

**Bonneville Power Administration  
Long-Term Regional Dialogue  
Policy Proposal**

**July 13, 2006**



**LONG-TERM REGIONAL DIALOGUE POLICY PROPOSAL  
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# **I. INTRODUCTION**

## **A. BACKGROUND**

Since the mid-1990s, the Bonneville Power Administration (BPA) and its customers and stakeholders have been discussing BPA's future power supply role in the Pacific Northwest. These discussions reach back to the 1996 Comprehensive Review of the Northwest Energy System, the 1997 Cost Review, the 2002 Joint Customer Proposal and 2005 recommendations by the Northwest Power and Conservation Council regarding BPA's future power supply role. During the same period, the Pacific Northwest utility industry has experienced significant events, including deregulation of wholesale transmission service, development of a competitive wholesale power market and the 2000-2001 West Coast energy crisis. Throughout these events, BPA and regional interests have struggled to define the optimal future role for BPA in terms of its power supply obligations, resources and rates in a way that provides greatest value to BPA's firm power customers and non-power stakeholders.

The "Regional Dialogue" is the most recent phase of this long consideration of BPA's future role. It has given the region an opportunity to have a focused discussion about BPA's power supply and marketing role for the long-term in a way that meets key regional and national energy goals. A key and shared aim has been to engage the region in an in-depth discussion leading to this policy proposal. Fortunately, there is a great deal of alignment among BPA customers, Northwest states, the Northwest Power and Conservation Council, public interest groups and other stakeholders on the broad goals and interests BPA should pursue.

These discussions reached a significant milestone in February 2005, when BPA announced its policy direction to limit its sales of firm power at its lowest-cost rates to an amount approximately equal to the firm capability of the existing Federal system and to charge a higher tiered rate for increments of power service above that. Implementing this policy will require new long-term contracts and rates for power service after the current contracts expire in 2011. The ongoing regional discussions and this policy proposal focus primarily on what should go into these new long-term contracts and rates.

In May 2005, the Northwest Power and Conservation Council (Council) released its Fifth Power Plan, which included a chapter on the "Future Role of BPA in Power Supply." The Council noted that now is the time to resolve many issues related to long-term power supply and recommended a fundamental change in how BPA carries out this role. The Council urged BPA to establish a schedule for making the necessary policy decisions that permit the offering of new 20-year contracts by October 2007.

In September 2005, BPA released a Concept Paper as a springboard for intense collaborative discussions between BPA and its customers and other regional interests on the policy issues that must be resolved before new contracts and rates can be put in place.

## **B. SIGNIFICANT RECENT PROGRESS**

The region made a great deal of progress toward agreement on key issues in the 6 months following release of the Concept Paper through dozens of meetings and collaboration on a wide range of topics. Notably, there was agreement on the basic set of “interests” or goals that a good BPA policy must serve. These interests are discussed below. There also was much agreement on the BPA policy direction that would best serve those interests. Although significant alignment and agreement was reached, disagreement remains on other important issues.

## **C. NEED FOR FORMAL BPA PROPOSAL NOW**

BPA is putting this formal policy proposal forward for public comment now because the time before current contracts expire in 2011 is getting short. Once BPA makes basic policy decisions, it will still take at least another 15 months to negotiate new contracts and have a long-term tiered rate methodology in place. This will leave little more than 3 years for the region’s utilities to make and implement their plans for developing any necessary power supply. It is in the region’s best interest to proceed with implementation of this policy and execute new contracts soon to accommodate such planning and development.

## **D. SUMMARY: HOW THE BPA PROPOSAL ADDRESSES INTERESTS AND GOALS**

Following is a discussion of each of the agreed-to interests:

### **1. Lowest Costs and Tier 1 Rates**

Low BPA rates are critically important to BPA, the regional economy and to BPA’s customers. Because BPA rates are cost based, low rates require low costs. BPA proposes to tier its rates to give customers the “undiluted” benefit of the low-cost Federal hydro system. The proposal includes a number of features aimed at holding down BPA’s costs and rates. First and most important is the proposal to give each customer a High Water Mark (HWM) defining its access to power at the Tier 1 rate, and to sharply limit any new power purchase costs that would be included in the Tier 1 rate. This would greatly reduce the augmentation costs that historically have been the greatest source of BPA cost and rate increases. Equally important, tiered rates would give BPA customers strong economic incentives to invest in new resources, including conservation and renewable resources. This should help BPA fully carry out its key responsibilities for conservation and renewables at the lowest possible cost.

The proposals for settling investor-owned utility (IOU) and public residential exchange benefits are designed to bring much greater long-term certainty to a category of costs that has historically been a large driver of BPA rates. Likewise, the proposal for direct-service industry (DSI) benefits would give the remaining DSIs a reasonable chance of operating, but at a cost level and rate impact below historic levels. In addition, cost control proposals in the policy would put unprecedented mechanisms in place to increase the level of customer and stakeholder input into, and transparency of, BPA’s cost decisions.

This proposal also includes features that would make Tier 1 rates and costs somewhat higher than they otherwise would be. These include proposals for limited resource removal for load loss, up to 250 average megawatts (aMW) of augmentation for new publics, and up to 300 aMW of augmentation for existing publics. However, BPA believes these limited cost and rate impacts are reasonable in light of the other key interests they would serve.

## **2. Durability/Stability/Contract Enforceability**

All parties to the Regional Dialogue want policy decisions, contracts, and rates that will stand the test of time and the inevitable surprises time will bring. Likewise, all parties want confidence that the agreements they make will be honored over the long run. Therefore, the provisions in this proposal for service to publics, residential exchange settlement, and DSI benefits have all been tailored to work even if future market conditions and customers loads differ significantly from today's best guesses. Also, to provide the greatest possible assurance of contract enforceability, BPA is proposing an approach to dispute resolution designed to provide a high degree of assurance to customers signing long-term contracts.

The proposals' durability requires regional consensus, which does not presently exist. BPA will work with interested parties through the public comment period to seek greater consensus. As addressed below, BPA is also including a Fallback Proposal that would remove these features if consensus cannot be forged.

## **3. Customer/Regional Support and Equity**

Because this proposal would have long-lasting impacts on the region and BPA customers, it needs broad support, and it will only gain support if it is seen as equitable. The region's utilities and other interested parties have made enormous progress over the last several years, especially the last 6 months, in developing possible solutions to contracts and rates issues. This proposal is a product of that effort and incorporates numerous ideas from these discussions. However, it does not yet represent a comprehensive regional consensus because disagreements remain, most notably over IOU residential exchange benefits and DSI support. Nevertheless, BPA believes, taken as a package, this proposal strikes an equitable balance among the affected regional parties. Again, BPA is open to changing the proposal to achieve consensus and will work further with regional interests toward that end during the comment period.

## **4. Certainty of Obligations for All Parties**

Most parties to the Regional Dialogue have expressed strong interest in long-term certainty about their rights and obligations. Such certainty is key to infrastructure development and risk management. Greater certainty about the actions BPA will take will give other parties greater confidence as they plan their own actions. All elements of this proposal are aimed at creating this certainty about BPA's future power supply role. Tiered rates and high water marks provide the clarity and certainty that public utility customers need to understand how much power they will receive after FY 2011, giving them the guidance they need to plan for that future. The proposal also provides certainty about BPA's goals for conservation and renewable development and generally how it would pursue them.

## **5. Promote Infrastructure Development Consistent with the Northwest Power Act**

Insufficient electric infrastructure contributed to the West Coast power crisis of 2000-2001 and to BPA's large rate increase in 2002. Although the region is not currently short of generation resources, new resource development requires long lead times. Adequate infrastructure development is essential to reliable future power supply and to avoiding excessive market price volatility. Public utilities and resource developers are motivated and able to develop new power resources to meet future Northwest needs. However, their ability to commit to new power sources is impeded by uncertainty about how much low-cost power each utility may receive from BPA in the long term and how BPA would price its power. Defining the amount of power each customer would receive from BPA at the Tier 1 rate would allow utilities to move forward with plans to meet additional load by developing their own resources, purchasing in the market or purchasing from BPA at the Tier 2 rate. Twenty-year contracts are necessary because utilities need the long-term certainty to back up their financial commitments to new resources that have lengthy capital recovery. Having willing utilities responsible for resource acquisition decisions also enhances competition in the market place.

This policy proposal acknowledges the ongoing effort in the region to develop resource adequacy standards and mechanisms to ensure that they are met. Limited contractual provisions are proposed that mesh with this effort.

## **6. Consistency with BPA Stewardship Obligations**

While BPA stewardship obligations embrace all its responsibilities, in the Regional Dialogue, the concept of stewardship obligations is focused on BPA's responsibilities for conservation, renewable resources, and fish and wildlife. This proposal would significantly enhance BPA's ability to carry out these obligations. First, the proposal creates strong economic incentives for utility investment in conservation and renewable resources through tiered rates. Second, it includes BPA's goals of accomplishing all cost-effective conservation in the load it serves and renewable resource development consistent with the Council's plan. Third, BPA proposes to create and sell a renewable-resource-based Tier 2 product.

With respect to fish and wildlife, the proposal would bring much greater certainty to BPA's ability to fund its obligations. Historically, this funding has been most at risk when BPA rates have approached or exceeded market prices, and BPA customers have reduced their purchases from BPA. This proposal would largely remove that risk for power supplied by BPA at the Tier 1 rate.

## **7. Legality**

Legally sustainable contracts and rates are critical to the region's interests in durability and certainty, and BPA has structured each element of this proposal to be legally sustainable. Some participants in the Regional Dialogue have suggested legislation as a means to resolve issues lacking consensus, either through up-front legislation or through Congressional ratification of contracts. BPA's view is that spending years developing contracts and supporting rates that require congressional approval is a brittle strategy, given the difficulty of accomplishing Federal legislation. Absent regional agreement, legislative solutions will not be easy to achieve. Moreover, if contracts require legislation, and such legislation does not occur, BPA and customers would very likely wind up in protracted litigation over replacement contracts for those

that expire in 2011, and the uncertainty during the interim period would jeopardize infrastructure development and other key goals.

## 8. **Simplicity**

Complexity is the enemy of the other goals. Complex solutions tend to have unforeseen consequences that reduce their durability. They tend to sow seeds of future disagreements. And they increase administrative costs. BPA’s proposal would create greater simplicity in its relationships with customers in several important ways, including a settlement of the highly complex residential exchange program and creation of standardized BPA power products sold under a standard set of contracts.

## 9. **Advance National Objectives**

Aspects of this proposal that particularly support national objectives include incentives for utility and private sector development of electric energy infrastructure, enhanced certainty that BPA will meet its obligations to repay Federal investment in the system by significantly reducing financial risk, instituting long-term, take-or-pay obligations that protect against future conditions in which BPA costs are above market, and promotion of regional resource adequacy standards consistent with Federal Energy Regulatory Commission initiatives.

## E. **PLAN AND SCHEDULE**

The schedule outlined below is ambitious and challenging. BPA agrees with a wide spectrum of customers and stakeholders that it is in everyone’s best interest to come to the earliest practical conclusion on these issues, and BPA intends to operate as closely as possible to the schedule. The schedule for the next 3 years (shown below) has been modified from the schedule published in the Concept Paper, primarily because of requests to extend discussions on the Concept Paper. The BPA Administrator intends to make final policy decisions and sign a Record of Decision in January 2007. Updated information will continue to be posted at:

<http://www.bpa.gov/power/regionaldialogue>.

### **Estimated Schedule**

<b>Milestone:</b>	<b>Date:</b>
Formal BPA Policy Proposal Released	July 2006
Public Comment on Formal Proposal, and Continuing Effort to Reach Consensus on Issues.	July - September 2006
BPA Review of Public Comments	October– November 2006
Administration Review	Estimated November 2006 - January 2007
Publish BPA Regional Dialogue Policy and Record of Decision (ROD) on Long-Term Issues	January 2007
Negotiate and Develop New Contract Prototypes, Based on Policy and ROD	February - December 2007
Develop Transparent Net Requirements Determination Process and Propose Revisions to 5(b)9(c) Policy	February – October 2007



<b>Milestone:</b>	<b>Date:</b>
Perform Staff Analysis and Public Workshops to Develop Long-Term Rate Methodology (Pre-7(i) phase)	August 2006 - January 2007
7(i) Process to Establish Long-Term Rate Methodology	February - October 2007
Window For Limited Bilateral Negotiations	January 2008 - April 2008
New Long-Term Contracts Signed by BPA and Customers	April 2008
7(i) Process to Set Rates for FY 2010-2011 (Subscription Contracts)	November 2008 - August 2009
7(i) Process to Set Rates for FY 2012 rate period (Regional Dialogue Contracts)	November 2010 - August 2011
Service and Rates Under New Contracts Begin	October 2011
Service Under Regional Dialogue Contracts Ends	September 2027

### **Relationship to President's Budget Proposal**

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

### **Fallback Proposal in the Absence of Regional Consensus**

BPA proposes to implement a fallback approach if regional consensus cannot be achieved. The fallback approach largely mirrors the policy proposal, with specific exceptions as explained in detail in Section XIV, Fallback Policy Proposal, in the Absence of Regional Consensus.

### **Rate Decisions**

The Regional Dialogue Policy Proposal makes no rate proposal for purposes of section 7(i) of the Northwest Power Act. Nor does the proposal make decisions for purposes of adopting any rate or rate design applicable to any existing or effective BPA General Rate Schedule Provision (GRSP). All rate decisions necessary to implement the policy of this proposal would be made in a section 7(i) proceeding.

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**Power Sales Agreements**

The terms of the power sales agreements implementing the proposal could affect the Federal income tax exemption for outstanding and future bonds backed by BPA, primarily for bonds relating to the Columbia Generating Station (CGS). Accordingly, the final terms of certain power sales agreements could reflect Federal tax law considerations relating to such debt.

## **II. BPA LOADS AND RESOURCES POST-FY 2011**

BPA currently estimates the firm output of the Federal Columbia River Power System (FCRPS) for FY 2012, net of all pre-existing firm system obligations, at approximately 7,100 aMW which is about 200 aMW less than was estimated in BPA's Regional Dialogue Concept Paper. This number, as well as BPA's regional net requirements load, is uncertain. This uncertainty is relevant to several issues, including the amount of lowest cost-based service that may be available to serve new publics and the anticipated time before existing customers are exposed to service at a marginal cost-based rate for their incremental power supply.

One way to better understand BPA's expected load obligation in FY 2012 is to use the sum of utilities (SOU) forecast of expected loads that can be placed on BPA (net requirement loads). This forecast aggregates net requirement load forecasts for public utilities, Federal agencies, investor-owned utilities and other BPA contractual obligations. The timing of individual utility updates to this forecast varies. While most of the load forecasts are quite recent, some are several years old. The SOU forecast indicates that BPA's firm load obligations will be about 7,275 aMW in FY 2012. This number, assuming medium case load growth, exceeds the current estimate of the Federal Base System (FBS) firm capability but, as noted later in the Service to Publics Section of this proposal, BPA is proposing to augment the FBS by up to 300 aMW, if necessary to meet the existing public utility net requirement loads BPA calculates in FY 2010, which loads will also be used to set the HWM amounts for customers' Regional Dialogue contracts. However, by FY 2013 obligations are projected to exceed existing FBS resources for the remainder of the forecast period (see Table 1). Table 1 and Table 2 assume no IOU or DSI firm loads.

**TABLE 1**

<b>Product</b>	<b>Current Projected Net Requirements</b>				
	<b>FY2012</b>	<b>FY2013</b>	<b>FY2014</b>	<b>FY2015</b>	<b>FY2016</b>
Full	2,350	2,380	2,409	2,438	2,462
Partial	1,590	1,628	1,665	1,702	1,738
Block	464	468	472	477	481
Slice (incl Block)	2,871	2,912	2,942	2,978	3,009
<b>TOTAL</b>	<b>7,275</b>	<b>7,387</b>	<b>7,488</b>	<b>7,595</b>	<b>7,691</b>
<b>Resources (Net of Other Firm Obligations)</b>	<b>7,111</b>	<b>7,015</b>	<b>7,160</b>	<b>7,059</b>	<b>7,202</b>

**Notes:**  
 Net Requirements for Block and Slice customers reflect the Total Retail Load projections from the Final 2007-09 Rate Case Study minus dedicated resources in the FY2002 Subscription contracts but excluding Centralia Replacements.  
 Resources (Net of Other Firm Obligations) reflect the Final 2007-09 Rate Case Study.  
 Resources (Net of Other Firm Obligations) in FY2013 and FY2015 decline due to CGS refueling.  
 Grant PUD was assumed to serve its load entirely with its own resources. However, as Grant recalls resources to serve load others' net requirements will increase. The increase is reflected in the Block figure. BPA recognizes there will need to be additional discussions on this.

Because of their importance, BPA recently revisited these numbers with particular focus on how its FY 2004 net requirement load compared to the SOU forecast. The SOU forecast projected net requirements loads in FY 2004 of about 6,700 aMW. The FY 2004 historic net requirements loads were checked by subtracting customers' dedicated resources in utility contracts from actual loads to derive a net requirement load of about 5,900 aMW, which is about 800 aMW lower than estimated in the SOU forecast. To check the potential surplus power in FY 2012 against these actual estimates of FY 2004 net requirements, BPA applied high, medium and low load growth rates (from the Council's 5th Power Plan) to FY 2004 actual loads and kept dedicated resources constant, but adjusted for the possible removal of the Centralia Replacement resource. The resulting forecast for surplus FBS power in FY 2012 ranges from an 800 aMW surplus (without any augmentation) to a 500 aMW deficit after augmentation of about 300 aMW. Using the medium load forecast yields loads about equal to resources (see Table 2). Extending these growth rates over time and assuming full augmentation of up to 300 aMW but not to exceed a total FBS of 7,400 aMW, the amount of surplus power is reduced to zero by FY 2015 in the medium load growth case, in FY 2020 for the medium-low load case, and not for the foreseeable future in the low load case. However, if the FBS available is less than 7,400 aMW then any surplus would be used up more quickly. (See Figure 1).

The key point is, under a "most likely" load forecast, the net requirement load of publics is expected to roughly equal available, augmented, firm capability of the existing Federal system in FY 2012. However, with robust load growth or substantive reductions in Federal system output, the total public customer net requirements load could exceed Federal system output before FY 2012. With low load growth, Federal system output could be sufficient for many years beyond FY 2012. In addition, neither Table 1 nor Table 2 reflects any uncertainty about the firm capability of the utilities' own generation resources. BPA's proposal, and the mechanisms used

to offer power and benefits equitably among stakeholders, must be robust against a range of outcomes with respect to the amount of firm power available to serve regional load.

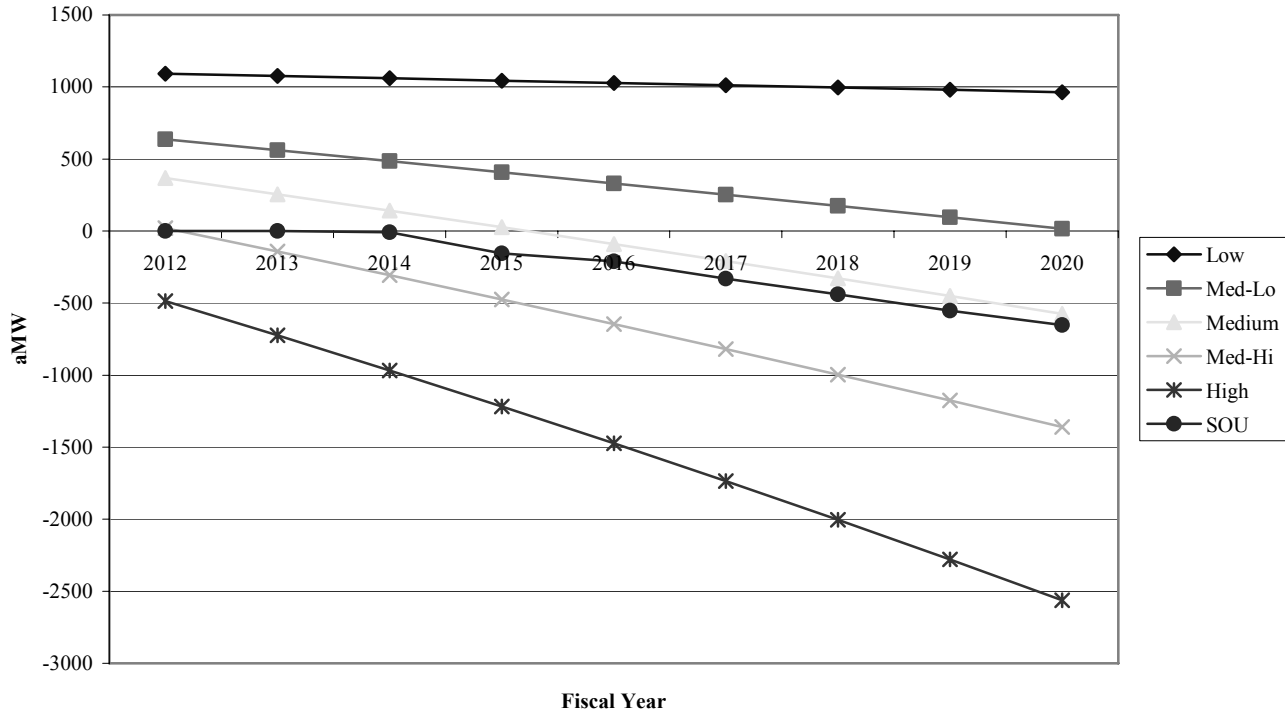
**TABLE 2**

	2004 Historic Approximation, annual aMW	2012 Forecast using NW Council Load Forecast Growth Rates				
		Low 0.2%	Med-Low 0.9%	Medium 1.3%	Med-High 1.8%	High 2.5%
<b>Estimated Load</b>	7,800	7,900	8,400	8,700	9,000	9,500
<b>Dedicated Resources</b>	1,900	1,600	1,600	1,600	1,600	1,600
<b>Net Requirements</b>	5,900	6,300	6,800	7,100	7,400	7,900
<b>Limited Augmentation for Existing Publics</b>		0	0	0	300	300
<b>FBS, Critical Adjusted</b>		<b>7,100</b>	<b>7,100</b>	<b>7,100</b>	<b>7,400</b>	<b>7,400</b>
<b>FBS-Net Requirement</b>		<b>800</b>	<b>300</b>	<b>0</b>	<b>0</b>	<b>-500</b>

**Notes:**  
 All aMWs rounded to nearest 100.  
 2004 Estimated Load is the sum of Net Requirements and Dedicated Resources.  
 NW Council forecast growth rates are 2005-2015 Total Non-DSI Load from the 5th Power Plan.  
 Dedicated Resources are the approximate amount from 2002 Contracts reduced by assuming BPA allows removal of the Centralia Replacement resource in the Forecast figures.  
 Net Requirements for Full and Partial Service are FY2004 actual purchases from BPA.  
 FBS, Critical Adjusted is the lesser of FBS Critical plus up to 300 aMW to meet net requirements or 7400 aMW.

