

June 13, 2005

BY ELECTRONIC MAIL

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Dear Paul,

Northwest Requirements Utilities (NRU) appreciates this opportunity to comment on the questions raised in BPA's May 11, 2005 letter regarding its power supply role post 2011. BPA serves the power and transmission needs of the 49 member utilities of NRU. NRU's mission includes working with BPA to ensure low cost power and reliability from BPA over the near and long term. The questions and issues raised in the May 11th letter are vitally important to the NRU membership. This letter has been circulated in advance to our members, and individual utilities may decide to submit additional comments.

Our response below moves through the questions posed by BPA and provides NRU's response to each question.

Service to Public Utilities

NRU has participated in the allocation discussions led by the Public Power Council and generally supports the PPC allocation proposal. We will assess the results of this effort according to the following key objectives of the NRU membership:

1. Federal Base System (FBS) operation

- The BPA system must continue to be operated as an integrated whole to maximize generation efficiency and provide maximum benefits to the region while meeting non-power constraints in the most effective manner possible.
- BPA will continue to offer a Full Requirements product similar to what is currently offered but with a separate component for loads beyond an allocated amount (expressed as a % of FBS at critical water) for each utility.

2. Allocation

- Allocation will be accomplished via 20 year contracts beginning October 2011; existing contracts will be honored at no disadvantage through 2011. That is, customers will be able to retain their existing contracts and contract rights to lowest cost PF power through 2011. In that context, it appears difficult or impossible to have new contracts with some customers with an effective date prior to October 1 of FY 2012 because of the opportunity it would create for cost shifts, confusion, and potential litigation among the customers.
- The allocation is a right to buy up to an established percentage output of the critical water FBS at the embedded cost price. If a customer's load is below its allocated amount at any time it will retain the right over time to grow back up to its allocation, with power provided at embedded cost.
- The PPC Proposal uses the 2002 net requirements determination done in 2000 and 2001 as the basis for this allocation. Full requirements customers will have a new net requirement determination performed before FY 2012 that will establish their percentage allocation.

3. Products under allocation

- The projected price for an embedded cost product in an allocated system should not exceed the price of an embedded cost product in an unallocated system.
- Customers must be able to choose additional products or product features to meet their needs for load growth, load following, etc. for load service beyond the allocated percentage of the FBS at critical water.
- BPA will offer an effective, and cost competitive, choice of products for load growth service. These products will be priced at the cost of the acquired resources or market purchases. The product choices will include at a minimum:
 1. a long term load growth product, with a take or pay obligation, reflecting the cost of a resource acquisition
 2. a long term load growth product reflecting the cost of a market contract
 3. a shorter term market contract
 4. a renewables resource package
 5. a mix of the above

4. Cost Control/Cost Separation

- Customers must have a contractually specified and substantive means to review, examine, and provide timely input on BPA and BPA-related policy and program options affecting power costs (more discussion of cost control is provided in the cost control section below).
- Contractual provisions must be agreed to regarding cost separation between products.

- Limited contract off ramps permitting a reduction in load placed on BPA should be provided for those customers that wish to choose other power providers, provided remaining customers are not harmed by this (see attached paper).
- Programs established by statute or contract that are embedded in the current cost of the FBS, such as the Low Density Discount (provided at a meaningful level), and the Power Business Line coverage of GTA costs will be included in the embedded costs of the FBS consistent with future program design and eligibility standards.
- Another important facet of cost control will be a contractual provision assuring that for the duration of the contract, the customer's right to cost based power – reflecting the embedded system, will not be effectively modified or removed by federal legislation or administrative directive that would try to impose a new pricing methodology, either instantly or gradually, such as “market based rates,” as some have advocated.

5. Resource development under allocation

- Full and Partial Requirements utilities will have the ability to develop or purchase non-federal resources to commit to load, at the bottom of their resource stack, to partially or completely offset the need for purchasing power supply above the allocated amount from BPA, for example to meet load growth.
- Customers that are not connected to the main Federal grid must be allowed to move non-federal power, or to federalize non BPA resources for load growth service such that the price for transmission of non-federal resources does not include a pancaked GTA charge. (see transfer service discussion below)
- Utilities will have limited rights to pool load growth service resources within the Full Requirements or Partial Requirements class, provided that such pooling does not impose costs on other customers.

