

June 20, 2005

BY ELECTRONIC MAIL

Paul E. Norman
Bonneville Power Administration
Post Office Box 3621
Portland, Oregon 97212

Re: Draft Slice Report

Dear Paul,

I am responding on behalf of Northwest Requirements Utilities (NRU) regarding BPA's Draft Slice Report dated May 31, 2005. We have reviewed the summary report as well as the June 3, 2005 collection of working papers, and discussed the report with the NRU Board of Directors. Our response has been circulated in advance to the NRU membership, and discussed with the Board. Individual members of NRU may want to send in their own comments.

Background

NRU as an organization was formed after BPA made the policy decision to offer the Slice of the System product. A number of Full Requirement utilities had philosophical and administrative concerns about BPA effectively "slicing" FBS generation output as a percent of the system. We also had concerns about creating an environment where the Agency's wholesale customers had a greater opportunity to be at cross purposes or in competition with what BPA was trying to achieve as the predominant regional resource supplier.

Our biggest concern was that operating in a Slice world would create the potential for cost shifts as parties tried to maximize the economic value of products. Some of the perceived cost shifts between product classes had the potential to be contentious. Others represented a reduction in the value of the FBS that non-Slice customers might not even recognize were occurring, because of the complexity of the Slice product, the cumbersome and somewhat ambiguous contract provisions, and the multitude of subsequent contract amendments.

Full Requirement customers to date have not had the staff resources on their own to either fully understand Slice operations, to participate in the details of contract development and offering, and to independently analyze the amendments made to the product. We have had to rely primarily upon BPA to ensure that the principles

established for Slice back in 1998 are being followed, with a particular emphasis on principle #1 – “*No risk or cost shift to non-Slice ratepayers.*” Thus we fully support BPA having the fortitude to undertake a detailed analysis of the Slice product.

The Current Environment

The current relationship among BPA, Slice Customers and Full Requirement Customers continues to be contentious and often unproductive. It impedes working collaboratively on other important regional endeavors. An illustration of this is the litigation NRU felt compelled to initiate regarding the 2002 Slice True Up, given the large dollar issues involved and broad questions regarding the venue for disputes over matters that have financial implications for all BPA customers. In an attempt to mediate differences, we have needed to invest a great amount of time where BPA decisions that affect all customers have been revisited and second guessed.

We have no idea what the cost of BPA staff participation in these processes has been, and at the end of the day how your costs are assigned. At BPA’s request, through mediation we have attempted to reach a fair conclusion on outstanding financial issues tied to the litigation, but have not succeeded. We need to resolve this, through agreement if possible, or if necessary by judicial determination. We want to turn our attention to other important matters, like new long term contract offerings, particularly for Full Requirement service. If the Slice True-Ups result in cost shifts to Full Requirement customers or the undermining of basic financial policies, NRU would not support continuing the Slice product in its current form after the expiration of the current contract.

Need for Further Analysis of Cost Shifts

We are concerned that the BPA assessment of cost shifts in the May 31 draft report is too limited in scope. The following issues need to be considered in the context of offering a Slice product in the future:

- Have the results of the cost shift study that was done in the 2002 rate case been verified? Can BPA do a “back cast” with that study to see if the forecast was on target? In the cost shift study it was found that the 50 year average water year annual cost shift as a result of selling Slice was \$5.7 million per year. (See May 2000 ROD page 16 – 32.) How does this compare to the cost shift that actually occurred (both assuming that the 9th Circuit court rules in favor or against BPA on the 2002 True Up?)
- How much overhead at BPA (how many staff, computer, legal, contractors, etc.) does it take to deliver the Slice product today, and is this recovered from the Slice customers? How much BPA executive, legal and other staff time has been spent in the litigation and mediation, and will this be recovered from the Slice customers?

- How much has the Slice customers' access to additional system flexibility cost BPA? How much would it cost BPA to afford this flexibility to Slice customers compared to the WAPA model?
- Have the Slice customers provided the necessary reliability reserves to BPA when called upon to do so?
- Has the application of the LB, FB, and SN CRACs to Slice and non-Slice customers led to cost shifts in the 2002 to 2006 period?
- Has there been a benefit/detriment to BPA's other customers as a result of the Slice product being available (lower/higher costs and risks than otherwise?)
- How much Federal power is being remarketed by Slice customers, for what terms, and what risk does this place on BPA?

Operational Issues

BPA raises the question as to whether some of the Slice contract amendments should have been subject to more structured review and broader customer involvement. BPA expresses difficulty determining the hydro system capacity and operating flexibility for Slice customers and for the system. Allegedly Slice load uncertainty can "force" BPA to operate outside of its desired or optimal marketing objectives. Reportedly Slice customers want rights for greater flexibility that could create cost shifts that were not addressed in the original cost-shift analysis. BPA has raised operational issues regarding the flexibility available to Slice customers, such as the right to change prescheduled amounts 30 minutes before the hour, compared to a WAPA model where prescheduled hourly energy amounts must be submitted three days in advance. Finally, BPA raises the concern that the Slice product is being used for remarketing opportunities – which raises a legal concern.

Frankly it is quite sobering to read about the scale of criticisms or concerns that BPA raised, particularly when there are no quantitative financial measures attributed to most of them. We need a better sense of what problems 1) are of little consequence, 2) are material but can be fixed, and 3) pose problems for cost shifts when taken individually or in aggregate.

Where Do We Go From Here?

Undoubtedly the Slice customers will have much to say in response to the BPA draft report. It would be premature for NRU to form conclusions about the issues raised by BPA in advance of seeing the Slice customers' response, and going through a review process. There is also an open question as to whether we have sufficient technical resources that are familiar with FBS operations and the Slice product to fully understand all of the issues BPA raises. We will attempt to address that issue.

At the end of the day, our interest is to see that if the Slice of the System product is offered post 2011, that it not result in cost shifts, and that the business relationship among BPA, the Slice customers, and non-Slice customers is much improved from where it is today. Assuming BPA initiates a regional Slice Review Group including "other interested parties," NRU will provide a representative to that group and actively participate. Pending the findings and conclusion of that process, it is premature to comment on which of the three basic options for future Slice sales presented by BPA (or perhaps another option) should be adopted.

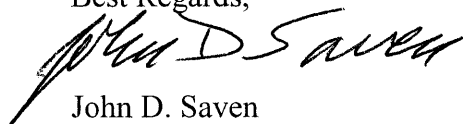
Putting Everyone on a Common Footing

In the long term, NRU members believe that the current difference between customer groups could be largely muted or eliminated by putting BPA's requirements products on the same cost basis. That is, the same costs would be used to develop the base cost of each product, with add on products provided for any additional services requested from BPA (for example load following services). We also envision common provisions for many of the contract features, such as dispute resolution, rather than the pronounced differences in place today. We will try to emphasize these points in the regional dialogue process.

Conclusion

The draft Slice audit raises very fundamental concerns among BPA's Full Requirement customers. We are willing to engage in a review of the product as the Agency recommends so that everyone can make an informed decision about the product post 2011. If you have any questions, please let me know.

Best Regards,



John D. Saven

CC Members of NRU
Marilyn Showalter
Slice General Managers