must purchase in the wholesale market to augment BPA's system. Recent history has shown a good deal of volatility in the price of power on the wholesale market. By reducing the need for BPA to purchase power on the market, it will minimize BPA's exposure to the volatility of the market.

Second, BPA's election also provides assistance to the investor-owned utilities by resolving some uncertainty regarding their resource needs during the FY 2007-2011 period. By providing notice more than a year prior to the time BPA must make the election, the investor-owned utilities are better positioned to make resource-planning decisions.

***Decision*:** Providing monetary benefits as opposed to power allows BPA to minimize its exposure to making purchases in the volatile wholesale market and contributes to investor-owned utility resource planning.

***Issue 12*:** *What is the basis for BPA using a mark-to-market methodology along with the caps and floors in calculating monetary benefits?*

Comments: ICNU asks why BPA decided to use a mark-to-market methodology to determine the FBPF, as well as caps and floors. As noted earlier in this ROD, BPA and the investor-owned utilities both sought to bring some transparency to the determination of the FBPF. The investor-owned utilities viewed establishing the market price in a BPA rate case as an opportunity ripe for manipulation. They believed that pressures on the Administrator to reduce costs could result in a very conservative determination in a rate case of the market priced used for FBPF, thereby reducing the level of the investor-owned utilities' benefits.

To address this concern, BPA proposed an independent market price survey. BPA viewed using the independent price survey from a list of EDPs over a multi-month period as a means of providing the desired transparency and at the same time providing a similar mechanism for determining the FBPF.

The proposed contracts also hedge BPA's exposure to the level of investor-owned-utility benefits. When BPA originally agreed to provide some power deliveries to the investor-owned-utilities as part of the Subscription Strategy, the power deliveries were seen as a hedge against the possibility that the financial portion of the benefits would become higher than anticipated. Unfortunately, the power deliveries did not work to hedge BPA exposure. At the time of the Subscription Strategy, BPA envisioned a manageable level of market purchases in order to meet its demand. However, as events unfolded, BPA found itself in a position that required it to make a significantly greater level of purchases to augment the Federal system to meet its load obligations. This fact undermined the hedging effect that power deliveries would have had at the time of the Subscription Strategy. The hedging strategy was further undermined due to the fact that many of these purchases were made at a time of unprecedented high wholesale market prices. As a consequence, the hedging effect of the power sales to the investor-owned-utilities did not materialize as planned.

The proposed agreements do two things to attempt to correct this problem. First, BPA is electing not to provide any power deliveries. This allows BPA to minimize its exposure to the wholesale market. Second, the mark-to-market methodology is collared by a cap and floor. The cap on the on the monetary benefits further ensures that BPA is not exposed to unanticipated benefit levels for the investor-owned-utilities. The floor, conversely, represents a trade-off for obtaining the cap on benefit levels. Together however, the cap and floor bound the level of investor-owned-utility benefits at levels BPA originally anticipated.

***Decision*:** BPA believes the mark-to-market methodology provides the desired transparency that, taken together with the caps and floors, provide BPA a hedge against

exposure to the level of investor-owned utility benefits. These elements, together with the decision to provide only monetary benefits, provide BPA with a reasonable balance.

***Issue 13*:** *Whether it is appropriate to offer the proposed contracts without requiring all other parties to waive their legal claims challenging BPA's provision of benefits to the investor-owned utilities*.

Comments: ICNU questions the wisdom of providing the proposed contracts without obtaining agreements from public power to dismiss the pending litigation challenging the provision of these benefits. NRU viewed the decision to disconnect dismissal of litigation and the decision to offer the proposed contracts as positive. In NRU's view, this decision allowed the cases to continue in a timely manner and yet provide the desired rate relief.

Evaluation: BPA believes that certain public power litigants are unwilling to dismiss their current legal claims. Attempting to require them to do so would likely be fruitless. BPA's continuing goal is to find ways of achieving near-term rate relief for BPA's customers. The consideration provided by the investor-owned utilities in return for the mark-to-market methodology, along with the other aspects of the proposed contracts, was a way to achieve this objective without the need to require parties to dismiss litigation. BPA views this matter much the same as NRU, namely, that the offer of the proposed contracts achieves needed rate relief and allows resolution of other issues before the court.

Decision: It is not necessary to require parties to forego legal claims in order to establish the rate relief provided by the proposed contracts.

***Issue 14*:** *Whether the proposed contracts establish a precedent for post-2011 service to the investor-owned utilities.*

Comments: ICNU asks whether the proposed contracts establish any precedent for the provision of benefits to the residential and small farm consumers of regional investor-owned utilities after FY 2011. NRU states that its support for the proposed contracts is conditioned upon assurances that BPA will not rely on them to determine benefits for the investor-owned utilities beyond FY 2011.