6. New publics/Exchange

- In the event that the BPA chooses to serve new publics that have met the eligibility and timing standards (e.g. sufficient notice period) for service with embedded cost power, BPA will do a capped augmentation (say 75 aMW for defined periods) to serve the load and include the costs of this service in the embedded cost of the FBS.
- The historic public exchange is untenable going forward under allocation, and must be negotiated to an equitable conclusion, both for public power systems and in consideration of the benefits provided to residential and small farm customers of IOUs

7. Moving forward

- If allocation fails it would be unacceptable for BPA to institute Tiered Rates in its place absent accompanying contractual safeguards that the customers support. Tiered Rates, without further contractual provisions and assurances, affords BPA too much discretion to alter the customer's access to Tier 1 power and the pricing of Tier 1 power from rate period to rate period.
- In order to move forward into an allocated framework, all classes of customers will need to be assured that they collectively will not be worse off as a result of allocation. An analysis of the effects of allocation and related matters on delivered BPA power prices will need to be completed well before contracts are offered.
- We need to accomplish all of the above, or as much of it as is possible, through good faith discussions and negotiations between BPA and all customer groups, without new federal legislation.

8. Providing customers with more stability and predictability about their rates by establishing a long-term rate methodology

A long term rate methodology is necessary for determining the price of the embedded cost product. The price of the embedded cost product must be clearly defined in advance of new contract initiation according to the categories of costs that will be allowed. These costs should be limited and include:

- production and debt service at existing generation facilities,
- conservation and renewable resources, resources with existing output-purchase contracts
- system costs such as fish and wildlife protection,
- BPA's internal operations costs,
- Other system costs such as the cost of the Low Density Discount and PBL coverage of the GTAs costs.

Load growth service and load variance will be billed separately from the cost of the embedded power product. The pricing of these products will also be governed under a long term pricing policy. We look forward to participating in developing these long term pricing policies.

9. Whether BPA should make modifications to the Full and Partial Requirements contracts?

Modifications to these contracts will be necessary in order to carry out the points described in this document and we stand ready to work with BPA as we develop these contract changes.

Benefits to Residential and Small farm customers of IOUs

NRU is in litigation with regard to the calculation of Investor-Owned Utility (IOU) benefits for the FY 2002 to 2006 period, because we are concerned about how BPA has approached the issue of IOU benefits in recent years. The basis for this litigation is that BPA should have followed the directives of the Northwest Power Act when it calculated IOU benefits and its rates for 2002 to 2006. These directives provide the means whereby IOUs will obtain benefits from the federal system and the protections that are afforded public power in the conferring of these benefits. We recognize that the average system cost and rate test provisions are difficult to implement, however, the statute should be administered as written.

A primary purpose of the Northwest Power Act was to better equalize the residential and small farm electric power rates of publicly and privately owned utility customers however, the current benefits for IOU residential and small farm customers are too generous. For many NRU members, residential rates are higher than the residential rates of nearby IOU residential customers, due to the current high level of IOU financial benefits being conferred upon the IOUs by BPA and paid for by public power. We expect that this situation will be exacerbated when the pre-subscription products expire in 2006.

For the FY 2007 to 2011 period, NRU believes that any benefits to the IOUs should be monetary in nature only, given the load resource balance situation that BPA faces post 2007 and the limitations being placed on BPA's future load service obligations. Having a cap on IOU benefits is useful, and the revised method of determining financial benefits achieves greater procedural clarity about how the benefits will be derived. However, in light of the anticipated BPA Priority Firm rate post 2006, the inequities of the generous benefits that the IOUs receive will be perpetuated. Given that likely circumstance, NRU is open to discussing long term benefits for the residential and small farm customers of IOUs in a package that may include revisiting the benefit levels for the FY 07 – 11 period, if all parties are open to such an approach.