FIGURE 1

Surplus/Deficit Projections  
(Assuming 7400 aMW FBS Resource)



### **III. SERVICE TO PUBLIC UTILITIES**

#### **A. SUMMARY OF THE PROPOSAL FOR SERVICE TO PUBLIC UTILITIES**

There is broad agreement among BPA, its customers, and other regional and national stakeholders that limiting BPA's open-ended obligation accomplishes our shared goals of promoting regional resource and infrastructure development, limiting BPA's costs, rates, and risk by not diluting the low-cost Federal system with high-cost power purchases, and helping ensure that the U.S. taxpayers can continue to expect full and timely repayment of their investment. The cornerstone of the Regional Dialogue policy is to limit BPA's sales of firm power at the lowest-cost-based rate to public preference customers to meet their firm requirements loads to approximately the firm capability of the existing Federal system. BPA proposes to establish the limit based upon concepts advanced by public power customers through the Public Power Council "allocation" proposal (PPC Proposal). While the PPC originally proposed a physical allocation of power, BPA proposes a different approach which allocates the cost of the existing system through a tiered rate construct. BPA proposes that each customer have a high water mark (HWM), which sets a lowest-cost-based rate ceiling for purchasing firm requirements power from the existing Federal system. The HWM is one of the most important aspects of this proposal, providing 20 years of certainty on how much load BPA would meet at its lowest-cost-based rate. For load beyond the HWM the customer may choose to either develop or buy its own resources, or ask BPA to meet its loads with Federal power at a Tier 2 rate.

BPA proposes that each customer's HWM would be based on the calculation of the difference between its actual 2010 firm regional consumer loads and the amount of resources serving its consumer load during that year under current Subscription contracts. This and other details of this proposal are founded on the recommendations contained in the PPC Proposal provided to BPA on April 10, 2006. The HWM approach would be established in the Tiered-Rates Methodology established through a 7(i) process concluding about the same time new long-term contracts are signed. Under the long-term tiered rates structure, rates that reflect the low-cost existing Federal system (or Tier 1) would be distinguished through the HWM from rates that reflect the costs of power from incremental resources (or Tier 2). This tiered rates structure would send the appropriate marginal-cost-based price signal to customers for service for load growth beyond their HWM.

Establishing the amount of power available for customers priced at the cost of the existing Federal system is intended to minimize the dilution of the low-cost existing system with higher cost resource/power purchases. This cost structure only works well if public utility customers do not use the Residential Exchange Program (REP) to shift some of the cost of the resources they acquire to meet load growth to other BPA customers. Most customers agree with this point. Therefore, we expect that existing public customers would want to settle their REP rights for the term of the contract.

BPA proposes to continue to provide customers a range of products to meet their power needs. These products would clearly define the respective obligations of BPA and its customers to meet regional load, develop, acquire, or purchase resources, and would be relatively simple to administer. BPA proposes to offer a load-following product similar to current Full and Partial

Service products. BPA also proposes to offer a Block product. In recent months, BPA and its customers have intensively evaluated several alternative approaches for the Slice product for post-2011 service, consistent with BPA's Draft Slice Report issued in June 2005 and comments received on that report, which is discussed later in this proposal. The cost basis for these products would be roughly the same for all public customers for power purchased at Tier 1 rates with customers bearing the cost for the additional product features they choose to purchase from BPA.

If customers want to purchase power priced at the marginal cost of BPA acquiring or purchasing such power for their load above their HWM, BPA proposes to offer several service alternatives that reflect the full underlying costs of the new resources or market purchases used to provide them priced at a Tier 2 rate. BPA will not subsidize Tier 2 rates to create a financial advantage for a customer to make a choice to buy from BPA instead of the market. The costs of power acquired to serve load subject to a Tier 2 rate would be kept as low as possible and would not be melded with costs of the existing Federal system, unless otherwise unrecoverable under Tier 2 rates consistent with section 7(a) of the Northwest Power Act. BPA will structure its rates and contracts to recover the cost of power purchased for Tier 2 within the year such power is delivered. Examples of the kind of resources BPA is considering using to serve customer load at the Tier 2 rates include new renewable resources, short- and long-term market purchases, and melded market purchases.

These proposals envision a new paradigm that sets up a different business relationship between BPA and its public customers. The following sections describe our proposal for Service to Publics in more detail.

## **B. ACCESS TO POWER AT LOWEST-COST-BASED RATES**

### **1. Future Access to Lowest-Cost-Based Rates**

BPA proposes a framework that would allow BPA and its customers to implement the region's desire to limit the dilution of the value of the Federal Base System (FBS) by limiting access to power from the existing Federal system at the lowest-cost-based rate. A HWM would be set for each customer that sets the maximum power amount available to it at a Tier 1 rate, reflecting the lowest-cost-based power of the existing Federal system. While the HWM establishes an upper limit on how much firm power a customer can purchase at the Tier 1 rate, the amount of firm power each customer can actually purchase in any particular year would be limited to its net requirements. Amounts of PF power a customer chooses to purchase from BPA to meet its net requirements beyond its HWM would be priced at a Tier 2 rate. The HWM approach establishes the foundation for the pricing each public utility customer would experience during the term of its Regional Dialogue contract.

### **2. Mechanics of High Water Marks**

BPA would distribute HWMs among public customers that add up to the firm power output of the existing Federal system, using critical water to calculate the firm power, as it has traditionally been defined for regional planning purposes. The following six steps would be used to establish each customer's HWM:



Step 1. . . Decide Net Requirements Approach: Prior to signing new Regional Dialogue contracts BPA would conduct a public process that establishes a consistent, simple and transparent approach that would be used to establish net requirements for and during the contracts, consistent with BPA's 5(b)9(c) Policy.

Step 2. . . Forecast Individual HWMs in FY 2007. The starting point for each customer's HWM would be its net requirement for FY 2010, as forecast in FY 2007 using the newly established net requirements approach from Step 1. BPA would need the ability to obtain data on and measure each customer's total retail consumer load for this calculation. BPA would forecast each customer's FY 2010 net requirement in FY 2007, establishing an estimate of the HWM. The actual HWM would be determined through the adjustments discussed in Step 3 through 6 below. The calculation would use the firm resource amounts that are dedicated to serve the customer's load in FY 2010 under its Subscription Contract, except for distinct and specific adjustments discussed later in this proposal.

Step 3. . . True-Up Individual HWMs with Actual FY 2010 Loads. The loads used to calculate the preliminary HWMs would be trued-up in FY 2011 based on the actual loads experienced and measured in FY 2010, normalized for weather and in rare instances, adjusted for significant one-time force-majeure events.

Step 4. . . Determine Total FBS Available for HWMs. Total BPA supply used to determine HWMs will be equal to the public utility net requirements calculated in Step 3 except for three conditions: (1) total HWMs will not be augmented above a total of 7400 aMW, (2) BPA will not augment the existing FBS by more than 300 aMW, (3) if the existing FBS without augmentation equals or exceeds the net requirements calculated in Step 3, HWMs will be based on the available BPA supply. The number would set the aggregate HWM amount. Actual augmentation amounts would generally be lower than the augmentation limit BPA sets since the HWM sets a cap on Tier 1 power available for each utility but not all utilities would grow to their HWM and some may actually lose load. Augmentation amounts would be determined each rate period when BPA forecasts the size of the existing FBS system and the loads that would be priced at Tier 1 rates. If such augmentation is necessary, its costs would be added to and recovered in the Tier 1 rates. The limit on augmentation would also be addressed in BPA's Tiered Rate Methodology 7(i) process and the Regional Dialogue contracts.

BPA is particularly interested in public comment on the approach for setting the total HWM limit. BPA recognizes that the net requirements of some utilities in FY 2012 and beyond will probably fall below their FY 2010 net requirements. This would result in some "unused" HWM amounts. BPA is interested in input on this issue.

Step 5. . . Resize Individual HWMs. The HWM numbers for each utility calculated in Step 3 would be adjusted proportionally up or down so that in total for all then current public customers they equal the amount available for HWMs established in Step 4.

Step 6. . . Account for Conservation Achieved. In order to ensure that each utility continues to have an ongoing incentive to invest in conservation infrastructure even

though it could affect the load levels used to calculate their HWMs, BPA proposes to add the amount of conservation achieved by each utility from FY 2007 through FY 2010 to its individual HWM calculated in Step 5. Such conservation amounts must be cost-effective and verified by BPA. For this purpose BPA proposes to count 100 percent of self-funded megawatts and 50 percent of BPA-funded megawatts (i.e., through rate discount and bilateral contracts). BPA expects these conservation amounts to add up to around 200 aMW. Finally, after the conservation adjustments, all HWMs are reduced on a pro rata basis so that they again sum to the total HWM determined in Step 5. While conservation would be included in calculating customer HWMs, conservation would not be included in BPA's annual net requirement load calculation for the customer since conservation is a reduction in load.

The number calculated for each utility through the steps described above establishes its individual HWM. This HWM would be included in each public utility's power sales contract with provisions that adjust the HWM each rate period based on the changes in projected amounts of firm power from the Federal system. To increase regional confidence in the process, BPA proposes to make the results of its net requirement load and HWM calculations in each step above for each utility publicly available so that each utility would know the effects of each step on both themselves and other utilities. This approach for setting HWMs is very close to the PPC proposal, with a few differences as explained below:

- *Use of FY 2010 Resource Amounts.* This proposal uses customers' FY 2010 non-Federal resource amounts to set HWMs rather than FY 2012 suggested in the PPC Proposal. BPA proposes to use the same year for both resource amounts and loads because the FY 2010 resources are known amounts already established in Subscription contracts. BPA is concerned that using FY 2012, which would be projected amounts, introduces uncertainty. There could be significant changes in the amounts of customer and consumer resources applied to load from what is currently in Subscription contracts, well over 100 aMW, resulting in lower HWMs for most customers than expected. BPA proposes one exception to the use of FY 2010 customer and consumer resources listed in Subscription contracts; a customer's hydroelectric resources used prior to 1980 that BPA expects would be returned to a customer by withdrawal from other customers for the post-2011 period. The returned hydro resources would be used to serve the customer's firm load and a corresponding reduction to the other customers' resources for the withdrawal would also be made.
- *Different Conservation Basis.* BPA's HWM approach counts all FY 2007 through FY 2010 BPA verified conservation achieved by the customer. The PPC Proposal looked at a longer FY 2002 through FY 2010 time horizon but only counted conservation funded by the utility. FY 2007 is the proposed starting point because historic data has no impact on future decisions to make conservation investments. PPC proposed a full HWM credit for utility-funded conservation, but no such credit for BPA-funded

conservation. If publics receive no HWM "credit" for BPA-funded conservation, then conservation achieved through those programs could possibly reduce their 20-year HWM. Utilities have indicated that they would see this as a significant disincentive to participation in those programs. This perception could jeopardize BPA's ability to meet its goal of ensuring development of all cost-effective conservation in the loads it serves. On the other hand, if publics received HWM increments for each aMW saved through BPA-funded programs, they would realize a very significant financial gain through additional low-cost power, on top of the BPA payment for their conservation programs. This could lead to equity concerns among customers.

BPA's proposal accounts for more conservation achievement than the PPC's, increasing the total amount of conservation that would be added to HWMs from an estimate of about 100 aMW to around 200 aMW. Neither of these two approaches to crediting HWMs for BPA-funded conservation would affect the total HWMs or Tier 1 rates, since HWM credits for conservation shift HWMs among customers rather than increase the total HWM. BPA proposes a middle ground for HWM crediting for BPA-funded conservation for each aMW of BPA-funded conservation achieved in the FY 2007-2010 period, customers would receive a 0.5 aMW HWM increment. BPA believes that this approach preserves a strong incentive to conserve, while reducing the potential for inter-customer equity concerns. BPA is particularly interested in comment on this point since there has been no public discussion of it in the context of the new PPC Proposal for determination of HWMs.

- *Augmentation Limits.* BPA's approach on augmentation is very similar to that of the PPC, allowing for up to 300 aMW of augmentation to the FBS. However, unlike the PPC, BPA's proposal would not augment above 7,400 aMW, to provide power for existing publics at the Tier 1 rate. This approach significantly bolsters the ability of the publics to know how much power would be available at Tier 1 rates and also reduces the likelihood of significant augmentation and its corresponding dilution of the value of the existing FBS.

### **3. Changes to Individual High Water Marks**

BPA contracts and the long-term rate methodology would list the FBS resources and capabilities that would be used to establish the initial HWMs, and the source of information and the rate case process that would be used to periodically adjust resource capabilities and HWMs. During the term of Regional Dialogue contracts, other than for changes in the FBS capability, there would be no changes in individual HWMs, except for changes in public utility service territory created by annexation or similar actions, which require a redistribution of a HWM among publics. Amounts of load that are annexed by a public utility from an existing public utility would receive part of the existing public's HWM, proportional to the percentage of the customer's load they

have annexed.

#### **4. High Water Marks and Pooling**

HWMs would be set on an individual customer basis to give each customer certainty regarding the amount of Federal power it can purchase at the Tier 1 rate. Consequently HWMs cannot be pooled among customers. BPA is concerned that pooling would work against the goal of reducing regional conflict and would become administratively burdensome. Pooling would also increase Tier 1 rates, because any gain in value by the select group of customers who pooled would be at the expense of the other customers since it would reduce the amount of secondary power available to market to lower Tier 1 rates and cause a need for greater amounts of augmentation, within the 300 aMW cap, than would otherwise be required.

#### **5. Amounts of Power a Customer Can Buy from BPA**

While the above-described HWM calculation determines a limit on the amount of power at the Tier 1 rate a customer can buy, the amount of Federal power a public utility customer is actually eligible to purchase in any particular year is determined by its net firm power load requirement. That is, the amount of the customer's regional retail consumer load that is not being served by the customer's non-Federal resources, as described below.

#### **6. Annual Net Requirement Calculations**

BPA proposes to calculate net requirement loads each year to determine the amount of power each customer is eligible to purchase from BPA that year. However, to provide resource and rate planning certainty, customers would be provided short-term mechanisms for load loss within the rate period that maintain both BPA and the customer's risks and benefits in that rate period, such as limited resource removal rights for purchases at Tier 1 rates. This annual approach is consistent with BPA historical utility practice and its obligations under the Northwest Power Act to determine its total load service obligation. In conjunction with a limited resource removal right for load loss, it provides the certainty intended by the PPC request that BPA only perform net requirement calculations once each rate period.

For many customers the importance of the net requirement calculation increases under the HWM construct, since it would determine where their loads are relative to their HWM and how much of their BPA load service is subject to Tier 2 rates. Power amounts available for Block and Slice customers are based on a BPA-produced annual forecast of their net requirement loads. BPA would determine each customer's initial purchase rights with a new net requirement load calculation for FY 2012. Load-following customers would continue to be provided their full power needs less their resources.

#### **7. Relationship Between HWM and Tiered Rates**

The rates that the customer pays would depend on the relationship between the customer's individual net requirement load placed on BPA and its individual HWM. A Tier 1 rate would apply for deliveries of Federal power to meet a customer's net requirement load below its HWM amount, reflecting the cost of the existing FBS. A Tier 2 rate would apply for power purchased to meet a customer's net requirement load above its HWM amount, reflecting the marginal cost of serving the load.

## **8. Treatment of Centralia**

The PPC Proposal requested that BPA “not include a utility’s prior ownership share of a generating resource no longer owned by the utility,” for purposes of calculating their net requirement or HWM for Regional Dialogue contracts. Prior to the start of the Subscription contracts the Centralia Coal Plant was sold to an extra-regional party. Four public utilities-- Seattle, Tacoma, Snohomish PUD, and Grays Harbor PUD--were part owners of the project prior to the sale. Since this resource had been dedicated to serve regional load under their Subscription contracts, BPA required that these customers replace this resource. BPA intends to work with the PPC and the rest of the region to see if it can accommodate the PPC’s Proposal as a part of an overall package for service under Regional Dialogue contracts. BPA proposes to conduct a review of the Centralia sale under its 5(b)/9(c) policy. However, BPA would need to collect, review, and determine the facts and the circumstances of the customers’ sale of the Centralia resource. BPA would ultimately need to review the facts and determine whether it can sell firm power or only surplus power as a replacement for the Centralia resource under section 9(c) of the Northwest Power Act.

## **9. Rights to Remove Existing Resources**

In order to provide resource and rate planning certainty for BPA and our public utility customers, BPA proposes to offer a limited resource removal right but only for load loss a customer experiences within a rate period. BPA intends that the qualifying load loss only be the difference from the forecasted amount measured from the start of each rate period. This contract mechanism is intended to ease a customer’s take-or-pay risk, while assuring the recovery of BPA’s expected revenue under the contract. This right is in addition to resource removal rights BPA provides for new resources as discussed in the next section.

## **10. Customer Rights to Add and Remove New Non-Federal Resources**

Customers would have a right to add non-Federal resources, upon a specified notice to BPA, to serve their net requirements load in excess of their HWM, and subject to rules yet-to-be-developed on the resource shape and consistent with any obligations the customer has made to purchase BPA power at a Tier 2 rate. If a customer does add a new resource to serve its load above its HWM, then in addition to load loss amounts within a rate period, the customer would have a right to remove those new resources that are used to serve that load above the HWM. This right to remove non-Federal resources should ensure that the acquisition of such resources does not reduce the amount of firm power provided at the Tier 1 rate. To accomplish this type of resource removal and the limited resource removal rights for loads eligible for Tier 1 rates, BPA would need to review and modify the current section 5(b)/9(c) policy to reflect these changes in the treatment of customer resources.

## **11. Customer Rights for Consumer Resources**

The current Subscription contracts identify the amounts of specific consumer resources applied to load. As noted earlier, the calculation for each utility HWM would be based in part on resource amounts, including consumer-owned resource amounts, established for under Subscription contracts for FY 2010. Regional Dialogue contracts would continue to require that public utility customers list all consumer-owned resources in their service territory and whether they would be applied to load. Utilities may want to include notice provisions in their own arrangements with these loads to pass through the impact of BPA rate and contract provisions

that guarantee BPA's revenue even under low market prices. A consumer decision not to apply its own resource may increase a utility's net requirement load beyond its HWM, potentially subjecting the utility to Tier 2 rates.

## **12. Take-or-Pay Requirements for Regional Dialogue Purchases**

To ensure obligations to the U.S. Treasury are met, Regional Dialogue contracts would be take-or-pay for the amount of power that the customer is obligated to purchase from BPA. Customers would generally not have rights to add resources to reduce their Tier 1 rate purchases. BPA proposes to include a provision, as in the current Subscription contract, that would address the circumstance when a customer's net requirement load falls below its HWM and the customer chooses not to exercise the within-rate-period load loss resource removal rights available for its Tier 1 power purchases. In that circumstance the customer would face charges that ensure their choice does not shift financial costs to other Tier 1 rate customers. Purchases at Tier 2 rates would also be take-or-pay, subject to specific yet-to-be developed terms for those products. BPA would design those terms so that the benefits as well as the costs of those purchases are retained by the customer or customer group making the commitment, mimicking the cost and benefits of a comparable purchase from the market. A fundamental principle for Tier 2 rates would be that, to the extent possible, the customers retain all risks, costs and benefits for these marginal cost based purchases.