Evaluation: The proposed contracts are not intended to provide any precedent regarding the manner and method by which BPA will provide Federal benefits to the residential and small farm customers of regional investor-owned utilities for the post-2011 period. Such benefits will be established in a separate proceeding.

***Decision*:** The proposed contracts do not establish a precedent for post-2011 service to the investor-owned utilities.

***Issue 15*:** *Whether it is appropriate for BPA to determine investor-owned utility benefits outside a BPA rate case.*

Comments: Alcoa asks whether it is appropriate to determine investor-owned utility benefits outside of a BPA rate case.

Evaluation: BPA has never established investor-owned utility benefits in a BPA rate case. Rather, such benefits are determined outside BPA's rate cases and BPA's rate cases simply forecast the projected amount of investor-owned utility benefits for purposes of establishing rates. The proposed contracts substitute a mark-to-market methodology for a forward price forecast from BPA's rate case. Debate over the appropriate level of the RL rate, however, will still occur in BPA's rate cases.

BPA believes the mark-to-market methodology represents a reasonable alternative to a BPA rate case forecast because it provides a level of transparency not necessarily available with a rate case forecast. Additionally, the annual calculation of the price forecast will allow investor-owned-utility benefits to be more consistent with the level of benefits BPA provides its other customers. Under the existing arrangement, benefit levels are based upon a market price forecast for the rate period. As recent events have shown, a rate case forecast can deviate considerably from actual market prices experienced during the period. The difference between the rate case forecast and actual market prices has contributed to a sense of frustration among some customers that the benefits from the Federal system are not equitably shared. Using a market survey will help to address this concern.

***Decision*:** It is appropriate to use a mark-to-market methodology in calculating the FBPF.

***Issue 16*:** *Whether the proposed contracts should be modified to clarify that the Committee can act only through a unanimous vote, and to avoid the suggestion that there are two separate categories of Committee actions.*

Comments: PacifiCorp and Puget jointly submitted a proposed change to the wording of the proposed contracts. The proposed changes were not intended to change the substance or meaning of any section, but rather to clarify the intent of the parties. The proposed changes are as follows:

1. Section 3(b) of the Independent Methodology should be clarified to help ensure that section 3(b) is not misread to permit the Committee to act with less than unanimous vote and more clearly reflect the intent of the parties that the appointed representatives to the Committee act through unanimous vote only.

2. Delete the words "and determinations" from section 3(c) of the Independent Methodology to avoid the erroneous suggestion that there are two separate categories of Committee actions, (i)"actions" and (ii) "determinations."

Evaluation: The Committee referred to by PacifiCorp and Puget is a group comprised of one BPA representative, one PNW IOU representative, and one PNW Public representative. The primary purpose of the Committee is to select a list of eligible EDPs for the QTP to survey for the mark-to-market methodology. BPA believes that the proposed changes reflect the intent of the parties and clarifies the current language. It was the intent that the Committee act through a unanimous vote and the current language in the contract could be misread to imply otherwise. The proposed changes will resolve questions that may arise in the future regarding the intent of the contract. BPA will make these changes before offering the proposed contracts to the region's investor-owned-utilities.

***Decision*:** Proposed changes, to clarify that the Committee acts through unanimous vote only and that that there is a single category of Committee actions, are reasonable and help clarify the intent of the parties.

CONCLUSION

The proposed contracts for the region's investor-owned utilities provide for the deferral of the reduction-of-risk discount to FY 2007-2011. In addition, half of the reduction-of-risk discount, approximately $100 million, is waived in return for the offer of the proposed contracts. These actions will lead to a total reduction in BPA's revenue requirement in the current rate period of approximately $200 million. Such a reduction will result in a significant reduction in rates (through the LB CRAC) in the current rate period, which will provide a benefit to the Pacific Northwest region during troubled economic times.

In addition, the elimination of possible power deliveries and the provision of only monetary benefits to the investor-owned-utilities in the FY 2007-2011 period will reduce the need for BPA to acquire additional power supplies from the wholesale power market. This will reduce BPA's reliance on the unpredictable and volatile wholesale power market, which should enhance the stability of BPA's rates.

I have reviewed and evaluated the proposed mark-to-market methodology, cap, floor, and extended period for the pass-through of benefits to residential and small farm consumers. These modifications provide necessary transparency as well as a fair and independent system for determining the level and nature of investor-owned-utility benefits.

I have also reviewed the proposed changes to the Subscription Strategy and find that these are reasonable and proper under the circumstances.

I have reviewed and evaluated the record compiled by BPA on the proposed contracts. Based upon the record, the reasoning contained therein, and all requirements of law, I hereby offer the proposed contracts and other related documents and make the changes to the Subscription Strategy.

Issued at Portland, Oregon, this 25th day of May, 2004.

Stephen J. Wright
Administrator and Chief Executive Officer

Bonneville Power Administration

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