With regard to the new IOUs'/State Commissions' proposal for the post 2011 period, we concur at the highest level that future benefits should be financial in nature, rather than power deliveries. It may be possible to develop a replacement financial benefit calculation for the IOUs that is easier to administer, fair and transparent. We are willing to work on the development of such a mechanism. A future offering from BPA will be contingent upon 1) the resolution/outcome of pending litigation, 2) reconciliation with the Regional Act, and 3) the outcome of regional negotiations between the parties.

Treatment of DSI Loads Post 2011

NRU has previously submitted comments to BPA regarding service to the DSIs for the FY 2007 – 2011 period. In those comments we recognized that the DSIs as a customer class have no statutory or contractual right to continued BPA service of any kind following the expiration of current contracts in September of 2006. We stressed that any

power supply arrangement with the DSIs should not reduce the amount of power available for allocation to the preference customers for the post 2011 period. We did not support the provision of general financial benefits in lieu of power deliveries. NRU emphasized that any DSI transaction should be focused primarily upon preserving existing jobs, and that the cost of any DSI program needed to be accommodated within an overall rate target, or else we could not support it.

Unfortunately, we have seen nothing from the DSIs as a group or individual companies that would lead us to a conclusion that the criteria NRU offered will be accepted by the DSIs. Nor have we seen evidence that the DSIs are willing to reach an agreement in principle with BPA for FY 2007 - 2011 that the Agency would support, and that could be explored with other BPA customers. In light of these circumstances, we see no reason for BPA to plan for DSI power deliveries or financial support as a long term contractual obligation post 2011.

Resource Adequacy Standards

NRU staff is participating in discussions with BPA on the topic of resource adequacy standards. We believe that this topic merits attention, since the reliability of the power system is critical to the economic health of the region. In addition, as we consider an approach to the future of BPA's power supply obligations that requires utilities to take more responsibility for their own load growth, the resource adequacy issue will grow in importance especially for delivery of load growth products. Full service and simple partial customers expect that BPA as their primary or exclusive power supplier will be addressing the resource adequacy with us and on our behalf. We support a review of the need for resource adequacy standards and look forward to working with BPA to resolve this issue in a way that is not onerous to full service and simple partial customers.

Cost Controls and Dispute Resolution

NRU proposes the following approach to cost control. First, a Customer Cost Management Group would be developed to influence policy and program decisions on what activities are to be funded by BPA. Second, limited contract off ramps would be provided if BPA's rates increase above agreed levels. Third, contractual provisions would be provided to enhance cost control. Fourth, customers' rights regarding dispute resolution, and a clarification of issues that could be subject to arbitration is necessary. These elements are described in more detail below:

1. **Development of a Customer Cost Management Group (CCMG)** A CCMG will be founded and funded by and composed of a self selected group of BPA's paying customers. This will require a high level of customer commitment. The initiation of the CCMG should be formally recognized through a BPA decision making process which states the commitment of the Agency to work with and participate in the CCMG over the long term. The goal of the CCMG would be to:

- Influence policy and program decisions on what activities are funded. This is especially true for new activities or activities that are experiencing increased funding. The focus here would be both on those projects that are expensed and financed.
 - Influence the costs of those agencies that are included in the BPA power rate revenue requirement (ENW, Corps, Bureau, Fish and Wildlife Service, the Council).
 - Provide assistance with policy and program decisions on whether funding is expensed or capitalized.
 - Give customers the ability to ensure that activities that are currently funded are being conducted in the most efficient manner possible.
 - Give customers the ability to periodically test whether activities that are ongoing are still necessary and appropriate.
 - Provide greater transparency concerning the ongoing flow of funds (both revenues and expenses).
 - Advise BPA on risk management and risk recovery through rates.
2. **Contract Off ramps** As an incentive to help BPA control costs, during the course of a 20 year contract, customers will have a right to remove a percentage of load placed on the Agency that is served by FBS “vintage” power without incurring stranded costs if rate targets are exceeded. (see attached detailed explanation)
 3. **Specific contractual** provisions must be developed by BPA and its customers that carry out the cost control elements described in this paper.
 4. **Dispute Resolution Mechanisms** NRU supports a common set of dispute resolution mechanisms that would be available in all public power contracts and that would provide the same degree of protections to all customers for those matters that are subject to dispute resolution. Customers need to know that they can pursue an impartial resolution of disputed basic contract provisions, such as the underlying provision of the allocation proposal, the methodology for cost assignment, and related features. Equally important, customers need the certainty that other matters widely impacting all BPA customers that are addressed in forums, such as rate cases, can be concluded in that venue, and would not be eligible for dispute resolution in another forum. Given current litigation this is a contentious issue both among the publics and with BPA. However, NRU is anxious to work with all customers and BPA for a common dispute resolution mechanism and applicability provisions in future contracts.