Requirements contracts would include provisions which permit a customer to increase its Federal power purchase amounts consistent with its net requirement and subject to notice. Such rights would likely differ substantially between load-following and non-load-following contracts but would be subject to take-or-pay provisions. BPA recognizes, however, that customers with load following contracts may experience load loss from one annual net requirements calculation to another. Although there are many details to work out, in such circumstances BPA intends to establish a contractual approach that returns any proceeds to the customer that BPA receives from remarketing the Tier 2 power that the customer does not purchase from BPA. Just as with power purchased from the market, this remarketing could be a benefit or a cost depending on market prices.

## **13. Customer Rights to Billing Credits**

Under the Northwest Power Act, a customer may request billing credits for certain conservation or resource acquisition activities that reduce the obligation the Administrator otherwise would have had to acquire resources. BPA's view, which is shared by most participants in Regional Dialogue discussions, is that billing credits would be extremely difficult to make compatible with tiered rates without frustrating the broadly accepted goal of avoiding driving up the Tier 1 rate with the cost of new resources. To ensure this does not happen, BPA proposes that Regional Dialogue contracts include a provision where customers contractually agree to forego a request that BPA provide billing credits for those non-Federal resources.

## **14. Access to the Public Exchange**

An overarching reason for the Regional Dialogue proposal is to minimize the dilution of the low-cost Federal system with higher-cost purchases or resources. Just as with billing credits this fundamental purpose could be undermined if the costs of a customer's new resources or market purchases were to find a way back to BPA Tier 1 costs through the Residential Exchange

Program (REP). This addition of costs would be inconsistent with regional sentiments that customers should have choices in how they serve their load growth and face the responsibility to pay for the marginal cost of serving the increased load. For this reason, BPA's Regional Dialogue contracts would include a provision to settle the exchange for all existing public customers so that the tiered rate paradigm of defined access to BPA's lowest-cost-based rates and a differentiated rates structure would work. Otherwise, rates based on low-cost Federal resources could continue to be exposed to the costs of new resources. BPA expects the settlement amount for most current public customers to be nominal. However, settlement amounts may be higher for the small number of new or current public customers that have existing high-cost resources since BPA's settlement calculations would also consider whether the impact of these resources raises their average system cost above future Priority Firm (PF) Exchange rates. There is a large amount of uncertainty around what this amount would be, but for purposes of this threshold a settlement offer of \$45/MWh is reasonable because it is the approximate level BPA expects a customers' average system cost would need to exceed to receive REP benefits. Because of the broad agreement that it would not be appropriate for customers to shift costs of new resource acquisitions to other customers through the exchange, BPA expects that public customers would agree to settle their residential exchange rights.

#### **15. New Public Customers**

Another difficult issue is how to treat newly formed public customers that request service either before or during the new contract period. BPA must meet requests from new public customers for service under section 5(b) of the Northwest Power Act if those making the request meet the terms of BPA's policy on standards for service. Publics that do not currently exist but are able to form, meet BPA's standards for service, and sign a Regional Dialogue contract before the contract signing deadline would be treated the same as other existing public utilities.

In addition to new customers that become eligible to purchase in time to sign Regional Dialogue contracts, new public customers are likely to form and request service during the term of the Regional Dialogue contracts. A new public customer would have the same access to the REP as an existing public customer and, subject to notice periods, could purchase power to serve all of its net requirement load from BPA at PF. Their access to BPA's lowest-cost PF would, however, depend on the HWM they receive.

While new public customer formations are possible, BPA does not believe such formations are likely to involve large amounts of load. Over the last 25 years about 300 aMW of new public customer load has formed and taken PF service. For the 20-year term of the Regional Dialogue contracts BPA would earmark 250 aMW to provide an amount of power priced at the Tier 1 rate for new publics that is approximately equivalent to this recent history. HWM additions for new publics would be further limited to a total aggregate of 50 aMW each rate period, which strikes a balance between providing new publics significant access to lowest-cost BPA power and setting a limit on the costs that would dilute benefits to existing purchasers at Tier 1 rates. To provide BPA with sufficient planning lead time, a new public that qualifies for BPA service must request service from BPA through a 3-year binding notice before it is eligible to purchase power with a HWM. The HWM for a new public would be set at the customer's net requirement level in the year deliveries begin, with the potential for a slight reduction so that the new public's load does

not have a greater percentage of its eligible load served at lowest-cost rates than the average existing public customer.

To ensure that access to the 250 aMW is spread broadly and not used solely by one large new public utility, utilities larger than 10 aMW would have their HWM amounts over 10 aMW phased-in in 3-year increments, if there is more than one new public formed and their aggregate requests exceed the 50 aMW cap. The phasing-in would be 33.3 percent for the next 24 aMW of HWM and 20 percent for any remaining HWM amount after that. This example shows how this phasing approach would work for a new 64 aMW utility:

	<u>Year 1</u>	<u>Year 4</u>	<u>Year 7</u>	<u>Year 10</u>	<u>Year 13</u>
Initial Amount	10 aMW				
33.3% for next 24	8 aMW	8 aMW	8 aMW		
20% for all else	6 aMW	6 aMW	6 aMW	6 aMW	6 aMW
Annual HWM Addition	24 aMW	14 aMW	14 aMW	6 aMW	6 aMW
Cumulative HWM	24 aMW	38 aMW	52 aMW	58 aMW	64 aMW

In a rate period in which total eligible HWM requests exceed the rate period limit, individual HWM amounts of new publics would be prorated down to meet the 50 aMW limit. Amounts not provided to any new public due to the 50 aMW limit would automatically be added to eligible amounts in the next rate period. BPA recognizes that this type of pro rata reduction could inordinately impact a small customer; therefore, BPA proposes that the first five new publics during the Regional Dialogue contract term with net requirement load 10 aMW or smaller, , which would otherwise be affected by the 50 aMW limit, receive their full HWM without reduction. To illustrate, assume that in the first rate period there are qualifying requests totaling 100 aMW from new publics composed of one 50 aMW utility, one 40 aMW utility and one 10 aMW utility. Due to the 50 aMW limit only one-half of the requested amounts would be available providing 25 aMW, 20 aMW and 5 aMW, respectively. The 10 aMW utility would also receive an additional 5 aMW bringing its HWM to 10 aMW, making the total rate period HWM addition for new publics 55 aMW. The 20 aMW and 25 aMW unmet requests for the other two utilities would be added to any subsequent requests from other new publics for similar treatment in the next rate period. These additions for the small customers would increase the 50 aMW limit in the applicable rate period. Since this would only happen when rate period limits are exceeded and is limited to the first five new small customers, BPA believes this accommodation for small publics still meets the region’s interests while taking care of the special needs of these customers.

To the extent that requests for service to new public customer loads exceed the 250 aMW HWM limit established for new publics over the course of the Regional Dialogue contracts, new public customers would only be able to purchase power at Tier 2 rates for their net requirement loads above their HWMs until the next general contract development process.

BPA believes this proposal reasonably balances the needs of existing public customers and potential future new public customers. Within the constraints expressed above, BPA would first serve the Tier 1 rate loads of new publics with amounts of low-cost power not being purchased by other public utilities. As existing utilities grow into their HWM amounts this source would diminish. Once all low-cost power from the Federal system is purchased by existing customers,



BPA would augment the Federal Base System to serve the net requirements of new publics below their HWM amounts at a Tier 1 rate. The cost of that augmentation would be recovered through the Tier 1 rate.

## **16. Additional Considerations for New Publics**

Other considerations for new publics include the following:

- **HWM if a New Public is Formed from an Existing Public.** A new public customer that forms out of an existing public would receive a share of the existing public's HWM. It would receive a percentage of the existing public customer's HWM equal to its proportion of the existing utility's total retail load. The existing utility would see a corresponding reduction. If the HWM amount the new public receives equals or exceeds what would have been available under the standard approach for new publics discussed above, then the redistributed amount becomes the utility's HWM. Otherwise the proportionally redistributed HWM may be bolstered by additional HWM amounts through that standard approach. HWM amounts provided from existing public customers do not count against the other limits established for new publics.
- **HWM if formed from an IOU.** New public customers that form out of an existing IOU would only be eligible for HWMs through the standard approach discussed above.
- **Residential Exchange Benefits.** A new public would be eligible for REP benefits. However, BPA expects that they too would choose to settle their rights to REP in order to receive a HWM. Any settlement with the new public would take into account its expected ASC and any HWM it would receive as a new public. If the HWM covers most of their load, like other publics, the settlement would be for a nominal amount.

## **17. Effects of Reductions in FBS System Capability on HWMs**

BPA does not intend to augment the firm power capability of the existing Federal Base System in the future except: (1) for the potential for up to 300 aMW, when necessary, for existing publics; (2) up to an additional 250 aMW when needed to serve the limited HWM amounts of new publics; and (3) if BPA decides to provide power to the DSIs. Ongoing investments in the reliability and efficiency of existing generating plants, such as replacement of hydro turbines, are expected to increase their total output over time, but most likely by a small percentage. BPA would calculate the annual firm capability of the existing FBS as a part of each rate case and meet all eligible loads at the Tier 1 rate within that capability during the rate period. Each rate case BPA would change each utility's HWM in proportion to the change in the FBS capability. Changes to the FBS that occur during the rate period would be absorbed by BPA through balancing purchases to meet the committed Tier 1 rate eligible loads of all customers except Slice. Customers buying Slice would absorb the changes in the FBS in the power deliveries under the Slice product, and their costs under the Slice product would likewise not be impacted by the balancing purchases.

## **18. Federal Income Tax-Exemption on Columbia Generation Station Bonds**

BPA meets the debt service costs of about \$2 billion in tax-exempt bonds for the Columbia Generating Station (CGS). The tax-exemption is predicated on a tax law analysis that is in part

based on existing agreements and arrangements relating to the use of the output of CGS and the payment of the costs of CGS. Unless the new agreements are structured carefully, to the extent that a reduction in the HWM of a customer is due to a reduction or loss of CGS, the Federal income tax-exemption on the CGS, and on bonds to be issued for the Project, could be threatened. (In general under the Tax Code, the amount of tax-exempt bonds for a project is limited to the extent that the facility is deemed to be “used” by “private persons,” meaning entities such as cooperatives and other entities that are not qualifying state or local governments.) One possible solution may be that certain customers (generally cooperatives) may be required to replace all or a portion of the related HWM reduction with power from BPA at Tier 2 rates. Other solutions may be possible.

## **C. PRODUCTS AVAILABLE TO REQUIREMENTS CUSTOMERS**

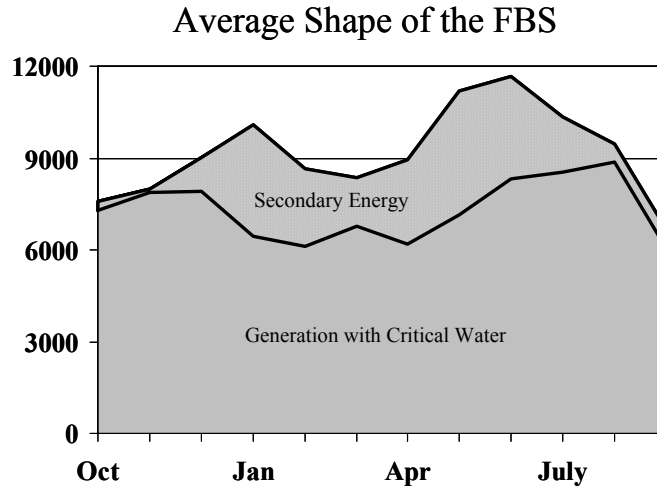
### **1. Introduction**

BPA believes limiting the amount of power available at the cost of the existing low-cost Federal Base System would create new opportunities for growing public utility customers since they would have choices on how best to serve their new loads. BPA proposes to continue to make an array of products available that would meet its customers’ diverse needs, offering comparable products to those currently available. Transmission products are not covered under this proposal; however, for load-following customers that do not have in-house expertise, BPA would offer a transmission management product at its cost of providing the service.

### **2. The Federal Base System ...The Starting Point for All Requirements Products**

A central feature of the PPC Proposal was that customers would get a choice of products similar to the current range of products provided by BPA, and that the starting point for setting the Tier 1 rate(s) for all the products would be the same – a fraction of the costs of the existing system with additional costs added as necessary to create each product. BPA proposes to adopt these important features of the PPC Proposal in large part because this approach is critical to the goal of reducing the level of controversy and conflict among customers over products and rate setting. These features are also important to the goal of providing price signals to customers that give them incentive to make least-cost infrastructure development decisions.

To understand product costs it is important to start with some basics about the FBS that produces the Federal power marketed by BPA. BPA would calculate the annual firm capability of the existing FBS under critical water conditions prior to each rate case, set HWM levels using this calculation and meet all eligible loads served at the Tier 1 rate within that capability. Critical water is essentially a near worst-case scenario for stream flows in the Columbia River Basin based on real-world experience from 1937. However, using an annual average megawatt number masks the true monthly variability of this number. In reality, there are significant monthly differences in available power because energy can only be produced when water is available to create the power. Power generation above critical water is called secondary energy, and it is the market value of this power, based on forecasted sales of the secondary power, that is credited against BPA costs to reduce the rates BPA charges its customers. The shape of the FBS with critical water and expected secondary energy is shown in the graph below.



A customer’s product choice can be viewed as a decision on the additional services the customer wants BPA to provide to take the FBS shape and convert it into energy deliveries that meet the customer’s net requirements. Reshaping the FBS is illustrated in the sections below for both load-following products and block purchases. The costs for reshaping the power produced by the Federal system are discussed later in the pricing section of this document.

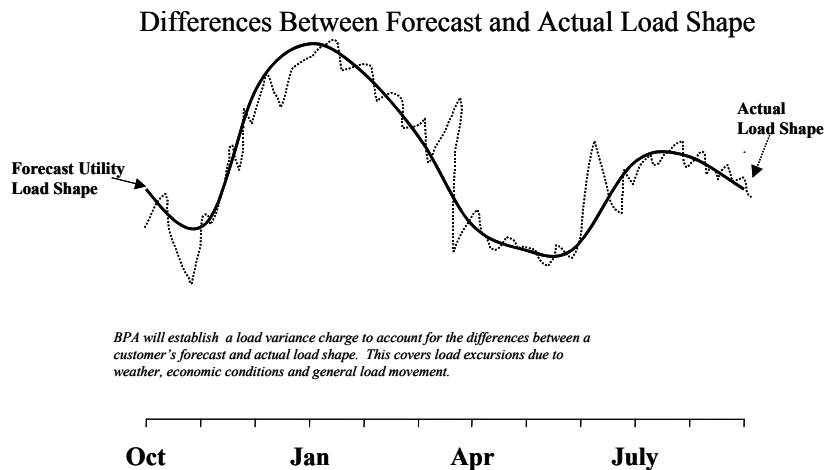
### 3. Load-Following Products

BPA proposes to continue to offer products that follow a customer’s loads, such as the current Full and Partial Service load-following products. Customers that choose a load-following service would continue to rely on BPA to meet their entire load, less any declared and defined non-Federal resource amounts. Due to the similarity of the business relationships and the fact that the HWM construct would likely encourage even more customers to explore resource development, BPA’s Regional Dialogue contracts would not maintain a purchasing distinction between load-following for Full and Partial service. Instead, the contract would provide a single load-following product with rules specified for existing or added resources to ensure they are operated in a way that does not create costs that must borne by other BPA customers. A brief description of the products labeled Full and Partial Service under the current Subscription contracts follows below:

- **Full Service:** The Full Service product provides all firm power necessary to meet a customer’s actual loads in excess of customer-owned small non-dispatchable generating resources. This service includes heavy load hour (HLH) energy, light load hour (LLH) energy, demand and any shaping necessary to cover load variations due to temperature changes and load loss and/or growth, except when the load loss is due to voluntary retail access.
- **Partial Service:** This product is the same as Full Service except that customers declare a resource amount that they would provide in a predefined or metered shape to serve their own loads.

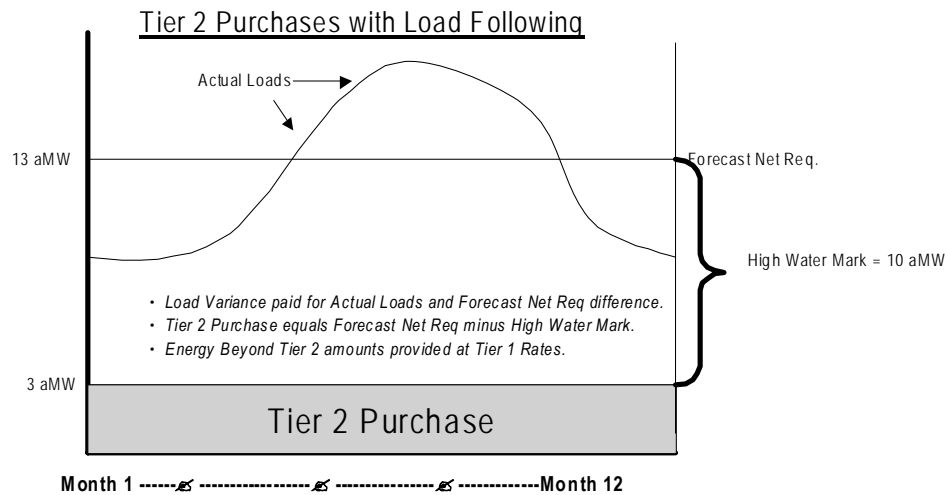
#### 4. Reshaping the FBS for Load-Following Products

Load-following products reshape the firm power of the FBS into the variable shape of the customer's net requirement load. For Full Service, this represents a customer's entire load. For Partial Service, it represents the load that remains after the declared amounts of a customer's non-Federal resources are provided. In addition to reshaping the critical firm power from the FBS to projected net requirement loads across months and hours, load-following service products also include the cost of deploying system flexibility and balancing purchases/sales to meet the hour-to-hour swings in customer loads. The proposed rate treatment for this service is discussed in the pricing section of this proposal. Load variance from the forecast load shape is depicted below:



#### 5. Tier 2 Rate and Load-Following Products

The customer's annual net requirement load forecast would determine how much Federal power bought by the customer for its net requirement load is priced at Tier 1 and Tier 2 rates. When a net requirement load is below the HWM, all power would be priced at the Tier 1 rate. If the net requirement load exceeds the HWM, amounts above the limit would be priced at a Tier 2 rate. When the Tier 2 rate applies, the amount of power provided at that rate would be predefined as a planned amount of power purchases at the time the net requirement load is established. BPA is not making a specific proposal since the rules for establishing the annual predefined shape of purchases subject to the Tier 2 rate will be the subject of additional discussions. However to encourage and foster discussion this is illustrated below as a flat annual block. Customers would be able to choose from Tier 2 rate pricing options discussed later in this document. The graph below depicts Tier 2 rate purchases for customers who purchase a load-following product.



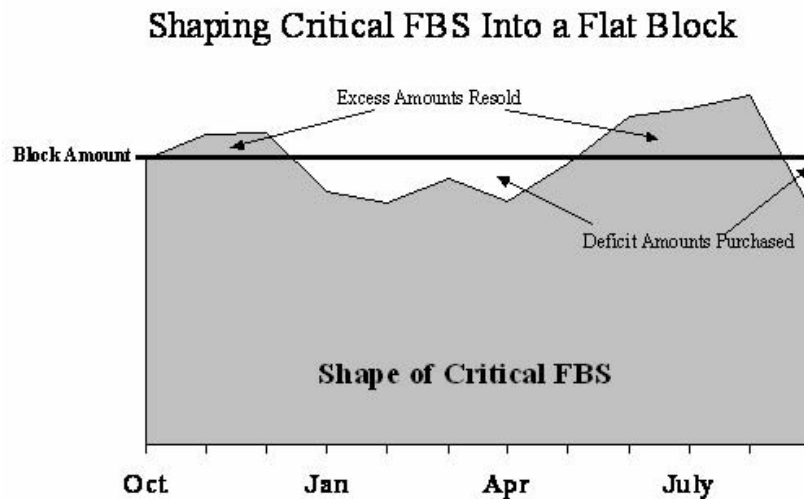
## 6. Non-Load-Following Products

BPA proposes to continue to offer products that would allow customers to supply their own load-following service such as the Block product and possibly offering a Slice product as discussed later in this document. These customers would receive an amount of power based on a forecast of their net requirement load and are responsible for integrating their BPA power purchase with their own resources to follow their actual consumer loads throughout the year. While BPA is not deciding any product design in this proposal, a brief description of potential Block and Slice follows below.

- Block.** This product provides predefined amounts of power to meet a customer’s forecast net requirement load, often in a constant shape in all hours of the year. Other predefined shapes may be possible, subject to product rules that will be worked out in a future product development process. The ability to increase block amounts during the contract term would be subject to notice provisions in the contract to ensure the customer’s choice to place more firm consumer load on BPA fits with tiered rates and does not place costs or risks on other customers. These contract notice provisions would be an important component for future product design discussions. The product design discussions would also establish rules for shaping the annual net requirement load into monthly blocks in a way that is equitable to other customers. A customer may choose to purchase only the Block product or pair it with a Slice product.
- Slice.** The Slice product, described later in this proposal, provides firm power for a customer’s net requirements load and an advanced sale of surplus energy based on the generation shape of the Federal system during an operating year. The Slice product is only available to serve load below a customer’s HWM and subject to the Tier 1 rate because it ties directly to the amount of generation from FBS resources. As a result, any service to load above the customer’s HWM at the Tier 2 rate would need to be made in the form of a Block product.