Conservation and Renewables

In the conservation area, NRU continues to support local utility implementation of conservation programs. The Conservation and Renewables Discount is a valuable tool in achieving this objective. As we move into a new power supply arrangement such models as the C&RD can provide valuable instruction for implementing conservation at the local level. While we believe that the C&RD continues to work and we continue to support it, we also recognize the discount program can be expected to evolve and improve over time. In large part the Northwest Power and Conservation Council defines those measures that are deemed cost effective within the discount program. We need to work with the BPA and the Council to better define cost effective conservation measures that work for local communities. BPA needs to continue to offer a small utility program.

BPA is taking generally the right approach in terms of moving towards facilitation of renewables, this approach is consistent with BPA's new definition of its power supply role. BPA should not be the backstop for the region's renewable resource and conservation development; However, BPA can provide a vital role in partnering with local utilities in the development of renewable resources and getting the energy from the resource to the load in a cost effective manner.

Transfer Service

Section 7(b) of the Transfer Service Agreements signed on April 6, 2005, describes a commitment by the parties to begin discussions on a subset of issues that were not resolved in the Agreements. These issues include Transfer Services for the following: (1) non-federal power deliveries over third party systems; (2) annexed loads; and (3) Slice surplus. These issues were removed from the list of issues subject to the comparability principle in Exhibit A to avoid confusion and conflicts with BPA's existing policies and contract provisions. Section 7(c) provides a timetable for the identification of the processes that will address the issues noted in sections 7(a) and (b). The provision now provides that BPA has 180 days from the execution of the proposed contract to identify the process or processes where items above will be discussed.

The following basic principle should guide our deliberations on these issues: Customers that are not connected to the main Federal grid must be allowed to move non-federal power, or to federalize non BPA resources for load growth service such that the price for transmission of non-federal resources does not include a pancaked GTA charge. This is especially critical if GTA customers are expected to look at other options, in addition to BPA, for load growth service. BPA and its customers should begin discussions on the resolution of these issues in September of this year with a target date for resolution by November 15th, 2005.

Bundled Service Offering

BPA should develop and offer a long-term bundled power and transmission product in 2011. BPA's now-decade-old decision to separate its business functions and require separate power and transmission contracts has been burdensome for the Agency's small utility customers. These utilities have load obligations but little practical ability to maintain the personnel and systems necessary to monitor power purchases or comply with the obligations imposed on them by the Agency's Open Access Transmission Tariffs, such as submitting power schedules, designating and scheduling points of receipt and delivery, or providing load and resource updates. NRU expects that providing separate services to these small utilities has been administratively burdensome on the agency, as well. NRU is ready to help the agency develop this idea more fully for a product offering in 2011.

Slice of the System Product

It is our understanding that BPA moved the customer comment period for draft Slice of the System report to June 20th. Our comments regarding the report will be separately sent by the June 20th deadline.

Conclusion

Thank you for the opportunity to provide comments regarding the Regional Dialogue issues. NRU staff and the membership have invested a great deal of time addressing these issues, both within the public power community, and with BPA and other customer groups. While we have made good progress on many fronts, a number of key issues remain unresolved. We will continue to be available to meet with BPA to help shape a package that meets the region's interests, and that will be acceptable to the Full Requirement customers. We urge the Agency to keep moving forward so that the momentum for this important endeavor is not lost. While everyone will not be fully satisfied with the outcomes, if we fail to come to conclusions, the fall back alternatives may be even more contentious. If you have any questions, please let us know.

Very Truly Yours,



John Saven
Chief Executive Officer

Cc: NRU membership
Marilyn Showalter, Public Power Council

BPA Cost Control – Off Ramp Optional Feature

Introduction and Overview of Customer Management Group

The following is a proposal linking BPA cost control with contingent and limited off ramp rights for BPA customers with long term power sales contracts. This paper assumes that a Customer Management Group will be formed and actively functioning during the 20 year contract period. CMG members will be high level General Managers or equivalents, and the organization will provide its own staff support. The organization does not form and dissolve with every rate case and requires long term stable membership to be successful.

BPA would need to make a policy decision to participate in the CMG process. This decision would be memorialized in a durable fashion, such as including such a commitment in the long term power sales contracts, or if that could not be achieved, by publishing a decision in the Federal Register. BPA would:

- Provide information and reports at the level of detail necessary for the CMG to render informed input on cost and policy decisions.
- Provide reports on actual costs relative to budgets and reasons for deviations.
- Make senior management level personnel (including the Administrator as appropriate) available to confer on major policy decisions and overall financial performance.

The CMG would at a minimum:

- Provide input to BPA on cost levels used for rate setting, major policy decisions that drive future costs, and the capital program.
- Review financial performance of the Agency.
- Provide input to Corps, Bureau, Energy Northwest and other cost centers as well as BPA.
- Work with BPA to oversee this “off ramp” option discussed below.

The nature and responsibilities of the CMG, particularly in rate cases, and how to encourage BPA and customers to reach consensus on cost and policy issues, are still under discussion between BPA and the Joint Customers. Regardless of the outcome of those deliberations, this off ramp option, and the related role of the CMG can be viewed as a stand alone function.

Assumptions Regarding Applicability to BPA Products and Rate Periods

Through contracts and rates, utilities will have rights to cost based “vintage” power from the generation output of the FBS, which is fully assigned to customers on a percentage basis. This “off ramp” proposal relates to cost control over this vintage portion of power supply. Utilities may be making other purchases from BPA to serve the balance of their loads based upon BPA’s cost of serving that additional load.

During a 20 year contract period, BPA will be conducting 2 year rate cases for the Power Business Line. It is also assumed that new long term contracts have an effective date of FY 2012.

The off ramp proposal is not advanced with the assumption that customers will view it as the only alternative to improve or maintain BPA cost control. Actually it is meant to give the customers additional leverage to help them influence the internal costs of BPA, and other agencies that pass on costs to BPA.

Summary of Proposal

During the course of a 20 year contract, if rates exceed a predetermined level, customers will have a right to remove up to a total of 20% of load placed on the Agency that is served by FBS “vintage” power, without incurring stranded costs. For the first two years of the new 20 year contracts, a BPA base Priority Firm rate will be set and it becomes a “benchmark” for future rate comparisons applied to the “vintage power” available to customers through allocation of FBS resources. For the next 18 years, for each two year rate period, in the event that the Agency’s newly established Priority Firm rate for vintage power exceeded the benchmarked rate from FY 2012 – 2013 (subject to adjustments described below), individual customers would have the right to remove load, up to the cumulative 20% individual customer cap for the contract period for this off ramp provision. (Whether the benchmark escalates over time, and the mechanism by which it is adjusted are dependent upon which of the adjustment options described below is adopted.)

How It Would Work

BPA will set a rate for vintage/tier I power that a utility can purchase at the lowest Priority Firm rate for FY 2012 – 2013. This will become the “benchmark” rate, in this example, Full Requirement customers. (Note a separate rate will also need to be established for Block and Slice customers, or a benchmark will need to be developed using a weighed average number based on all BPA vintage power products, giving everyone access to the an off ramp if the weighted average is exceeded.)