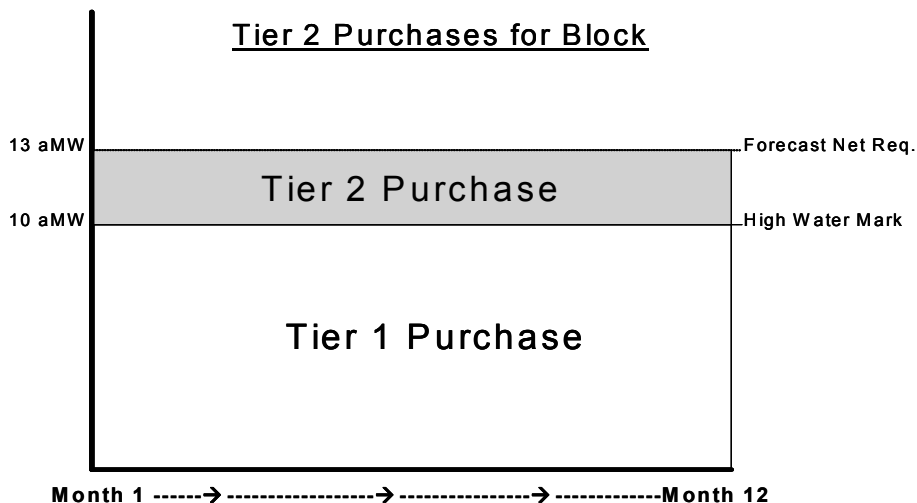
### 7. Reshaping the FBS for Block Products

The Block product reshapes the critical FBS into the fixed shape of the customer's monthly purchases. The amount of shaping required would usually be less than for a load-following customer. The charges for this reshaping are discussed later in the pricing and rates section of this proposal. This reshaping is illustrated below for a flat monthly Block but other block shapes are possible.



### 8. Tier 2 Rate and Non-Load-Following Products

Net requirement calculations would be performed annually by BPA to determine how much power for a customer's firm consumer load a customer it may purchase from BPA. When annual net requirement load amounts, less any previously committed Tier 2 purchases, are lower than the customer's HWM, all power provided would be at Tier 1 rates. If the net requirement load exceeds the HWM, planned amounts of power requested by the customer above the HWM would be provided as a block of power or other predefined shape, as discussed earlier in this section, at a Tier 2 rate. This is illustrated in the graphic below.



## 9. Tier 2 Rate Purchase Alternatives

For customers that want to purchase power from BPA at a Tier 2 rate, BPA proposes to offer customers a number of alternatives for Tier 2 rate pricing. BPA proposes to provide Tier 2 rate service priced to reflect the full costs of the generating resources or market purchases, or marginal costs in the event power is provided from the existing system. The costs recovered under Tier 2 rates would be kept as low as possible consistent with sound business principles. The power supplied under Tier 2 rates would be subject to take-or-pay accompanied with a provision that ensures that the customer receives the market value of the Tier 2 power they are unable to take, and BPA is able to remarket, as discussed in the “Pricing and Rates for PF Service” section of this proposal. At a minimum BPA proposes to provide the following service options subject to Tier 2 rates:

- **New Renewables:** Power priced at the cost of purchasing and integrating new renewable resources. The term of the purchase obligations would mimic the term of the renewable resource purchases made by BPA.
- **Default Pricing Construct:** Contracts would be designed so that there is a default product unless customers affirmatively choose a different Tier 2 rate pricing approach or commit to meet their future load growth with non-Federal resources. At the time of contract signing a customer commits to at least a 5-year purchase and a minimum notice of 3 years to switch to another product or apply their own non-Federal resource. Other Tier 2 rate pricing constructs would be designed so that BPA would know at least 3 years in advance if a customer is switching to this default construct. Rates would be based on a portfolio cost for market purchases that BPA makes to serve the loads subject to this rate.
- **Long-Term Purchases:** Under this option, power would be priced at the cost for purchases that BPA makes for loads subject to the Tier 2 rate that commit to a purchase of longer than 5 years. The details for this would be defined in future product discussions but pricing would be aligned with the cost of purchases consistent with the purchase commitment.
- **Full Load Growth Coverage:** By selecting this pricing construct a customer would commit to purchase all of its load growth beyond its HWM from BPA for the term of its Regional Dialogue contract. Pricing would be comparable for all customers in this group and would be based on the melded costs of market purchases BPA makes to serve loads beyond these customers’ HWMs. Much like the full service construct under Subscription, load-following customers choosing this approach would be able to rely on BPA to meet their load growth but their loads greater than their HWM would be priced at the Tier 2 rate.

## D. PRICING AND RATES FOR PF SERVICE

### 1. Introduction

As a cornerstone of this proposal, and to give customers long-term predictability and certainty, BPA proposes to establish a long-term tiered rates methodology that would limit the amount of

power sold at our lowest cost-based rate to approximately the firm capability of the existing FBS under 20-year contracts. At the outset it is important to note that any rate proposal would require a Northwest Power Act section 7(i) rate setting proceeding and specific decisions on rates would be made in each rate case, consistent with the long-term methodology. This section describes the process and the key rate construct—a tiered PF Preference Rate—that BPA would put in place to meet the goal of minimizing the dilution of the low-cost service from the existing Federal system and the need to resolve the impact of the PF Exchange Rate on tiered rates. This pricing section concludes by discussing the rate construct for reshaping the FBS into the available power products.

## **2. Long-Term Rates Methodology**

BPA recognizes that the rate construct discussed in this paper needs to be transparent and meaningful to customers in order to provide price signals that encourage resource development and minimize the dilution of the existing Federal system. BPA would provide this assurance by conducting a separate 7(i) process to establish the long-term tiered rates methodology for the Regional Dialogue contracts. BPA proposes to conduct public workshops to develop the methodology which would be followed by a formal 7(i) process that would be completed prior to the signing deadline for the contracts under the schedule proposed earlier in this document. Through the combination of this tiered rate methodology 7(i) process and development of new contract terms, BPA would establish a policy to retain the established tiering approach for sales of Federal power throughout the term of the Regional Dialogue contracts. Customers accepting the contract would ultimately need to agree not to challenge the final tiered rate methodology. Among other things, the methodology must address the methods that would be used during the rate cases for establishing and changing HWMs, and accounting for the existing FBS resources and the changes in the firm capability of the system, including the source of information and the process that would be used to periodically adjust the resource capabilities.

## **3. Establishing Rates for PF Preference Power**

BPA proposes to establish a rate structure for power BPA sells at preference rates that differentiate between the costs of service from the existing Federal system and the cost of power to meet load growth.

- **Tier 1 Rates for PF Power:** BPA is proposing to limit access to the lowest-cost-based rate by providing customers a HWM to define maximum amounts of power available to each customer at Tier 1 rates. Tier 1 rates would include the cost of the existing FBS and other costs such as the following:
  - a. REP Costs. The cost of the REP, including any costs for REP settlements for both public and IOU customers.
  - b. Public Benefits. Public benefit costs such as the fish and wildlife program, Endangered Species Act compliance.
  - c. Conservation. Acquisition costs for BPA's share of regional conservation targets.
  - d. Renewables. Costs for facilitation and renewable activities (discussed later), but not for the costs of any renewables acquired as the source of a Tier 2 rate service option by BPA.
  - e. Power Purchases. Balancing purchases; up to 300 MW of augmentation to serve existing public customer loads; and costs for actions, such as capacity purchases from



- new resources BPA is required to take so that BPA products provided at the Tier 1 rate comply with resource adequacy standards.
- f. New Public Customers. Augmentation up to 250 aMW over the term of the contract to serve limited amounts of new public load if no unused lowest-cost (Tier 1 rate) FBS power is available.
  - g. GTA Costs. Costs for new or existing transfer service allocated to BPA power loads.
  - h. DSI Service. Any cost for DSI benefits or augmentation
  - i. Other. Recovery of lost revenue for Low Density Discount (LDD) and Irrigation Rate Mitigation.

The level of the Tier 1 rate would be recalculated every rate period based on the costs of FBS output and all non-Tier-2 rate costs. Although unlikely, it is possible that, in some future rate periods, the Tier 2 rate(s) may be below the Tier 1 rate if market prices fall dramatically from current levels.

When the new contracts start in FY 2012, some customers are likely to have net requirement loads below their HWMs, resulting in fewer purchases than the available firm power output of the FBS. BPA proposes to retain the value and costs of the existing Federal system in the Tier 1 rate, including this temporarily available FBS power, to keep Tier 1 rates as low as possible.

- **Tier 2 Rates for PF Power:** BPA proposes that power provided to meet a customer's net firm power requirements loads beyond its HWM would be provided at Tier 2 rates. BPA would set rates to fully recover the costs from those customers who request Tier 2 service. To the extent that FBS power is provided to serve load beyond a customer's HWM, it would be priced at BPA's marginal cost of power with the excess value above the average FBS cost being credited back to Tier 1 rates. Customers would have choices about the types of resources they choose for service at the Tier 2 rate. BPA proposes to establish notice periods associated with providing service subject to the Tier 2 rate. To help ensure Tier 2 costs stay separate from the Tier 1 rate, Tier 2 price options would include take-or-pay provisions that ensure the expected BPA revenue, but also provide the customer the market value of power they are not able to take and that BPA is able to remarket. While Tier 2 products and rates would be designed to assure full cost recovery to meet requirements of Section 7(a) and (g) of the Northwest Power Act, BPA must preserve the ability to reallocate costs to the Tier 1 rate in the unlikely event that Tier 2 costs cannot be recovered through the Tier 2 rate.

#### **4. Rates and the Residential Exchange Program (REP)**

BPA customers can currently access benefits from the Federal system through both direct power purchases and through the Residential Exchange Program for their residential and small-farm loads. As noted earlier, REP access for public customers creates regional cost uncertainties and is incompatible with the region's goal of minimizing the dilution of the benefits of the existing Federal system. BPA's Regional Dialogue contracts would require that existing public customers agree to settle their rights to the REP during the term of the contract, with only nominal consideration for most customers and the potential for additional consideration for customers that have existing resources that would cause their average system costs to exceed the PF exchange rate threshold of \$45/MWh BPA proposes to use for settlement purposes. In

addition to existing publics BPA recognizes there may be new publics that would qualify for REP benefits in addition to the HWM amounts that BPA makes available to them. BPA expects to settle their REP benefits as well using the same threshold.

## **5. Rates for Reshaping the FBS for Customer Use**

The HWM and tiered rate concepts set a limit on the amount of firm power at BPA's lowest cost-based rates that customers can purchase. The starting load shape for that power sold is the forecast monthly shape of the FBS under critical water. The correlation of the natural shape of the FBS to the customer's actual consumer load needs is not direct. To meet a load following customer's regional consumer load needs, the shape of the FBS under critical water must be transformed to a more load-friendly and useful shape. For each rate case, BPA proposes to design the rates for these shaping services so that the projected reshaping costs are borne by the customers that use the services. To do this, BPA would compare the costs of the shape of the FBS under critical water with the cost to provide the same amount of energy in the shape required by the customers. Customers purchasing products that have shaping services would be required to pay a charge to reshape the FBS into the projected shape of their product. This charge would reflect costs incurred by BPA for shaping. In addition customers that purchase load-following products would pay a charge for the cost and risks BPA faces serving their actual loads rather than their forecast load.

BPA proposes that charging reasonable opportunity-cost-of-service-based adjustments for shaping services is an important element of the overall proposal to equitably provide access to BPA's lowest cost-based rates. It is also the approach discussed in earlier versions of the PPC Proposal. Charging less than BPA's projected opportunity cost of service would allow a customer's use of system flexibility to reduce the value from the existing Federal system to the remaining customers. BPA's proposal is designed to ensure that a customer's use of FBS flexibility is provided equitably to all customers. By charging the opportunity cost for buying and selling energy to shape amounts of FBS power to what a customer actually purchases that customer's use of these services does not erode the value of BPA's secondary energy, which maintains the rate-reduction benefits of the credits for this secondary revenue. Any Slice product would not be affected by this reshaping because a Slice purchaser does not buy load shaping or load following from BPA and can use the flexibility within contractually established limits directly to manage the Federal power with its other non-Federal resources for its own loads.

## **E. OTHER ISSUES**

### **1. Low Density Discount**

Section 7(d)(1) of the Northwest Power Act requires the Administrator to provide low density discounts (LDD) to customers with low system densities "to the extent appropriate." The Administrator has discretion to review and establish the criteria under which the LDD would be offered and to determine whether it is appropriate to offer an LDD based on the criteria adopted. In FY 2004, BPA provided LDD benefits to 55 customers at an annual cost of about \$20 million.

The LDD methodology has been revised in BPA's general rate case proceedings under Section 7(i) of the Act, most recently in 2002. BPA proposes to continue to review and possibly

revise the LDD in future 7(i) general rate case proceedings, including implementation details relating to eligibility, the discount level and applicable rate.

## **2. Irrigation Rate Mitigation**

There have been times when spring/summer intensive irrigation loads have borne an inordinate burden because of the way seasonal rates are shaped. The goal of irrigation rate mitigation is to address this issue and support the economic health and competitiveness of the region's irrigated agriculture. BPA has long provided some form of assistance either through surplus firm power sales or rate mitigation.

To avoid a serious adverse economic impact on rural communities, BPA as part of its rate cases would propose to continue rate mitigation for customers serving irrigation consumers who would be inordinately affected by BPA's rate design, in particular the shaping of seasonal rates. Beginning with the FY 2012 rate period, BPA proposes to make available irrigation rate mitigation in the form of a fixed mills-per-kWh discount limited to the Tier 1 rate in the PF rate schedule, and not as a separate product. BPA proposes to treat participating customers equally by providing all irrigation rate mitigation participants with the same fixed mills-per-kWh discount during May, June, July and August. The program would be adjusted to include September irrigation loads; however, the \$/MWh discount would be reduced proportionally leaving overall program costs unchanged. The irrigation discount would apply only to eligible irrigation loads of customers participating in BPA's irrigation rate mitigation product during FY 2007-2011 or in BPA's FY 1997-2001 summer seasonal product.

A section 7(i) rate proceeding would establish the need for, and amount of, an irrigation discount applied to qualifying irrigation loads starting with the FY 2012 rate period. Regional Dialogue contracts would include a provision acknowledging the irrigation discount program, the terms of which would be determined in rate proceedings and subject to BPA's general rate schedule provisions. Any discount, if adopted by the Administrator, would be included in BPA's General Rate Schedule Provisions for BPA's FY 2012 Tier 1 power rates or successor rates.

BPA proposes to limit the overall program costs to a fixed percentage of the summer rate, times a fixed number of eligible MWh. The fixed percentage is determined as the effective reduction in the melded, weighted average of the summer rates caused by the irrigation rate mitigation product in the average FY 2007-2009 PF rates. The eligible MWh would be limited to the FY 2002-2004 3-year average energy amounts identified for the FY 2007-2011 period, including adjustments for September irrigation loads. In addition, the amount of mitigation the Block product would be eligible for is the lesser of the Block energy purchases for the May-September period or the FY 2002-2004 eligible irrigation MWh. BPA also proposes requiring participating customers to implement cost-effective conservation measures on irrigation systems in their service territories.

## **3. New Large Single Loads**

BPA published a new large single load (NLSL) policy in April 2001, which was based on statutory determinations, and policy and contract decisions. The Administrator issued a policy review and requested comment on three specific issues. After reviewing comment, he issued a Record of Decision on the policy in FY 2002. BPA again addressed NLSL issues in its

February 2005 *Policy for Power Supply Role for Fiscal Years 2007-2011*. BPA proposes to continue to refine its current NLSL policy by proposing certain clarifications to the policy below. Several of these clarifications would affect service both in the FY 2007-2011 period, and are proposed as modification to the current policy and for the post-2011 contract period.

To encourage use of renewable and on-site cogeneration resources by consumers whose loads are or would otherwise be New Large Single Loads, BPA provided an option to a consumer to reduce its load behind the meter by purchasing and delivering either renewable resources or on-site cogeneration, in a shape that reduced the single large load to less than 10 aMW served by the utility. If the consumer can reduce that load with renewables or on-site cogeneration to less than 10 aMWs, BPA would provide the utility up to 9.9 aMWs of Federal power at the PF rate.

BPA has reconsidered its policy and in light of the response and other efforts to promote renewable resources in the region, BPA believes a time limit for the off-site renewables option in its current NLSL policy is needed. BPA proposes to sunset its off-site renewable option effective December 31, 2006. Consumers and customers must have completed all necessary arrangements for obtaining off-site renewables for service to a NLSL and must commence service with the off-site renewables and the total load including that served by the renewable resource must have reached 10 MW by December 31, 2006. Once service has commenced, the consumer load behind the meter must be less than 10 aMW to receive the benefit of PF rate service under the terms established in the February 2005 policy for each month. In addition, the remaining monthly HLH and LLH amounts remain below 10 aMW. BPA customers and their end-use consumers who are unable to complete such service arrangements and commence service by taking more than 10 aMW of power by that time would be ineligible for the off-site renewables exception.

As described elsewhere in this proposal, BPA is proposing a multi-pronged approach to meeting its renewable resource development targets. In the context of this approach, this NLSL policy provision on off-site renewables is not necessary. Furthermore, this issue is likely to be a transition issue as BPA moves to a tiered rate pricing structure that gives utilities market-based incentives to develop renewables by limiting utilities' access to lowest-cost pricing.

As described above, BPA proposes retaining the portion of the current NLSL policy that allows a consumer to apply an on-site renewable and on-site cogeneration to an NLSL as an option to reduce the load behind the meter to less than 10 aMWs. Under this approach, the on-site renewable and cogeneration applied to the load must be continually applied and must reduce the remaining load to less than 10 aMW. As long as the remaining load placed by the consumer on the utility stays below 10 aMW on a 12-consecutive-month basis, that remaining load would be eligible for Tier 1 rate service provided the utility customer's net requirement load is below its HWM. However, if the amount exceeds 10 aMW in any consecutive 12-month period, the load would be billed at the applicable NR rate for that year and thereafter. Other rate service charges may apply to monthly variations in the load.

#### **4. Transmission Considerations**

Customers using the Federal Columbia River Transmission System (FCRTS) to wheel resources (Federal or non-Federal energy) to load need BPA transmission. Wheeling of resources to load

can be provided by either Point-to-Point Transmission service or Network Integration Transmission Service under BPA's Open Access Transmission Tariff (OATT). The earlier customers apply for transmission to move new resources to load, the better equipped BPA will be to respond to the request. To improve its ability to develop transmission when needed, BPA recommends an integrated planning process that establishes a coordinated planning cycle that links individual utility resource planning with a transmission open season.

BPA will be working with its transmission customers prior to offering Regional Dialogue contracts to ensure the requirements for requesting modifications to OATT service are met and customers understand the transmission implications of their resource choices.

## **IV. SLICE PRODUCT**

### **A. INTRODUCTION**

As part of the Regional Dialogue process, a Slice Product Review Team was established to seek broad alignment on preferred post-2011 Slice product alternative(s) to inform BPA's Regional Dialogue policy proposal. The team included representatives of Slice customers, Northwest Requirement Utilities/non-Slice customers and BPA staff. They discussed both the operational and financial aspects of the Slice product, with the existing Slice product used as the starting point for the review. The team proposed changes to the current Slice product to resolve existing concerns and to promote alignment around the following:

- A set of overarching principles to guide future decisions on a post-2011 Slice product contract;
- A preferred product design alternative; and,
- An amount of Slice, if any, to be offered post-2011.

The five originating principles and the four proposed Slice product alternatives/options that the team evaluated are outlined below. BPA future offer of a Slice product will depend upon successful resolution of the Slice litigation. While regional discussions continue on numerous outstanding operational issues, a settlement of the Slice litigation would remove concerns raised in the litigation that Slice runs unacceptable risks of cost shifts, and would positively assist future offering of the product.

### **B. ORIGINAL PRINCIPLES**

- No risk or cost shift to non-Slice ratepayers.
- No risk or cost shift to taxpayers.
- Slice must recover its share of fish-related costs.
- No interference in Federal Columbia River Power System (FCRPS) operating decisions.
- No change in Federal law.

### **C. REGIONAL DIALOGUE CONCEPT PAPER PRODUCT ALTERNATIVES**

***Alternative 1:*** Replace the Slice product with flexible power and capacity products at appropriate cost-based rates.

***Alternative 2:*** Continue sales of the Slice product at approximately the current amount, with modest reductions in the current level of operating flexibility and/or clarification of the nature of the capacity rights and flexibility.

***Alternative 3:*** Offer an expanded quantity of the Slice product, but with sharply scaled-back operational flexibility. For example, increase the lead-time for hourly pre-scheduling, with no rights to change.

Slice customers suggested a fourth option be considered:

***Alternative 4:*** Offer an expanded quantity of the Slice product, leaving the operational flexibility similar to current practice and addressing administrative terms and issues that are perceived to cause customer dissatisfaction.

Discussions regarding product principles focused on questions regarding what changes, if any, should be made to the originating principles and what new overarching principles should be considered or added based on BPA's May 31, 2005, Draft Slice Report and customer comments. These discussions ranged from desires for increased clarity among the principles, equity among customers, operational control, and new concerns such as resource integration.

#### **D. PRODUCT DESIGN DISCUSSIONS**

An operational sub-team focused on concerns with the current product, and how any future Slice product would work with new policies proposed in broader Regional Dialogue discussions. The team narrowed its focus to the following core issues.

***Net Requirements:*** How does BPA maintain the ability to meet its total requirements load obligation when a subset of requirements customers has long-term rights (under Slice) to energy that is potentially surplus to their requirements load, but not surplus to BPA's total requirements load obligation?

***Operational Uncertainty:*** How should the risks associated with ongoing operational uncertainty and imperfect definition of Slice capabilities be shared among Slice and non-Slice customers?

***Resource Integration:*** Should a centralized entity (BPA) be responsible for offering a product to integrate new resources utilizing the limited FCRPS capability or should individual customers be required to procure these services from the market?

***Control Area Services:*** Should BPA sell a product that is treated as self-supply of control area services using unrequested FCRPS energy, or should BPA require all customers to either purchase these services from the control area or a third party or self-supply from their own non-FCRPS resource?

***Transmission Scheduling/Redispatch:*** How should the Slice product be designed to be flexible or responsive enough to manage changes that will be required under constrained transmission scheduling and re-dispatch?

The team ultimately decided to allow issues being discussed concurrently in the broader Regional Dialogue process, such as the use of firm power in excess of load and net requirements, to be resolved in that broader forum. The team recognizes that resolution of these and other issues will require consistent treatment in any final Slice product design and contract.

A financial sub-team focused on how Slice could be put on a more common financial basis with non-Slice products, through modifications such as eliminating the annual Slice audits and “true-up adjustments” post-2011. The primary goal is to reach alignment around risk mitigation, equity and durability. Discussions ranged from how to reduce or eliminate the tension between non-Slice and Slice customers associated with the current Cost Recovery Adjustment Clauses (CRACs) and Slice “true-up adjustments” to the development of new rate and risk mitigation approaches that allow future power product selections, uninfluenced by the pricing mechanisms of the product.

During the Slice Product Review process, BPA was urged to perform additional analysis to validate the need for each proposed change and to establish that there would be no cost shifts among customers. While acknowledging that more analysis could be performed in some areas, BPA concluded that the level of analysis needed to provide a basis to reach alignment in the specified areas had been performed. Additional work also will be required to develop the level of detail required for contract negotiations.

The team principals reviewed progress and provided guidance for the technical staff. This included an agreement that the team should focus on better defining BPA’s Alternative 2 as a preferred alternative, if BPA were to offer a Slice product. Alternative 2 would keep the future amount of Slice close to the current amount, clarify the actual amount of operational flexibility available from the FCRPS, and reduce certain uses of the Slice product such as ancillary services self-supply, in return for pro rata sharing of actual revenues BPA received for use of system capacity for regional reliability and other public purpose functions. This was done with the understanding that the full range of options noted above would be included in the Regional Dialogue proposal, and that the focus on further defining Alternative 2 would not prejudice future decision on whether or not BPA would offer a product.

All parties agree that consensus on any preferred Slice product alternative would be subject to review and approval by their respective boards and executive committees. Prior to finalizing the definition of Slice Alternative 2, the principals and executives reviewed the alternatives and determined that additional clarity was needed in some areas such as product flexibilities in terms of rights to system capability and self-supply of ancillary services, assurances that net requirements were being taken to load, and the potential quantity of Slice to be offered. Discussions with customer principals and technical staff followed.

## **E. PROCESS RESULTS/CONCLUSIONS**

The Slice Product Review process allowed Slice customers, NRU/non-Slice customers and BPA to reach partial alignment on a number of operational and financial issues. However, alignment could not be reached on number of issues, and this policy does not represent overall alignment.

BPA is proposing a set of product principles that are key to the post-2011 product design. If a Slice product is offered post-2011, these principles would set the context for contract negotiations, product design and the amount of Slice product offered. In addition to the principles, BPA is proposing more detailed concepts that would guide any future Alternative 2-type Slice product negotiations, if they were to occur, and better ensure customer



understanding of issues subject to third party dispute resolution. Finally, it should be recognized that any future Slice product offering would need to conform to other decisions arising out of the Regional Dialogue process.

**Proposed Principles for Post-2011 Slice Product:**

1. There are no unintended shifts of costs, risks or benefits between power products and all power products bear a share of the costs and risks.
2. There is no risk or cost shift to Federal taxpayers.
3. Slice purchasers bear an allocation of FCRPS costs and risks and receive an allocation of FCRPS energy, hourly scheduling flexibility and specific BPA power revenues.
4. To the maximum extent possible, the rate adjustment mechanisms for common cost components in the Slice and other PF power products are the same.
5. FCRPS operating decisions are solely Federal decisions, and there will be no interference in those decisions.
6. BPA estimates of FCRPS capability, after reducing such capability for system obligations, determine Slice delivery limits for pre-schedule.
7. BPA will establish a forecast system operation that accommodates Slice and non-Slice customer pre-schedules.
8. Delivery limits established for real-time will reflect BPA's determination of the updated flexibility of the FCRPS, as determined by FCRPS operating decisions establishing actual system configuration.
9. The Slice product will not include within-hour load-following, dynamic scheduling or ancillary services. Generating capacity and energy provided from the FCRPS to TBL for Interconnected Operating Services will come "off the top," and revenues PBL receives from TBL for those generating inputs will be shared on a proportional basis.
10. The Slice product offering will require no changes in Federal law.

These principles include both originating and new principles intended to add greater clarity and definition to post-2011 contract negotiations, product development and implementation. The new set of principles defines the product as a sale of Federal power indexed to the generating capability of the FCRPS, while recognizing the need to avoid unintended cost shifts to either Slice or non-Slice customers. While the principles recognize the goal to provide a power product under Slice, in cases where power cannot be provided on an agreed, prudent basis, revenue sharing may be substituted if it is determined to be an equitable and prudent alternative.

## **F. CONCEPTUAL DESIGN OF THE ALTERNATIVE 2 SLICE PRODUCT**

### **1. Operational Aspects**

The proposed Alternative 2 shorthand intent was to, “keep current Slice quantity but with reduced flexibility and clarified capacity rights.” This proposal changes the existing product by defining it as a system sale of requirements and surplus power indexed to the variable FCRPS energy and storage capability within defined delivery limits, rather than a sale of resource capability. This reflects BPA’s desire to simplify the product offering and address issues raised in the areas of capacity and product definition. The team agreed that dynamic scheduling would not be a feature of the Slice product. In addition, BPA is proposing to discontinue both the self-supply of operating reserves and the self-supply of energy imbalance. Generating capacity and energy provided from the FCRPS to TBL for Interconnected Operating Services would come “off the top,” and revenues BPA’s PBL receives from TBL for those generation inputs would be shared in proportion to the customers’ Slice share.

The Alternative 2 definition continues to provide the customer significant ability to modify real-time schedules from pre-schedule, and thereby accrue significant capacity value and the ability to shape supply to meet load or otherwise optimize non-Federal generation and market participation. The product proposes a simplified characterization of the FCRPS system for purposes of calculating the obligations and scheduling flexibility of Slice customers. In addition, the proposal allows BPA hydro duty schedulers to pass through any system operational constraints on a real-time basis to Slice customers.

The removal of the right to dynamically schedule FCRPS energy and to self-supply ancillary services makes it clear that this product does not provide the purchaser with any ownership type, operational right to a percentage share of the system. On the other hand, it continues to provide the buyer of the system flexibility in terms of scheduling rights, except as those scheduling rights may be limited by BPA to support regional reliability and other public purposes. This alternative places all Slice and non-Slice requirements customers on a comparable service basis with regard to their ability to access and control within-hour system operations. These modifications address the “modestly reduced flexibility and clarified capacity rights” aspects of the alternative.

### **2. Financial Aspects**

Alternative 2 also includes the results of partial alignment regarding the financial aspects of the Slice product. The team agreed conceptually on a cost recovery objective that would provide Slice customers and non-Slice customers with the same method to mitigate risk associated with commonly shared expenses. Although allocating BPA financial reserves among various customers groups in the future was considered, BPA has significant concerns with such a concept and does not support this approach. The team acknowledged that the issues regarding common risk mitigation measures couldn’t be settled until the FY 2012 rate case, when the risk mitigation methods will be proposed and decided. The Slice financial team also agreed that whatever method is selected should be simple, easy to implement and avoid audits and contentious dispute resolution processes. Preliminary BPA internal discussions have indicated a preference toward an annual true-up approach. Current Slice and non-Slice customers may agree upon a different risk mitigation approach, and if that approach is consistent with statutory and

policy needs and not unduly burdensome, BPA will give it strong consideration. BPA will commit necessary staff resources to address this risk mitigation issue in future power rate design.

### **3. Amount of Slice Offered**

Alternative 2 maintains the current Slice quantity, but with modestly reduced flexibility and clarified scheduling and capacity rights. While Slice currently accounts for 22.6 percent of public preference purchases, BPA initially offered the product in the range of 22-28 percent of firm system capability in 2001. Final product selections for the FY 2002-2011 period reflected balancing between Slice and Block product purchases to accommodate operational needs and the fact that Slice was an untested and complex product. Alternative 2 does not increase the amount of the product above the range previously offered. Further adjustments may be needed post-2011 between the amount Slice and Block purchases by current Slice customers. In addition, some utilities may be interested in switching BPA product selections, for example, going from Full Requirements to Slice or vice versa.

A key issue for Slice customers is the fear that their ability to follow load with their Slice share may be jeopardized if there is a large interest in the product post-2011 and BPA limits the quantity offered to approximately the current amount. Current Slice customers have blends of Slice and Block products, with the Slice component typically 50-66 percent of the requirements portfolio. BPA has examined how the Slice component would be reduced if there were an over fiscal year subscription to the product and BPA prorated the allocation. The assessment is that it would take a major customer shift to the Slice product to significantly reduce the percentage of Slice in customer portfolios.

Certain issues relevant to Slice will be addressed elsewhere in the Regional Dialogue process, and after that process, will need to be appropriately reflected in the Slice product. The most important of these are HWM allocations, resource removal and net requirement determinations. It is assumed that current litigation regarding the costs of the Slice product is successfully resolved. Assuming modifications to the Slice product in this proposal and that BPA offers Slice, BPA proposes re-offering an amount of Slice capped at 25 percent of the existing FCRPS provided that the increase does not violate private use restrictions on Energy Northwest debt. This amount would add about 160 MW to Slice over the current contracted amount of 22.6 percent. This represents a modest increase consistent with all parties' perspective that little, if any, new interest in Slice is expected. It is possible that future Slice Agreements could have tax consequences on existing and future bonds, and BPA is interested in keeping the costs of such bonds as low as possible. While BPA expects to consider several alternatives including making available Alternative 2 as a future Slice product, in some instances the particular provisions of any final Slice alternative and a Slice power sales agreements could, if necessary, reflect tax considerations related to BPA-backed tax-exempt debt.

### **4. Debt Optimization Program**

Recovery of certain costs associated with the Debt Optimization Program (DOP) is a subject of dispute between BPA and Slice customers in litigations filed before the U.S. Court of Appeals. Mediation discussions are ongoing in an attempt to resolve these disputes for the current contract period. It is in all parties' best interest to avoid future disputes relating to this issue. Therefore,

should a Slice product be offered post-2011, it is BPA's proposal that all DOP costs would be shared appropriately by Slice and other customers in their PF rates, and that such costs would be recovered in the future PF rates and rate designs, whether through a true-up or other cost recovery adjustment mechanisms established for such purpose.

**G. ALTERNATIVE 2 PROPOSED CONCEPTS**

Although the concepts are not comprehensive, the following table provides additional detail summarizing characteristics of the proposed Alternative 2 Slice product starting in FY 2012, if any Slice product is offered. The team agreed some parts of the existing Slice contract remain workable and would be considered as a starting point for any new agreement.

<b>Post-2011 Proposed Slice Principles that are Supported</b>	<b>Alternative 2 Refined Product (Conceptual Basis)</b>
#1, #3, #5, #6, #7, #8, #9	<p>Product Defined The Slice product will be clearly defined as a system sale of Requirements and surplus power indexed to the variable FCRPS energy and storage capability, within defined delivery limits.</p> <ul style="list-style-type: none"> <li>• Slice is not a transfer of resource ownership, control or capability</li> <li>• Slice delivery limits would be defined by sustainable energy over a specified time period</li> <li>• Slice energy would be scheduled in full hourly increments</li> </ul> <p>Ancillary Services</p> <ul style="list-style-type: none"> <li>• The Slice product would not include within-hour load following, dynamic scheduling or ancillary services. Generating capacity and energy provided from the FCRPS to TBL for Interconnected Operating Services would come “off the top,” and revenues BPA Power receives from BPA Transmission for those generation inputs would be shared in proportion to the customers’ Slice share.</li> </ul>
#1, #6, #10	<p>Off-the-top Obligations</p> <ul style="list-style-type: none"> <li>• Off-the-top obligations would reduce the amount of FCRPS output provided from the Slice system (a defined set of Federal resources) and include system obligations similar to those defined in the existing Slice contract such as fish obligations, Canadian Entitlement, plus other obligations such as those that pertain to regional reliability, regional requirements and prudent system operation.</li> <li>• Examples of other obligations may include system capability needed for wind integration, system optimization, generation redispatch and operational uncertainty.</li> <li>• Prudent system operation includes additional capacity buffers deemed necessary</li> </ul>

<b>Post-2011 Proposed Slice Principles that are Supported</b>	<b>Alternative 2 Refined Product (Conceptual Basis)</b>
	<p>based on the professional judgment of BPA hydro duty schedulers. Off-the-top obligations related to operational uncertainty and prudent system operations (buffers) do not have direct costs or revenues and would be applied proportionally to Slice and non-Slice customers.</p> <ul style="list-style-type: none"> <li>• BPA Power revenues resulting directly from off-the-top obligations would be shared proportionally with Slice customers.</li> <li>• The amount, value and distribution of any revenue or credit provided to Slice and non-Slice customers for Integrated Operating Services (IOS) provided to BPA's FERC-regulated transmission services function is a matter of rate design and cost recovery and would be established in BPA rate proceedings.</li> </ul>
#1, #5, #6, #7, #8, #9	<p>Design and Flexibility Concepts</p> <ul style="list-style-type: none"> <li>• The Slice product would be clearly defined as a system sale of Requirements and surplus power indexed to the variable FCRPS energy and storage capability, within defined delivery limits.</li> <li>• Slice is not a transfer of resource ownership, control or capability.</li> <li>• Slice delivery limits would be defined by sustainable energy over a specified time period.</li> <li>• Slice energy would be scheduled in full hourly increments.</li> <li>• Dynamic scheduling, self-supply of Operating Reserve, and self-supply of Energy Imbalance are not a features of the Slice product.</li> </ul> <p>Provisions that determine Slice delivery limits would be developed in a manner that enables simplified and improved implementation of the Slice product while maintaining the allocation of energy and hourly scheduling flexibility concept, consistent with principle #3.</p> <ul style="list-style-type: none"> <li>• Eliminate Slice delivery provisions that have seen little or no use in over 4 years of Slice implementation.</li> <li>• Timing of real-time schedule change rights would be based on the then-current BPA power scheduling practices.</li> <li>• Recognizing that a majority of system storage and shaping flexibility exists at the Grand Coulee/Chief Joseph storage complex, PBL would develop detailed Slice delivery limits that emulate that flexibility.</li> <li>• Recognizing that there is much less storage and shaping flexibility at the Snake and lower Columbia run-of-river complexes, BPA's Power Business Line</li> </ul>

<b>Post-2011 Proposed Slice Principles that are Supported</b>	<b>Alternative 2 Refined Product (Conceptual Basis)</b>
	<p>(PBL) would develop simplified Slice delivery limits that emulate that flexibility.</p> <ul style="list-style-type: none"> <li>• PBL would establish Slice delivery limits that consider the hydraulic link that exists between the Coulee/Chief storage complex operation and the lower Columbia run-of-river complex operation.</li> <li>• PBL would establish Slice storage limits that represent the storage space that exists only at those projects with significant and accessible storage space.</li> <li>• PBL would establish pre-schedule Slice delivery limits that reflect expected energy and storage capability based on forecast stream flows, operational constraints and off-the-top obligations.</li> <li>• PBL would establish real-time Slice delivery limits that result from BPA customers' aggregate pre-schedule election, as well as actual stream flows, operational constraints, off-the-top obligations and other operating criteria as determined by the BPA hydro scheduler.</li> <li>• PBL would update Slice delivery limits on a periodic basis in real-time to represent actual operating criteria and conditions.</li> <li>• Measurable(s) would be developed that enable PBL to monitor and assess: (1) the success of the Slice product in relation to product principles; (2) the accuracy of Slice limits verses actual system limits; (3) the use of Slice energy to meet Requirements load; and, (4) risk mitigation. This information would be available to BPA customers to monitor Slice product implementation.</li> <li>• Charges or fees would be applied to violations of Slice delivery limits.</li> </ul>
#1, #3, #6	<p>Transmission Scheduling/Redispatch</p> <ul style="list-style-type: none"> <li>• Operational impacts of control area required redispatch would be shared proportionally between Slice and non-Slice customers. The impacts of future congestion management initiatives on the Slice product have not been determined, but the expectation is that Slice customers would comply with control area requirements applicable to all scheduling entities. There is a risk that Federal Points of Receipt previously identified for the purpose of acquiring transmission contracts may require greater accuracy or additional detail under new procedures.</li> </ul>
#3, #6	<p>Slice – Resource Integration</p> <ul style="list-style-type: none"> <li>• Uses of the product by Slice customers for resource integration would be supported to the extent Slice limits allow.</li> </ul>
#3, #10	<p>Amount of Slice</p> <ul style="list-style-type: none"> <li>• BPA proposes limiting the amount of Slice to 25 percent. This represents approximately a 10 percent increase over the current amount of 22.6 percent.</li> </ul>

<b>Post-2011 Proposed Slice Principles that are Supported</b>	<b>Alternative 2 Refined Product (Conceptual Basis)</b>
#1, #2, #3, #6, #7	<p>Net Requirements</p> <ul style="list-style-type: none"> <li>• A specific monthly test that would be traceable, repeatable and documented for identifying power taken to customer load, and power not taken to load, similar to the current contract test but eliminating or reducing the bandwidth adjustments. The consequences for non-compliance with this test would be appropriate penalties, rather than contract termination.</li> <li>• The test must be reasonable and be aimed at establishing factually what the customer did with the power it scheduled from BPA over the specific period of time.</li> <li>• Changes in control area management or compliance with statutory obligations may require separate hourly schedules of requirements and surplus energy.</li> <li>• A simple crediting mechanism would be developed to reimburse the Slice purchasers for power that cannot be taken, in the event that annual consumer load loss exceeds the amount of the customer's non-Federal resource removal rights under the new contract.</li> </ul>
#1, #2	<p>Governance and Information Sharing</p> <ul style="list-style-type: none"> <li>• PBL reserves the right to withhold any information normally shared with Slice customers from any non-Slice entity that becomes a scheduling agent for a Slice customer.</li> <li>• Slice is available only to preference customers of BPA and cannot be assigned to non-preference customers or agents.</li> </ul>
#1, #2, #10	<p>BPA Product Offerings</p> <ul style="list-style-type: none"> <li>• BPA would offer other products that do not expand operational and financial risk to BPA, with various degrees of operational flexibility, as an alternative choice to meet requirements loads. Some products may be usable in conjunction with this proposed revised Slice product.</li> </ul>
#1, #2, #3, #4	<p>Financial Issues</p> <ul style="list-style-type: none"> <li>• The Slice financial team reached alignment conceptually on recommending a cost recovery design that provides Slice and non-Slice customers with the same method to mitigate risk associated with the levels of commonly shared expenses (essentially, these include all risks except for power supply and secondary revenue risks).</li> <li>• Issues regarding common risk mitigation measures cannot be settled until the 2012 rate case, when the risk mitigation method would be proposed and decided.</li> <li>• Whatever method is selected should be simple, easy to implement, and avoid audits and contentious dispute resolution processes. BPA has expressed a preference toward an annual true-up type approach, but is also willing to consider other joint customer proposals.</li> </ul>

<p><b>Post-2011 Proposed Slice Principles that are Supported</b></p>	<p><b>Alternative 2 Refined Product (Conceptual Basis)</b></p>
<p>#1, #2, #3, #4</p>	<p>Accounting for Slice Implementation Expenses</p> <ul style="list-style-type: none"> <li>• Slice Implementation expenses would still be accounted for separately and paid for by Slice customers, much as done currently.</li> <li>• These expenses consist of PBL personnel costs, Financial Services and Information Technology personnel costs, between business line costs, contractor costs, and computer equipment and hardware costs associated with implementation of the Slice contract.</li> </ul>



## **V. BENEFITS TO THE RESIDENTIAL AND SMALL-FARM CONSUMERS OF THE INVESTOR-OWNED UTILITIES AND PUBLIC AGENCIES**

### **A. INTRODUCTION**

A sustainable allocation of the benefits of the FCRPS requires the region to agree on an appropriate level of Residential Exchange Program (REP) settlement benefits to residential and small farm customers of investor-owned utilities and public agencies. BPA is seeking a way to settle disputes regarding implementation of the REP that provides an equitable level of benefits to residential and small farm customers of investor-owned utilities and to high-cost public agencies, while ensuring that BPA's lowest firm power rate reflects the cost of the undiluted existing Federal system.