The vintage rate(s) will include any major changes in BPA costs associated with implementing the basic long term future role of the Agency, including issues such as cost of serving publics, IOU residential and small farm customer benefits, and service (if any) to the DSIs. Given final decisions about BPA’s long term future role being made in advance of the FY 2012 - 2013 rates going into effect, future rates should be more stable than those in place today, and subject to only minor changes. Modifications in FBS resources are possible, but would not likely impact BPA’s benchmarked rate for “vintage” power, but rather the amount of vintage/tier I power available.

No off ramps for vintage power purchases would be available to the customers during the first two year period – FY 2012 – 2013. Beginning in the FY 2014 – 2015 rate case, and for each subsequent two year period, customers would be able to exercise off ramp rights

in the event that the new vintage power rate exceeded the benchmark rate by more than a defined adjustment. (see options below for benchmark adjustments)

Using 2014 – 2015 as an example, once new rates were set, and if the rates exceeded the benchmark, the customer would have a window of time, say 90 days into FY 2014, to notify BPA of the amount of vintage power to be removed, not to exceed either 20% in any rate period, or 20% cumulatively for the customer during the contract term. Power could be removed at the end of FY 2014. While the customer would have one remaining year of the rate period where the load had been removed, BPA would have had 9 months notice during the first year to remarket the power. It is anticipated that the limitations on power removed, the lead time for removal, and the generally competitive expected price of vintage power would lead to an economic set of circumstances where BPA would not incur stranded costs that would have to be passed onto other customers. In the event that stranded costs were forecast to be passed on to other customers, BPA would make every effort to reduce expenses such that actual costs incurred by other customers (those not removing load) would be minimized.

Four Options are presented for adjusting the benchmarked rate over time.

1. No future automatic adjustment in the benchmark rate set in FY 2012 – 2013, but BPA and the CMG can mutually agree to change the benchmark if requested by either party.
2. Once the rates are set for FY 2012 – 2013, no adjustment to the benchmark for the following three rate periods, until FY 2020-2021 and then again in FY 2028 – 2029. The CMG or BPA could seek binding arbitration regarding the revised benchmark.
3. An agreement at the outset between BPA and the CMG as to an inflationary index that would be used to adjust the initial benchmark rate.
4. Establish either an index or a fixed escalation rate in the power supply contract that would be used to adjust the benchmark.

Customer Off Ramp Rights and Responsibilities

Power sales contracts would contain a provision allowing customers to trigger limited off ramp rights if the BPA rates exceeded a defined benchmark. If the benchmark was not exceeded, no off ramp rights would be available. If the customer did not provide the off ramp notification within a defined window of time, the customer would forego the off ramp option in the short term that is tied to BPA's then current two year period rates. However, off ramp rights would still be available in the event that BPA adopted in a subsequent rate period, rates that were higher than the applicable benchmark. There would be no reduction to the amount of off ramp available to a customer that elects not to use the off ramp when it is available.

Any diversification off of vintage BPA power would be effective for the balance of the contract period. Any public customer taking load off of BPA would be reducing their amount of "allocated vintage BPA power supply" and would forego returning to BPA

during the remaining contract period at the vintage power rate. This contract provision does not impact market/new resource based purchases made by BPA on behalf of the customer. Customers removing vintage power would not be precluded from returning load to BPA during the remainder of the contract period, but at a rate established by BPA to cover such returning load.

It is assumed that the public preference power supply load placed on BPA in FY 2012 is about 7,300 aMW – the total resources of the FBS less other obligations. Except as provided in the paragraph below, the amount of load removal would be limited to no more than 20% of the vintage power, or less than 1,500 aMW, as a total amount over the 20 year term of the contract.

Beginning the third year of the new contract, and every two years thereafter, utilities could exercise off ramp rights in the event that the rate ceiling was exceeded. Each utility would be limited to 20% of its vintage allocated power supply for diversification during the contract term. A utility might decide to remove 10% of its vintage power supply following one period if a rate ceiling was exceeded, and would therefore maintain the right to remove up to another 10% if ceilings were exceeded in future periods.

These amounts of load removal would be allowed without the utility exercising such rights facing the prospect of stranded cost recovery for the power system applied to the departing load.

Final Comments

This proposal can be implemented administratively and we believe does not require legislation.