BPA has developed estimates of REP benefits in FY 2012 based on a range of assumptions regarding utility average system costs (ASCs) and BPA costs.<sup>1</sup> Based on these assumptions, BPA has examined the uncertainty created by one disputed legal interpretation and several factual uncertainties. Based on a Partial Resolution of Issues in BPA's WP-07 rate proceeding, decisions on these issues would not establish any precedent for future rate cases. Variations in the assumptions on ASC levels, BPA costs, and outcomes of the legal interpretation used for the estimates show REP benefits for residential and small farm consumers of investor-owned utilities ranging from \$0 - \$329 million per year and REP benefits for residential and small farm consumers of public agencies with high ASCs ranging from \$0 - \$65 million per year.

Several public agencies have filed litigation challenging BPA's authority to offer a comprehensive settlement of REP disputes. BPA believes it has the authority to offer comprehensive settlements of such disputes and is assuming a favorable court decision in proposing this policy. During the Regional Dialogue public process, different settlement approaches were discussed, but with no regional consensus forming around any particular proposal. BPA proposes a settlement providing benefits to investor-owned utilities of \$250 million in FY 2012 with a rate period adjustment based on the ratio of changes in a weighted average approximate calculation of investor-owned utility ASCs to changes in a proxy BPA Priority Firm (PF) Power rate for a public agency full requirements customer. BPA believes this settlement reflects a reasonable amount to settle REP disputes and the actual payments BPA would make if BPA were to implement the REP.

### **B. FAILURE TO ACHIEVE A SETTLEMENT OF THE REP**

Because no utility is obligated to accept a settlement offer, BPA must be prepared to update its policies to implement the traditional REP. The schedule for these processes would depend on the number of utilities electing the traditional REP. BPA's first step would be to release for public review a proposed policy for acquiring in-lieu resources. The proposed In-Lieu Power

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<sup>1</sup> These estimates are approximations of potential REP benefits based on the 7(b)(2) rates model using assumptions from BPA's FY 2007 initial proposal and are meant for comparison purposes only. BPA believes these estimates reasonably replicate the results of the rate case model for FY 2012.

Policy would establish BPA's right to buy resources from the market or other resources in lieu of buying an exchange resource from an exchanging utility under the REP. An In-Lieu Power Policy would hold BPA's Tier 1 rate down in the event market purchases cost less than a utility's ASC. The proposed policy would address the notice needed to convert an exchange purchase to an in-lieu purchase; the term of sale; point(s) of delivery; and the source, amount, shape, and cost of the in-lieu power. The proposed In-Lieu Power Policy would apply to both REP contracts requested by public agencies under the Subscription policy as well as REP contracts requested under the Regional Dialogue policy.

BPA's settlement proposal described below includes development of an approach that allows BPA to estimate ASCs for purposes of adjusting and allocating proposed settlement benefits. Such an approach could form the basis of a new ASC methodology. In developing a new ASC methodology, BPA would address long-standing issues, such as taxes, return on equity, and inclusion of transmission costs, as well as more contemporary issues regarding the treatment of regulatory assets and trading floor revenues. If the new ASC methodology included a new streamlined process for establishing ASCs from published information, the new methodology would address the source of information used in developing individual utility ASCs and the timing for updating ASC calculations. For example, BPA believes a review should investigate developing a methodology that establishes an individual utility's ASC based on published accounting documents, such as FERC Form 1 for investor-owned utilities, as well as annual results of operations documents that utilities file with state regulatory commissions. Basing ASC calculations on historical periods could require the ASC methodology to also address forecast parameters for loads and variable costs that would occur during the benefit period following the historical period. Determining if these ideas could form the basis of a simplified ASC process would be decided in a consultation proceeding to develop a new ASC methodology.

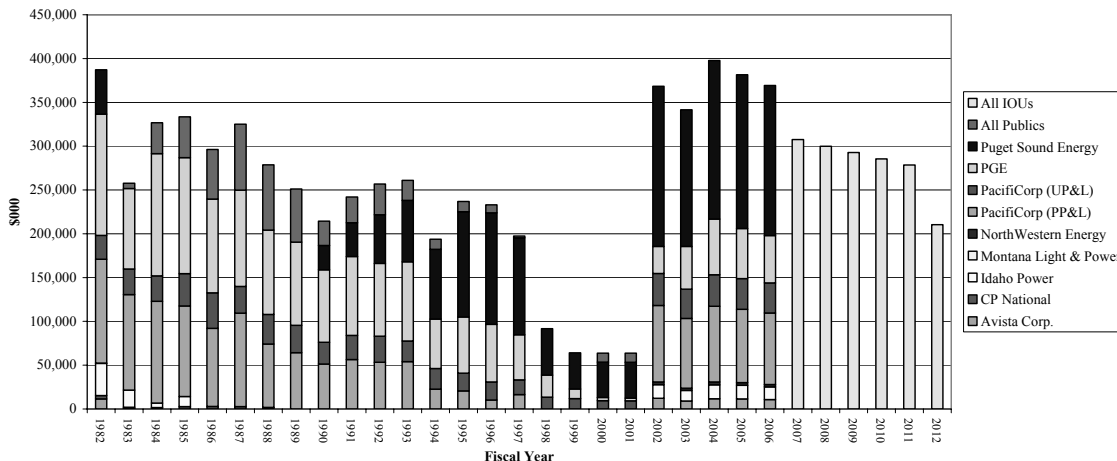
BPA expects any proposal for a new ASC methodology to address participation in the REP by public agencies. A new methodology based on published accounting documents would require public agencies that participate in the REP to file equivalent accounting and financial statements to those filed by investor-owned utilities. BPA would establish a process to calculate ASCs on a periodic basis. Although BPA is not making any substantive decisions regarding a new ASC methodology in this policy, calculating ASCs once every rate period just prior to the Section 7(i) process establishing BPA's wholesale power rates would provide a reasonable basis to coordinate the calculation of ASCs with BPA's proposed In-Lieu Power Policy.

BPA also recognizes that it needs to review its Section 7(b)(2) methodology. This review would occur in a Section 7(i) proceeding. BPA would determine whether the 7(b)(2) methodology should be modified to make it simpler and more applicable to current factual conditions. The review would resolve contentious issues such as the appropriate treatment of the Mid-Columbia resources.

### C. HISTORICAL BENEFITS UNDER THE RESIDENTIAL EXCHANGE PROGRAM

BPA believes a settlement of \$250 million adjusted for the relative escalation of investor-owned utility average system costs to escalation of BPA’s PF power rate is a reasonable proxy for actual payments if BPA were to implement the REP. A settlement in this range also reflects the historical level of benefits under the REP. The following table shows the historical benefits under the REP in 2005 dollars.

IOU and Public Agency Residential Exchange Benefits (2005 \$)



BPA’s settlement proposal provides REP benefits to the region’s investor-owned utilities that are in the middle of the historical range of benefits. A settlement also eliminates the cost to the region of administering an REP program. These costs to BPA alone could add more than \$5 million annually to the power revenue requirement to be recovered in rates. BPA’s settlement proposal is based on its best estimate of the expected outcome of implementing the REP. Arguments can be made about a number of different legal and policy issues on how the REP should be implemented. Investor-owned utilities and public agencies dispute a number of the policies that BPA has adopted to implement the REP. Settlement of the REP avoids the need to litigate these disputes.

BPA believes that the 7(b)(2) rate test would limit benefits under the REP to the range of \$250-\$300 million. The 7(b)(2) rate test limits REP payments based on a set of assumptions included in the Northwest Power Act. Arguments have been made to adopt a number of 7(b)(2) positions that are different than the positions reflected in the rates model used today to estimate future REP benefits. Some of these positions, if adopted by BPA, would increase REP benefits. An example of such a position would be the treatment of certain occurrences as uncontrollable events (such as WNP-1 and -2 termination, financial reserves for risk, and planned net revenues for risk) in the 7(b)(2) rate test. If adopted, such changes would likely guarantee that the 7(b)(2) rate test would never trigger. BPA has previously disagreed with these positions.

Other issues could also increase REP benefits. Removal of the Mid-Columbia resources from the resource stack would significantly reduce a 7(b)(2) trigger and increase REP benefits. Other

issues concern the treatment of conservation, the valuation of reserve benefits, and the allocation of amounts under Section 7(g) of the Northwest Power Act.

Similarly, some positions would reduce REP benefits. For example, arguments have been made that BPA should change its existing position on the treatment of conservation resources in a manner that would lower such REP benefits. The Partial Resolution of Issues in BPA's WP-07 rate proceeding delays decisions on most 7(b)(2) issues until after the policy is adopted.

Other factors impacting the level of REP benefits are the wholesale power costs of utilities reflected in their ASCs and the level of BPA costs reflected in BPA's PF Exchange rate. If market prices are high in FY 2012, REP payments could be high if BPA's PF Exchange rate is reduced through increased secondary energy credits and a minimal need to acquire resources while the ASCs of investor-owned utilities may be increased due to the need to acquire high-cost resources. During low market conditions, BPA's PF Exchange rate could increase due to lower secondary energy credits and the ASCs of customers may decrease due to lower resource costs. In addition, BPA believes that the ASCs of customers would be capped in low market conditions based on wholesale market costs.

The proposed adjustment mechanism will reduce the proposed settlement payment if the PF rate escalates at a faster pace than the investor-owned utility ASCs after FY 2012. Thus, the proposed adjustment mechanism is expected to serve as a reasonable proxy for how a conventional REP might behave.

#### **D. PROPOSED SETTLEMENT OFFER TO INVESTOR-OWNED UTILITIES**

BPA's proposed settlement offer would establish a total annual benefit of \$250 million per year for the region's six investor-owned utilities. This amount would be established in FY 2012 with an rate period adjustment starting in FY 2014 based on the ratio of (1) the ratio of the current year weighted average total proxy average system cost for all six investor-owned utilities to the FY 2012 weighted average total proxy average system cost for all six investor-owned utilities; to (2) the ratio of the current year calculated proxy BPA Priority Firm Power rate for a public agency full requirements customer to the FY 2012 proxy Priority Firm Power rate. For example, this equation for FY 2016 would be:

$$\text{FY}_{2016} \text{ REP Benefits} = \$250 \text{ million} * \frac{\sum \text{weighted } ASC_{2015} \text{ for six investor - owned utilities}}{\sum \text{weighted } ASC_{2012} \text{ for six investor - owned utilities}} \frac{\text{Proxy PF}_{2015}}{\text{Proxy PF}_{2012}}$$

The current year ASC and the current year proxy PF Power rate are calculated based on the fiscal year preceding the start of each rate period. BPA would calculate the total settlement amount for each rate period by applying this ratio to the \$250 million settlement amount for the six investor-owned utilities.

Under the proposed settlement prior to each rate period, BPA would calculate a proxy ASC for each investor-owned utility using a new “cookbook approach,” i.e., an Excel-based program assigning costs by function and estimating ASC, which would be negotiated as part of the proposed settlement. After calculating each utility’s proxy ASC based on the 1984 ASC Methodology, BPA would calculate a weighted average total average system cost for all six investor-owned utilities based on each investor-owned utility’s forecasted residential and small farm exchange load. BPA would also calculate a proxy PF power rate for a public agency full requirements customer. The proxy PF Power rate would be based on the sum of the net requirements of BPA’s public agency customers for each year. BPA would assume that the sum of the high water marks for public agencies is available to serve these loads from Tier 1. Any net requirements in excess of the sum of the high water marks would be assumed to be served by a standard Tier 2 requirements product identified in the proposed settlement.

BPA’s settlement offer adjusts the initial settlement amount based on the relative increase in investor-owned utility ASCs to the relative increase in BPA costs included in the PF rate. Since BPA proposes to settle the REP for the period from October 1, 2011, through September 30, 2027, BPA believes the initial settlement amount must adjust over time to reflect changes in costs. BPA believes the proxy ASC costs and costs establishing the proxy PF rate are a reasonable method to adjust the settlement payment and reflect the actual costs used in determining benefits under the REP. Since BPA is proposing to use the same factors to allocate the settlement benefit among the six investor-owned utilities, BPA believes it is reasonable to adjust the benefits for the six investor-owned utilities as a group.

BPA’s settlement offer would also include allocation provisions for the distribution of the total annual investor-owned utility settlement amount among the investor-owned utilities. BPA’s proposed allocation methodology directs the benefits primarily to investor-owned utilities with high average system costs. The allocation methodology in the proposed offer would be based on the ratio of each investor-owned utility’s proxy REP benefit to the sum of the proxy REP benefit for all six investor-owned utilities. Each investor-owned utility’s proxy REP benefit is its REP load times the difference between its proxy ASC and the proxy PF power rate.

The four state utility commissions have indicated they would collaborate on a recommendation for allocation of the investor-owned utility benefits. BPA welcomes such recommendation and will ultimately decide the appropriate allocation methodology after consideration of all comments.

## **E. PROPOSED SETTLEMENT OFFER TO PUBLIC AGENCIES**

Existing public agencies with high cost resources would be eligible for an REP settlement comparable to the settlement offered to investor-owned utilities. BPA would make the following offer to settle REP disputes to such public agencies if their respective individual forecast proxy ASC during FY 2012 is above \$45/MWh. This level represents a forecast of the PF Exchange rate for FY 2012 assuming a medium range forecast of average system costs and the Mid-Columbia resources not included in the resource stack. Any public utility seeking REP settlement benefits based on a forecast proxy ASC above the \$45/MWh threshold must provide explanations and audited documentation of the accounting costs supporting the forecast.

New public agencies taking over investor-owned utility service territory after the offer of initial contracts and receiving an HWM for only a portion of their load would be eligible for the REP. Any settlement offers by BPA will be made when they request participation in the REP. Settlement offers to existing public agencies would provide a financial payment that is an additional amount of money to the amount offered to the six investor-owned utilities and that is based on the total \$250 million settlement amount offered to them. BPA would develop a ratio of the forecast REP load for a public utility in FY 2012 to the total forecast REP loads for the six investor-owned utilities in FY 2012. This ratio would be calculated only once for settlement offers included in initial contracts. BPA's settlement offer would provide a public agency an initial settlement amount calculated by applying this ratio to the initial settlement amount of \$250 million provided to investor-owned utilities each year. This initial amount would be adjusted starting in FY 2014 by applying a ratio of (1) the ratio of the current year proxy average system cost for such public agency to the FY 2012 proxy average system cost for such utility, to (2) the ratio of the current year proxy PF Power rate to the FY 2012 proxy PF Power rate.

BPA believes this offer to public agencies is comparable to the offer to the investor-owned utilities. Since BPA believes new public agencies could see significant reductions in their ASC over time, BPA believes it is more reasonable to adjust their settlement amount individually as opposed to including them in the adjustment process with the investor-owned utilities.

BPA has included estimates of expected REP benefits for public agencies in FY 2012 in the charts below. These estimates are based on BPA forecasts of public utility ASCs in the FY 2007 rate case. Once BPA has the opportunity to perform a more detailed analysis, BPA expects the actual amount of settlement dollars offered to existing public utilities to be less than \$30 million per year.

#### **F. PROVISIONS APPLICABLE TO SETTLEMENT OFFERS TO BOTH INVESTOR-OWNED UTILITIES AND PUBLIC AGENCIES**

BPA has a legal obligation to ensure that the benefits of the REP and REP settlements go to the intended recipients. Benefits under the settlement would not be assignable if another entity takes over the distribution system of a participating utility. If another entity takes over all or a portion of the distribution system of a participating utility, the participating utility's initial amount of benefits under the settlement will be reduced on a pro rata basis. That amount would be removed from the initial settlement amount used to calculate the total annual settlement benefit that is allocated to other investor-owned utilities if the proposed allocation methodology for investor-owned utilities is adopted and the participating utility is an investor-owned utility. Participating utilities consumer bills should designate "Benefits of the Federal Columbia River Power System" to describe the benefits each consumer receives. Settlement contracts also will include provisions permitting BPA to review the manner in which the benefits of the Federal system, through settlement of REP disputes, are being provided to the intended beneficiaries, that is, the utilities' residential and small farm consumers.

BPA expects its lowest firm power rate reflecting the cost of the undiluted existing Federal system to be substantially below market prices in the future. However, BPA will include a provision in its settlement proposals allowing BPA termination of the settlement on 2-years'

notice if the wholesale market price in the Northwest for a flat annual block of power is below BPA’s lowest firm power rate for a flat annual block of power. BPA will decide at that time whether to make a revised settlement offer or implement the REP. And, as a condition of receiving the REP settlement, all exchanging utilities would agree not to challenge the long-term tiered rates methodology or other REP settlements.

**G. ESTIMATED REP BENEFITS IN FY 2012**

The tables below show a range of REP benefits that BPA has estimated under low- and high-rate scenarios. These do not represent the complete range of potential BPA costs but a reasonable estimate of the range for the majority of expected BPA cost levels in FY 2012. The scenarios examine potential benefits using different assumptions about DSI service and the resources included under the 7(b)(2) rate test. Estimated ASCs for the low, medium, and high cases are \$41/MWh, \$51/MWh, and \$59/MWh for public agencies and \$43/MWh, \$51/MWh, and \$59/MWh for investor-owned utilities. Estimates of ASCs in the medium case are based on the FY 2012 forecast in the WP-07 rate proceeding. The estimate for the low case is 85 percent of this amount and the estimate for the high case is 115 percent of this amount. Total public utility REP load is 917 aMW and total investor-owned utility REP load is 5,215 aMW based on the FY 2012 forecast of REP load from the WP-07 rate proceeding.

Table 1 provides an estimate of REP benefits under a low BPA unbifurcated PF rate in FY 2012 (which is assumed to be \$24/MWh without any REP costs and a known capped cost for DSIs of \$59 million in the “No DSI Service” scenarios).

Table 1 Projections of Traditional REP Benefits Under Low BPA Rates						
<b>No DSI Service with Mid-C Resources In Resource Stack</b>				<b>560 MW DSI Service with Mid-C Resources In Resource Stack</b>		
REP Benefits - \$ Millions			Rates - \$/MWh		Rates - \$/MWh	
	Publics	IOUs	Total	PF Rate	PF EX	IP
ASC low	None	None	None	24.06	60.46	
ASC med	None	None	None	24.06	69.54	
ASC high	None	None	None	24.06	78.81	
<b>No DSI Service with Mid-C Resources Out of Res. Stack</b>				<b>560 MW DSI Service with Mid-C Resources Out of Res. Stack</b>		
REP Benefits - \$ Millions			Rates - \$/MWh		Rates - \$/MWh	
	Publics	IOUs	Total	PF	PF EX	IP
ASC low	40.8	210.2	251.0	29.58	38.03	
ASC med	49.9	255.5	305.4	30.70	44.54	
ASC high	59.0	300.8	359.8	31.88	51.05	
ASC low	41.3	212.7	254.0	29.73	37.87	32.07
ASC med	53.4	270.6	324.0	30.81	44.02	35.76
ASC high	65.4	328.5	393.9	31.90	50.17	39.45

Table 2 provides an estimate of REP benefits under a high BPA unbifurcated PF rate in FY 2012 (which is assumed to be \$31/MWh without any REP costs and a known capped cost for DSIs of \$59 million in the “No DSI Service” scenario.)

**Table 2**  
**Projections of Traditional REP Benefits**  
**Under High BPA Rates**

<b>No DSI Service with Mid-C Resources In Resource Stack</b>						<b>560 MW DSI Service with Mid-C Resources In Resource Stack</b>							
	<u>REP Benefits - \$ Millions</u>			<u>Rates - \$/MWh</u>			<u>REP Benefits - \$ Millions</u>			<u>Rates - \$/MWh</u>			
	<u>Publics</u>	<u>IOUs</u>	<u>Total</u>	<u>PF Rate</u>	<u>PF EX</u>		<u>Publics</u>	<u>IOUs</u>	<u>Total</u>	<u>PF</u>	<u>PF EX</u>	<u>IP</u>	
ASC low	None	None	None	31.30	60.46	ASC low	None	None	None	30.09	47.64	43.75	
ASC med	None	None	None	31.30	69.64	ASC med	1.4	12.8	14.2	30.27	55.50	45.02	
ASC high	None	None	None	31.30	78.81	ASC high	14.0	87.7	101.7	32.25	57.47	45.26	

<b>No DSI Service with Mid-C Resources Out of Res. Stack</b>						<b>560 MW DSI Service with Mid-C Resources Out of Res. Stack</b>							
	<u>REP Benefits - \$ Millions</u>			<u>Rates - \$/MWh</u>			<u>REP Benefits - \$ Millions</u>			<u>Rates - \$/MWh</u>			
	<u>Publics</u>	<u>IOUs</u>	<u>Total</u>	<u>PF</u>	<u>PF EX</u>		<u>Publics</u>	<u>IOUs</u>	<u>Total</u>	<u>PF</u>	<u>PF EX</u>	<u>IP</u>	
ASC low	33.2	177.3	210.5	35.98	39.00	ASC low	32.2	173.2	205.4	35.68	39.03	34.73	
ASC med	43.4	227.6	271.0	37.25	45.37	ASC med	44.2	231.1	275.3	36.76	45.18	38.42	
ASC high	52.5	272.9	325.4	38.40	51.88	ASC high	56.3	289.0	345.3	37.85	51.33	42.11	

These estimates do not examine the impact of an in-lieu policy that would cap utility ASCs based on wholesale market costs. They also do not address the impact that reopening the 7(b)(2) methodology to update and simplify it could have on REP costs. The estimates address the uncertainty that a new consultation process to revise ASC methodology would create by examining a range of forecast ASCs and the impact of different REP benefit levels on BPA costs by examining two different BPA cost levels.

This settlement proposal uses BPA's best estimate of the ultimate resolution of implementation of the REP. While there are many uncertainties to address in such implementation, BPA believes an outcome of very low BPA Priority Firm power rates and no benefits for the residential and small firm consumers of the investor owned utilities and public agencies may be unrealistic because it assumes an outcome on the Mid-Columbia resources that may not reflect BPA's ultimate legal position.

The foregoing numbers, and other supporting analyses, have convinced BPA that its proposed settlement of \$250 million in FY 2012, adjusted for the relative escalation of investor-owned utility average system costs to escalation of BPA's PF power rate, is a reasonable proxy for benefits that would be paid if the REP were implemented instead of settled.



## **VI. SERVICE TO DIRECT-SERVICE INDUSTRIES**

### **A. BACKGROUND**

Historically, the direct-service industries (DSIs) have been an important BPA customer group that created family-wage jobs and made up an important part of the Northwest economy, particularly in certain communities. The predictable and stable load shape of the DSIs provided a steady payment stream to BPA for many years prior to 2001. In recent years, reductions in world aluminum prices, development of new, more efficient smelters outside the Pacific Northwest and increases in Northwest power prices have put the viability of the Northwest's DSI aluminum smelters at risk. At present, while aluminum prices are up sharply, this is offset by the fact that input costs (alumina) are at historic highs. As a result of the combined effects of world aluminum and alumina prices and higher power prices in the Northwest, BPA service to the region's smelters has declined from 3,000 aMW in calendar year 1995 to below 300 aMW today. Some former companies have entered into bankruptcy, and several smelters are in various stages of permanent decommissioning. There is little evidence that economic conditions for aluminum smelting will improve dramatically in the Pacific Northwest in the foreseeable future. Nonetheless, the remaining DSIs served by BPA are, or have potential to be, the economic mainstays of their communities. These include Ferndale, Wenatchee, Port Townsend, and Goldendale in Washington; Columbia Falls in Montana; and The Dalles in Oregon.

Current DSI contracts expire in 2006. After a lengthy public process, BPA decided in June 2005 to offer contracts to four DSIs for the FY 2007-2011 period. These contracts would provide a maximum of 577 aMW of surplus power to the local utility for resale to the individual DSI, or the financial equivalent to each DSI, with a cap of \$59 million per year for the aluminum portion. How much of this the companies will be able to use is uncertain and would be a function of aluminum market conditions and wholesale power prices. BPA allocated the value of 320 aMW to Alcoa, 140 aMW to Columbia Falls Aluminum Company, 100 aMW to Golden Northwest Aluminum Company and 17 aMW to Port Townsend Paper Company. These amounts could shift among companies during the FY 2007-2011 period if any company cannot use its portion. The 577 aMW total benefit could be permanently reduced if another company does not pick up the unused allocation.

### **B. CONTINUE THE DSI DISCUSSION**

The question of whether to offer continued service to the DSIs after FY 2011 poses many difficult policy issues. BPA is not required by law to offer contracts to DSIs but has authority to do so. Because the decision process on FY 2007-2011 DSI service was so protracted, there has been little regional discussion of service after FY 2011, although the post-2011 issues are similar to the FY 2007-2011 issues. As in the FY 2007-2011 DSI service decision, BPA will weigh the sustainability of important family-wage jobs against its other goals, especially the imperative of keeping rates as low as possible and managing the agency's risk profile. BPA's view is that a post-2011 DSI service proposal should give the remaining DSIs an ongoing opportunity to operate and provide employment in their communities (though not a guarantee of operation) while meeting the following principles:

- **Legality.** Any DSI solution must be implementable under existing law that provides BPA the authority but not an obligation to provide DSIs power benefits.
- **Lowest Tier 1 Costs/Rates.** BPA will continue to be mindful of how any DSI benefit solution impacts the rates of other customers.
- **Customer/Regional Support and Decisions Seen as Equitable.** BPA sees resolution of DSI benefits as an important part of a sustainable regional package.
- **Certainty of Obligations for All Parties.** Any solution for DSIs must define the obligations and benefits for the term of Regional Dialogue contracts.

BPA's September 2005 Concept Paper proposed extending the FY 2007-2011 DSI service construct with a cap on annual benefit levels into the post-2011 period as the alternative that would best meet these principles. Under this approach, allocations to individual companies and annual benefit levels would be the same as those in effect at the end of the FY 2007-2011 period. If any of the 577 aMW of benefits available in the FY 2007-2011 period are not used in that period and not assigned to another company before 2011, the amount available in 2012 and beyond would be less than 577 aMW. There is no guarantee that the DSIs would be able to continue to operate with benefits provided by BPA. In fact, the level of service to DSIs may continue its downward trend if economic conditions continue to be unfavorable.

BPA is interested in comments on this and other alternatives for post-2011 DSI service raised in the regional discussions following release of the Concept Paper. One alternative advocated by some parties is to view the benefits provided in FY 2007-2011 as the final installment in the long regional partnership with the DSIs and to provide DSIs no benefits in Regional Dialogue contracts. A second alternative is to provide physical power to DSIs under a Regional Dialogue contract. BPA would establish the amount available to each DSI based on the amount of power BPA either provided in FY 2010 or would have provided in FY 2010 under its FY 2007-2011 contract if the benefits had been delivered as a physical power sale. This limits the aMW physical power amount to a maximum of 560 aMW to smelters. The power sale would be priced at the Industrial Firm Power (IP) rate to the DSI or, if provided through the local utility, the FPS rate at a price approximately equal to Tier 1 of the PF rate. If BPA were to make such a sale, BPA would augment the FBS so that such sales would not result in a decrease to the public's HWMs.

To help the region focus on the DSI issue, BPA intends to conduct at least one public meeting that centers on DSI benefits after FY 2011. BPA has also commissioned a study to explore both the economic benefits of regional support for DSI jobs through BPA service and the economic impact of rate increases that result from that support. This additional dialogue about DSIs should highlight the importance of the issue and ensure the region thoughtfully explores the range of alternatives for DSI service prior to finalizing this proposal.

## **VII. CONSERVATION**

### **A. INTRODUCTION**

BPA's conservation program meets a fundamental purpose under the Northwest Power Act. BPA and its customers have made investments in conservation consistent with the Act and with power plans developed by the Northwest Power and Conservation Council. Because conservation has, in many cases, been the least-cost resource for the region, BPA, its customers, and the citizens of the Pacific Northwest have benefited greatly from this investment.

BPA proposes that its goal for conservation in the post-2011 period should be the same as it is now – ensuring development of the cost-effective conservation in the load BPA serves while keeping the costs and rate impacts of doing so as low as possible. With tiered rates, customers will see that each MWh they conserve allows them to avoid a MWh of purchases at the cost of new power supply. This should provide a strong economic incentive for conservation, and make it easier for BPA to meet its goal of ensuring that cost-effective conservation is developed.

### **B. ACHIEVE CONSERVATION IN THE LOAD BPA SERVES**

BPA proposes to continue pursuing an amount of conservation equivalent to all cost-effective conservation in the load it serves at Tier 1 rates at the lowest cost to BPA. BPA believes that the loads it serves at the Tier 1 rate should drive BPA's share of conservation in the region. BPA proposes to continue to count all conservation achieved as a result of BPA-funded efforts toward meeting its target. By taking responsibility for this share of the Council-defined regional cost-effective conservation targets, which is proportional to the percent of total regional load that would be served by BPA at the Tier 1 rates, BPA would reduce its need to acquire new resources to serve load. Because BPA is not proposing to serve IOU residential and small-farm loads with firm power, the proposal does not include those loads in determining BPA's conservation target. Similarly, DSI eligibility for benefits would be limited and their loads, if any, would not be factored into BPA's conservation target. BPA proposes recovering costs of achieving conservation on the loads it serves in Tier 1 rates.

### **C. ENSURING CUSTOMERS HAVE ECONOMIC INCENTIVES TO CONSERVE**

BPA proposes two primary actions to meet its conservation goal. First, ensure that tiered rates create an economic incentive for customers to pursue conservation. Second, provide a set of conservation programs that build on those incentives to ensure that conservation targets are met at least cost. By establishing tiered rates BPA expects customers will have a greater economic incentive to conserve electricity whenever they face Tier 2 rates. If they face Tier 1 rates, there is still a significant incentive to conserve since conservation achieved would serve to lengthen the time before a customer's net requirement load exceeds its HWM and thus delay application of Tier 2 rate service or market prices. BPA's proposals for these economic incentives are described in the "Service to Public Utilities" section.

#### **D. FUTURE CONSERVATION PROGRAMS**

BPA proposes a portfolio of approaches similar to that developed by a collaborative workgroup in 2005. The portfolio approach can accomplish conservation at the least cost and with the bulk of conservation achieved at the local level. The portfolio approach now used has four components: (1) a rate credit that provides steady funding for local programs and targets the conservation that is reasonably evenly distributed throughout the region; (2) bilateral contracts that provide the means to acquire additional cost-effective conservation where available in specific utility service territories; (3) third-party contracts and market transformation activities that can be used in conjunction with local programs where a coordinated regional effort is needed either to reduce costs or to move market players that do not respond at a local level; and, (4) regional infrastructure support by BPA. BPA expects to improve the approach in the post-2011 period as a result of what the region learns.

#### **E. CONSERVATION USED TO SERVE TIER 2 LOAD**

Under BPA's proposal, a utility with a HWM below its firm net requirements load may request BPA to serve its load in excess of the HWM at a Tier 2 rate. The opportunities to provide conservation to customers in lieu of more expensive Tier 2 purchases may not always be feasible, but providing these opportunities is a legitimate response to customer needs BPA could potentially help a utility develop conservation to offset its need to buy power in excess of its HWM. Depending on the circumstances, BPA could develop financial incentives to assist such a utility to develop conservation in amounts that reduce some or all of the utility's load growth. The cost of such conservation could be fully recovered from the customer by BPA through a bilateral arrangement. The long-term amortized cost of the conservation should provide load reduction at a much lower cost than market power.

## VIII. RENEWABLE RESOURCES

### **A. BPA GOAL AND APPROACH**

The appropriate BPA goal for renewable resources is defined by BPA's responsibilities under the Northwest Power Act. The Act encourages development of renewable resources, and gives them second priority after conservation to meet BPA's firm power load obligations. In recent years, BPA has defined its renewable resource program in terms of budget—how much it would spend each year to support renewable resources. BPA proposes to change this by holding its renewables program to the same objective it has for its other programs—the achievement of well-defined goals at the least possible cost.

The Council's Fifth Power Plan foresees the development of up to 5,000 MW of wind capacity in the Northwest during the next 20 years. BPA proposes that the goal for its renewable resource program be a percentage of the Council's regional target based on public power customers' share of regional load growth, which is different than the current percentage of regional load. As a starting point, BPA assumes that load growth of public power will be about 40 percent of regional load growth. This equates to a goal of about 100 MW a year. This percentage would have to be adjusted over time for actual load growth. Recognizing that the Council's forecast is ambitious, BPA proposes to apply this target to *all* renewable resources, not just wind. Over time, BPA would adjust its renewables target as the Council revises its renewable generation forecasts. To determine if BPA is meeting the target, BPA would simply count the amount of MWs of incremental renewables generation that BPA and public power utilities are purchasing.

BPA proposes to spend *up to* a net \$21 million a year (plus annual escalation) on a range of facilitation activities with its public power customers, to the extent necessary to meet the renewables target. BPA will not use any of this \$21 million to reduce its Tier 2 rates to create a financial advantage to purchase BPA Tier 2 over buying from the market. This goal to facilitate development of renewables consistent with the Council plan makes sense because it enhances the likelihood that public power customers will assume responsibility for developing new cost-effective resources instead of leaving that responsibility with BPA. This approach reduces BPA's overall costs because BPA's capped renewable facilitation costs would likely be lower than the costs of BPA acquiring the same amount of new resources. Further, adopting this goal helps ensure that new regional resource development meets the key tenets of the Act: cost-effectiveness and encouraging development of renewable resources.

BPA would deploy these facilitation dollars in a way that maximizes the amount of new renewable generation per dollar of BPA spending. Any costs associated with these renewables facilitation activities would be recovered in Tier 1 rates. BPA would also revisit the \$21 million level during each rate period to see if it should be modified. BPA expects that its proposed tiered rates and high water mark approach would result in its public power customers shouldering more of the resource acquisition role. However, BPA is likely to have some ongoing responsibility to acquire power for Tier 2 rate service and possibly for some very limited augmentation for Tier 1 rate service.

## **B. LEAST-COST ACTIONS TO MEET GOAL**

A crucial question is what set of actions will meet the goal at the least cost. The marginal cost signal sent to customers by tiered rates coupled with a strong emphasis on facilitating development of renewable resources by public power requirements customers and cost-effective renewable acquisitions by BPA to meet net requirements load served at Tier 2, is likely to be the least-cost path to achieving this goal. Facilitation dollars could be used for both, if needed.

There are promising signs that a combination of market factors and policy initiatives will continue to drive increasing demand for renewables among BPA's public power customers. Several of the proposed facilitation activities described below harness these positive trends and may not need significant financial outlay by BPA. BPA would use a least-cost approach in selecting support activities and, depending on progress, it may not be necessary for BPA to spend the entire \$21 million, although BPA is committed to such spending if the Council's targets are at risk.

## **C. ACTIONS PROPOSED TO MEET THE RENEWABLES GOAL**

BPA believes the following portfolio of facilitation activities with its public power customers has the best chance of meeting the renewables target at the least cost. BPA would revisit this portfolio periodically and make adjustments as needed.

### **1. Cost-Effective Renewable Resource Acquisitions for Tier 2**

Some public power requirements customers likely will rely on BPA to meet their energy needs in excess of their HWMs. A Tier 2 rate based on renewables would be designed by BPA to enable customers to make renewables a substantial component of their resource portfolios, thus supporting achievement of the Council's targets. The Tier 2 pricing alternatives would be designed to address the unique characteristics of renewable resources and would address both the energy and capacity requirements of incremental load service.

During the Concept Paper discussions, the question was raised whether BPA should position itself to acquire new renewable resources in advance of having actual contracted load that absolutely demonstrated the need. Such an approach might allow BPA to secure access to low-cost or well-sited renewable resource opportunities to serve a reasonably forecast need. Notwithstanding these potential benefits, entering into agreements to purchase power generated by renewable resources in advance of load that BPA may or may not be obligated to serve creates significant risk and cost exposure. One approach to managing such risk while taking advantage of attractive renewable resource opportunities is the use of resource contingency planning. Such planning would allow for the siting and licensing of resources that could be built quickly and placed into operation when needed to meet future loads at Tier 2 rates. This approach, highlighted in the Council's plan, is a potentially useful alternative to the risk and cost exposure of acquiring resources in advance of an assured load obligation.

BPA also recognizes that acquiring resources in small increments, precisely matching customer load growth, may not be an economical or practical approach in all circumstances. Therefore, BPA may move to acquire renewable resources somewhat in advance of need for eventual

service at Tier 2 rates. Any costs associated with these advance renewable purchases (both energy in excess of market and predevelopment costs) would count against the proposed annual cap on renewables facilitation costs included in the Tier 1 rate.

## **2. Integration Services**

Recent experience has shown that public power customers and others in the region desire products and services that can be used to shape and integrate their renewable resources—which are often intermittent in nature—to serve their loads. BPA intends to use the flexibility of the FCRPS to provide cost-based wind integration products for wind projects serving requirements load, provided there is adequate capacity in the system to do so. At present, BPA is only offering limited sales of these services because of uncertainty about FCRPS flexibility due to ongoing Biological Opinion litigation. Once this uncertainty is resolved, BPA hopes to offer additional Network Wind Integration and Wind Storage and Shaping products, as well as other products and services that may evolve, under long-term contracts to public power customers for resources serving regional load. Although BPA proposes to offer integration services under long-term contracts (10 years and perhaps up to 20 years), *prices* for such products and services would be established periodically in rate cases along with prices for other load-following products. Pricing for integration services would necessarily include a risk component to cover any market purchase costs incurred by BPA when the hydro system does not have adequate capacity.

## **3. Coordinated Planning**

The development of 5,000 MW of renewable resources will require coordinated planning on the part of the region's utilities to ensure a diversified portfolio of renewable resources consistent with the operational characteristics of the region's power and transmission systems. BPA intends to work closely with the Council, utilities, developers and other regional organizations to promote long-term resource planning and minimize the costs of integrating substantial amounts of wind energy into the regional grid. Modest expenses may be incurred on an ongoing basis to advance development of regional wind forecasting capability and to help fund regional wind integration studies.

## **4. Research, Development, and Demonstration**

BPA intends to continue providing a limited amount of financial support for RD&D focusing on those projects and technologies benefiting multiple regional needs or which are embarking on commercial demonstration. Rather than using facilitation dollars, BPA plans to use Green Energy Premiums to fund this activity.

## **5. Targeted Financial Support**

The actions listed above may or may not be sufficient to meet BPA's renewables goal. Under the Regional Dialogue construct, BPA's public power customers are responsible for procuring energy and capacity to meet their incremental load growth, either from BPA at Tier 2 rates or from other suppliers. Customer resource procurement decisions will, therefore, be the major driver of progress toward meeting the renewables targets. Facilitation dollars would be used to further support public customers' efforts to foster renewables if BPA concludes that the target will not otherwise be met.

To determine progress toward the Council's targets BPA proposes that prior to each rate period, public power customers share with BPA their renewables acquisition plans for the next 5-10 year period. In the event that renewable resources continue to be priced attractively relative to market, it is possible that customers will choose to purchase renewable resources (whether from BPA through Tier 2 or from other market providers) for purely economic reasons and may require limited facilitation dollars. BPA can use the facilitation dollars in multi-year increments to help progress towards the Council's plan. Facilitation dollars may be targeted at various elements of the cost structure of renewables projects, including development costs, physical infrastructure costs (substations and generating equipment), integration services and commodity risks. The facilitation dollars may also be used to continue a rate credit program or other incentive program(s) that narrow the spread between the cost of renewable energy and the market.

#### **D. RATE TREATMENT**

BPA renewables facilitation dollars would be recovered as a Tier 1 rate cost. The spending limit of net \$21 million per year (plus annual escalation) is above and beyond the energy costs of BPA's existing renewable projects (not including the existing Fourmile Hill geothermal project) that are, and would continue to be, included in existing rates. BPA expects the costs of those projects to be at or below the market value of their output. The cost of the Fourmile Hill project, net of the market value of its output, would count against this cap if that project comes on line and BPA is purchasing the power.

#### **E. GREEN ENERGY PREMIUMS**

BPA proposes to continue its existing practice of reinvesting Green Energy Premiums; to the extent they are available, in renewable research, development, and demonstration projects and education programs. As with the facilitation dollars, BPA would revisit the efficacy of this spending prior to each rate period.

#### **F. TRANSMISSION**

This proposal does not address transmission products and services, which are also critical services needed for integrating renewable resources into the power system and delivering them to load. These services are available to all transmission users, including both public power utilities and investor-owned utilities.

#### **G. OTHER POLICY ISSUES**

1. BPA proposes to eliminate the 200 MW (in aggregate) of renewable resource additions established under the Subscription contracts and BPA's 5(b)/9(c) policy. To encourage customers to support the development of renewable resources, the Subscription contract and policy gave customers the right to identify and add new renewable resources to serve their firm retail load. Customers could also define the duration of applying and removing the renewable resource, returning the retail load to PF rate service without application of the targeted adjustment charge (TAC). Because BPA proposes to establish tiered rates



and offer renewable resource facilitation assistance to its customers, BPA no longer sees the renewable exemption as providing customers an incentive to develop and use renewable resources to serve load.

2. The 2010 resource amounts BPA uses for purposes of calculating the HWM would not include any renewable resources a customer dedicates to its load that have on-line dates later than July 2006. Simply stated, new renewable acquisitions by the customer would not reduce its HWM.
3. BPA proposes to establish a time limit for the off-site renewables policy in its current NLSL policy. See Section III.E.3. of this proposal.

## **IX. TRANSFER SERVICE**

### **A. BACKGROUND**

BPA's transmission system was built in large measure to deliver Federal power to regional customers. Similarly, several other public, cooperative, and investor-owned utilities also built transmission facilities in the region. In many cases, it has been more economical and efficient for BPA to contract with these other transmission owners to deliver Federal power over their facilities rather than build duplicate facilities. This is called transfer service, and it is implemented through transfer agreements with neighboring transmission systems. The number of transfer agreements has grown over time, and currently 80 preference customers receive all or part of their Federal power through transfer service.

In early 2005, BPA signed 20-year contracts titled Agreement Regarding Transfer Service (ARTS) with transfer service customers. These agreements require BPA to: (1) continue to arrange for transfer service with third-party transmission owners for the delivery of Federal power; (2) continue to be financially responsible for specified costs of the transfer service; and, (3) propose in its initial rate proposal to continue rolling specified costs of transfer service into either power or transmission rates. The ARTS requires the transfer service customers to work with BPA to reasonably limit the cost of transfer service.

The ARTS also describes the intent of the parties to address other transfer service issues not expressly covered by the terms of the ARTS. These issues have been discussed with representatives of transfer customers and other interested parties over the last several months, resulting in the proposals outlined below. The ARTS identified seven issues related to transfer service for additional analysis. The issues were: (1) direct assignment guidelines, including low voltage services; (2) quality of service; (3) administrative roles and responsibilities; (4) ancillary service costs; (5) non-Federal power deliveries; (6) transfer service to annexed load (and by extension to new public customers); and, (7) transfer service for Block and Slice power sales agreements. BPA has identified an additional issue: (8) Additional FTE and costs to implement the ARTS.

The following proposed resolutions to these issues are most consistent with the Regional Dialogue interests. If adopted they would be reflected in the tiered rates methodology and the 20-year Regional Dialogue power sales contracts, other applicable contracts, or rate cases, where applicable. To the extent possible, BPA intends to implement resolutions to issues 1-4, 7 and 8 upon finalization of the Regional Dialogue policy rather than waiting until service begins under new Regional Dialogue contracts.

### **B. TRANSFER ISSUES**

#### **1. Direct Assignment Guidelines**

In consultation with transfer customer representatives, BPA is proposing to use the proposed supplemental guidelines, in conjunction with the transmission direct assignment guidelines, for customers served via transfer over non-Federal transmission facilities. Third-Party Direct Assignment Facilities are: "Facilities or portions of facilities that are constructed by the

Transmission Provider for the sole use/benefit of a particular Transmission Customer requesting service under the Tariff. Direct Assignment Facilities shall be specified in the Service Agreement that governs service to the Transmission Customer...” that either:

- a. Do not have characteristics comparable to characteristics used to define BPA’s integrated network segment; or,
- b. Do not support the reliability or efficiency of the transmission provider’s network for the general benefit of users of such system.

The supplemental guidelines are intended to help determine cost responsibility between BPA and the transfer customer in cases where BPA, in its role as a transmission customer, is subject to another provider’s tariff provisions for direct assignment of costs. The supplemental guidelines also clarify the cost responsibility for new facilities put in service by a third party that operate at voltages below 34.5 kilovolt (or the voltage equivalent of delivery facilities as defined by TBL). If directly assigned service over facilities of this type are not subject to the delivery charge defined in the General Rate Schedule Provisions, the cost of new facilities meeting this definition would be directly assigned to the customer. Finally, the supplemental guidelines state that the transfer customer would be responsible for wholesale distribution costs beyond the step-down substation, and BPA reserves the right to assess the GTA Delivery Charge when third-party transmission providers roll in costs that would normally be directly assigned by other providers.

**Bonneville Power Administration**  
**Supplemental Guidelines for Direct Assignment of Facilities Costs Incurred Under**  
**Transfer Agreements**

This set of Supplemental Guidelines augments the BPA Transmission Business Line’s (TBL’s) “Guidelines for Direct Assignment Facilities,” as amended or superseded (TBL Guidelines), currently posted at:

[http://www.transmission.bpa.gov/Business/Business\\_Practices/default.cfm](http://www.transmission.bpa.gov/Business/Business_Practices/default.cfm)

In determining whether to directly assign to Transfer Customers costs incurred by BPA in providing transfer service to the customer, BPA will apply the current TBL Guidelines for Direct Assignment Facilities, and these Supplemental Guidelines. The Supplemental Guidelines apply only to transfer service acquired by BPA from third party transmission providers for service to Preference Customers. The Supplemental Guidelines use some terms defined in the 20-year Agreement Regarding Transfer Service. Also, Direct Assignment Facilities, as defined in most pro forma Open-Access Transmission Tariffs, are:

“Facilities or portions of facilities that are constructed by the Transmission Provider for the sole use/benefit of a particular Transmission Customer requesting service under the Tariff. Direct Assignment Facilities shall be specified in the Service Agreement that governs service to the Transmission Customer. . . .”

These Supplemental Guidelines are designed to supplement, not replace, the TBL Guidelines,

and to assist in predicting how BPA, as the default transmission customer for transfer arrangements, will recover costs for Direct Assignment Facilities assessed by third party transmission providers. Unless otherwise specifically excluded in the TBL Guidelines or below, the cost of Direct Assignment Facilities will be passed through to the customer.

#### Supplemental Guideline Regarding Voltages below 34.5 kV

For new facilities or new service over existing third-party transmission provider facilities at voltages below 34.5 kV that meet the definition of Direct Assignment Facilities, metered quantities for customer deliveries will be adjusted for losses to the point where the voltage is at or above 34.5 kV, such that BPA is not responsible for losses across such facilities. Loss calculations should be similar whether the customer or the transmission provider owns the delivery facilities. The cut-off voltage of 34.5 kV is used in the TBL guidelines. If this voltage level is changed in the TBL guidelines, these Supplemental Guidelines will be modified accordingly.

#### Supplemental Guidelines Regarding Replacement with Higher Capacity Facility or Addition of a Transformer in Parallel

Pursuant to the TBL guidelines, for a new transmission provider-owned facility that also adds capacity, the costs that exceed the cost of replacing the previous capacity may be directly assigned to the benefiting customer. Alternatively, BPA and the Customer may agree to full Direct Assignment in lieu of payment of the GTA Delivery Charge. Similarly, when a parallel transformer is added, BPA and the customer may agree to a simplified direct assignment of all delivery costs in lieu of some combination of Delivery Charge and direct assignment.

#### Supplemental Guidelines Regarding Construction Options

The customer may work directly with the third party transmission provider to develop and select among options regarding construction, cost sharing and ownership. BPA will work with the customer and the transmission provider to arrive at the best one-utility plan, workable cost-sharing options and equitable ownership and interconnection arrangements. Due to regulatory issues, it is PBL's current policy to not own facilities.

#### **Additional Guidelines:**

##### 1. Rolled-in Rate Treatment by Transmission Provider

If a customer receives new transfer service below 34.5 kV offered by the transfer provider under a rolled-in rate or revenue requirement, BPA reserves the right to assess the GTA Delivery Charge. BPA will not charge the GTA Delivery Charge for a new POD if specific facilities' costs are not rolled in but are directly assigned to BPA and in turn passed through to the customer.

##### 2. Wholesale Distribution Facilities Beyond the Step-Down Substation

On any new arrangement for delivery below 34.5 kV, the incremental cost for use of any facilities (other than potential transformers or current transformers for revenue metering) beyond the fence of the corresponding step-down transformer substation (or beyond a 20-foot radius of the step-down, for pole-top substations) shall be passed through to the customer, whether such costs are directly assigned to BPA or are imposed pursuant to a discrete wholesale distribution

rate or Load Ratio Share of a discrete wholesale distribution revenue requirement.

3. Customer Arrangements Directly with the Third-Party Transmission Provider

A customer may choose to contract directly with the third-party transmission provider for delivery below 34.5 kV, but must then do so for all such POD's with that transmission provider, and must take delivery from BPA at or above 34.5 kV for these POD's such that the customer is responsible for losses through the delivery facilities.

**2. Quality of Service**

To help identify specific problems related to the quality of transfer service, representatives of transfer customers surveyed their members. Transfer customers identified three major issues that, in their view, result in a lower quality of service:

- a. Communications among BPA, third party transmission providers and transferees (insufficient operational communications) resulting in less than optimal understanding of service restoration actions and priorities;
- b. Aging facilities owned by third-party transmission providers (excessive outages, slow restoration of service, voltage fluctuations); and
- c. Metering.

BPA would continue to act on behalf of transfer customers to ensure service fulfills established contracts and tariffs. BPA would seek to include the following in new or follow-on transfer contracts:

- a. Formalize communications between the three parties.
- b. Document communication standards (or protocols) in the transfer agreements.
- c. Take a more proactive role in working with third-party transmission providers during the planning of local transmission facilities, new or changes to existing metering, and seek to allow transferee participation.
- d. Work with third-party transmission providers to remedy existing localized problems with aging facilities and/or other known or potential operations issues.

BPA would seek to ensure that customers' needs are met and that customers are treated as well as the transmission providers' native loads. BPA's ability to make transfer service exceed the quality of service offered by the transmission provider to its native load is limited, and communication protocols under pre-FERC Order 888 transfer agreements are not always clear. BPA would bring its technical expertise to the discussion whenever the opportunity arises to ensure that solutions to service quality issues are fairly evaluated by all parties.

### **3. Administrative Roles and Responsibilities**

The complexity of day-to-day implementation of transmission services has evolved over the past 10 years. For example, more precision regarding scheduling of generation and loads is required by transmission providers in return for use of their systems. For BPA, this has meant additional requirements to accurately predict transfer customers' loads and schedule sufficient generation through third-party transmission providers to serve those loads.

Customers need to commit to the following:

- a. Provide as much advance notice of significant long-term load or resource changes (up or down) as possible to minimize punitive costs charged to BPA. Advance notice provides for better short and long-term planning.
- b. Attend annual Network Operating Committee meetings with transmission providers and BPA.
- c. Communicate with BPA on a regular basis on issues relating to changes in service territories, facility expansions, and changes in generation and new Points of Delivery (POD) requirements.

Transfer customers were keenly interested in who should hold the transfer contract with a third-party transmission provider. The ARTS expressly left open the prospect that the customer could be the contract holder. BPA would then reimburse the customer for qualifying expenses incurred under that contract. BPA recognizes that the best choice may be for customers to hold their own transfer contracts and that assignment language should be included in transfer contracts if and when they are renewed or converted to OATT service, if practical to do so. BPA would need a process to reimburse customers holding their own transfer agreements for Federal power and qualifying non-Federal power. Arrangements would have to provide significant limitations on BPA's cost exposure and clearly designate that customers bear the risks and responsibilities associated with the service. BPA is not making a decision at this time whether the customer should be the contract holder.

In some locations, there is a potential for shifting all or a portion of a customer's load from transfer service to directly connected service. In the interest of lowering transfer costs and improving reliability, BPA would work with the customers on a case-by-case basis to investigate the potential, feasibility, and economics of the customer making system additions that would allow for shifting load from transfer to directly connected service. Any plan for shifting load that involves an interconnection to BPA facilities must comply with the tariff requirements for new interconnects. BPA would retain discretion to participate in any plan for shifting load, and the customer may be responsible for any stranded cost caused by the load shift. Also, in the interest of cost control for transfer service, BPA would avoid plans of service or other arrangements that would change existing directly connected PODs to transfer service PODs, except in extreme circumstances.

#### **4. Ancillary Service Costs**

On a general basis, BPA would continue to be responsible for the costs of ancillary services assessed by a transferor for wheeling Federal power. Transfer customers would continue to pay for ancillary services that are not also provided under their BPA transmission contract. For customers required to purchase regulation and frequency response from a third-party provider, BPA would compensate the third-party transmission providers, directly or indirectly. BPA proposes that the customer reimburse BPA at regulation and frequency response rate as posted in the BPA Transmission and Ancillary Service Rate Schedules. Transfer customers without load matching service under their Subscription contract (such as Slice customers) would continue to reimburse BPA. It is important to note that BPA is subject to WECC rules and in the event the WECC's rules change with regard to the obligation to acquire ancillary services, and the customer is no longer required to procure these products from the TBL, the BPA reserves the right to pass through the costs assessed by the transferor for these products directly to the customer.

#### **5. Payment for Delivery of Non-Federal Power**

Transfer service should not unnecessarily bias a customer to buy only Federal power to avoid the additional cost of wheeling over third-party transmission facilities. Similarly, BPA should not use transfer service as leverage to induce customers to buy Tier 2 power from BPA, if practicable. That would be contrary to a fundamental goal of Regional Dialogue, which is to encourage customers to find their best fit of resources to serve their loads based on their own objectives and policies. Therefore, BPA proposes some level of financial support for the transmission of non-Federal energy deliveries under transfer service contracts held by BPA or the customers, under certain conditions. Non-Federal resource deliveries that BPA would financially assist are those used to serve a customer's net requirement load beyond the customer's HWM amount. The customer must designate the resource that will be relied on to serve such load and meet the eligibility requirements as follows:

- a. The transfer customer has historically been served under arrangements between BPA and a third-party transmission owner.
- b. The transfer customer must use the Federal Columbia River Transmission System (FCRTS) in combination with third-party transmission service.
- c. The third-party transmission service is from the FCRTS to the transfer customer's native loads.
- d. The third-party transmission service delivers power only to Points of Delivery of the transfer customer's service territory that existed as of October 1, 1996.
- e. The third-party transmission service is over facilities equivalent in function and voltage level of the FCRTS Integrated Network Segment.

If firm transmission capacity is not available between the third-party transmission system, or the FCRTS, and the customer's load area, BPA may consider other options on a case-by-case basis.

BPA further proposes capping the costs for the transfer of non-Federal energy at increments of 30 MW or \$800,000 each year in total for all customers, not to exceed a total of 600 MW or \$16 million for the term of the 20-year Regional Dialogue contract. BPA would not pay nor reimburse a transfer customer for delivery of non-Federal power to the FCRTS. BPA would pay the transmission network charges for non-Federal transmission wheel(s) that leaves the FCRTS. BPA would not cover losses for non-Federal power. This is comparable treatment to those customers that are directly connected to the FCRTS and purchase non-Federal power.

This policy would not totally remove pan-caking transmission costs where the acquired non-Federal resource does not travel over a portion of the FCRTS. However it would provide comparability with directly connected customers.

Currently Section 36 of BPA's Open Access Transmission Tariff provides a mechanism for supporting some transfer cost associated with non-Federal deliveries. Section 36 is subject to the outcome of future rate cases or subsequent tariff filings. The decision to cover future costs of non-Federal deliveries under Section 36, or another form of rate treatment, is not part of this proposal and is an issue for future rate cases.

## **6. Transfer Service for Annexed Load**

BPA would arrange and pay for the network component for Federal power deliveries under transfer service contracts to serve a new public load, or an existing transfer customer's annexed load, acquired after execution of the Regional Dialogue power sales contract under the following conditions. BPA would arrange and pay for transfer service for annexed loads upon written confirmation from the gaining and losing utility that they both agree to the annexation. BPA's provision of transfer service should not influence the annexation outcome. Without written confirmation, BPA would start providing transfer service for an annexed load only after final action by a court or state regulatory authority, or when a state agency clearly assigns the right to serve the annexed load.

The overall amount of additional transfer service provided for annexed loads and new publics ("Transfer Service MW cap") would be capped at 50 aMW for each rate period, with a limit of 250 aMW during the term of the Regional Dialogue contracts. This is a separate cap for transfer service, which is different and would be tracked separately from the overall Regional Dialogue cap on new publics. In addition, transfer service costs related to annexed loads or new public loads that are \$7/MWh, or above, would be arranged and paid for by the transfer customer. Existing Subscription customers may request BPA arrange for service that is \$7/MWh or above, however all costs would be assigned to the customer. Small annexed load or new public additions of less than 1 aMW, and annexations of loads that were previously served by BPA's Power transfer service, would not be counted against the transfer service aMW cap, but these loads would be subject to the \$7/MWh cost cap. The transfer service aMW cap would be implemented on a first come, first served basis. BPA would not arrange or pay for transfer service for annexations or service to new public load in excess of the 50 aMW/250 aMW cap. If a customer accepts any responsibility for transfer costs, that responsibility would continue for the full term of its long-term, post-2012 power sales contract.

Existing Subscription customers that are currently arranging and paying for transfer service may request that BPA arrange and pay for transfer service for the post-Subscription period. BPA



would need to hold the agreement to be eligible for this new service, post-2012, unless both the customer and BPA agree to other arrangements.

#### **7. Transfer Service for Block and Slice Power Sales Agreements**

Transfer services were, and continue to be, load service arrangements for delivering Federal energy to the load of customers not directly connected to the BPA main grid. The services acquired by BPA to provide electric power to customers do not include deliveries that exceed a customer's total retail load on an hourly basis. Therefore, acquiring and paying for transmission service to deliver energy in excess of a customer's net requirements is beyond the scope of transfer service.

#### **8. Additional Staffing and Projected Costs to Implement ARTS**

To implement the ARTS and increase the quality of service customers seek under transfer service, BPA is proposing the need to increase staffing. BPA's anticipated increased staffing needs with incremental projected costs over the 20-year contract term are approximately \$500,000 annually at today's cost. The following areas of service identified for improvement include:

- a. Customer Engineering Services for improved quality of service/best utility practices/review of transferor projects.
- b. Implementation and ongoing administration of cost reimbursement if and when a customer holds the transfer agreement.
- c. Scheduling and tracking non-Federal, Tier 2 power purchases and HWM compliance.
- d. Implementation and administration of Assignment Guidelines and billing.

## **X. RESOURCE ADEQUACY**

### **A. BACKGROUND**

BPA and the Northwest Power and Conservation Council have initiated the Regional Resource Adequacy Forum consisting of a technical committee and a steering committee. The goal is to establish a Resource Adequacy (RA) Framework for the Pacific Northwest to provide a clear and consistent means of determining if the region has adequate deliverable resources to meet its loads reliably and to develop an effective implementation framework. Such a framework is particularly important in light of the Regional Dialogue policy direction to limit BPA's footprint in the region by establishing tiered rates and providing customers a choice to acquire resources to meet future load growth. As BPA reduces its role in acquiring new resources, BPA must be reasonably assured that the region will continue to have an adequate supply of resources. This requires that BPA's customer utilities have a common understanding of what constitutes resource adequacy and procure adequate resources to meet their load not served by BPA.

The region must be aggressive in developing and implementing a resource adequacy standard. BPA views a sustainable RA framework as vital to the public interest, especially since the agency would not be the short-term default supplier if others fail to develop deliverable resources to meet their loads given the proposed 3-year notice provision for Tier 2 power purchases from BPA.

The forum's accomplishments to date include:

1. Adoption of the following principles (in summarized form) to guide the forum:
  - a. It is important to have regional RA metrics and targets;
  - b. An assessment mechanism to determine whether the regional RA metrics and targets are met is necessary and should include a reporting process; the regional assessments provide transparency and also allow individual utilities to assess themselves with respect to their position in the region;
  - c. There should be some reasonable mechanism to assure that the regional metrics and targets will be met going forward; and,
  - d. Jurisdiction of states or prerogatives of individual utilities in planning and acquiring resources to meet load must be respected.
2. The Northwest Power and Conservation Council adopted a RA energy metric and target in the form of an average annual load resource balance on May 10, 2006. The energy standard is described at the following link: <http://www.nwcouncil.org/library/2006/2006-5.pdf>
3. Agreement in principle on a capacity metric in which resource capability is measured in the form of sustained peaking capacity. This metric and target will also be the subject of broader regional review.
4. Ongoing discussions of how the third and fourth principles can best be met (assurance that adequacy standards will actually be met, but without trampling on the prerogatives of utilities or states). The following outline describes one approach being explored by the Forum.

#### PHASE I:

- Adoption of regional RA energy and capacity metrics and targets by the Northwest Power and Conservation Council pursuant to which the region's utilities agree to define how resource adequacy is assessed.
- Establishment of a confidential reporting process using Pacific Northwest Utilities Conference Committee's (PNUCC) existing process; individual utilities would provide data on their forecasted loads and resources on an annual basis.
- Performance of aggregate regional RA assessments of agreed-upon targets based on reported information.
- Definition of actions if assessments indicate targets are not or may not be met.

#### PHASE II:

- Development of non-binding guidelines for translating regional metrics and targets for individual utilities; and,
- Development of incentives for developing adequate resources.

Although the effort is not done, BPA believes that the Regional Resource Adequacy Forum has made good progress. The extent of utility buy-in and commitment to timely completion of standards and implementation mechanisms is currently unclear. A successful effort would eliminate the need for mandatory resource adequacy standard compliance as a provision in power sales contracts – which neither BPA nor its customers see as the preferred alternative. This contract-based alternative cannot be ruled out until the forum's work is completed. BPA is not including a proposal for a mandatory standard compliance provision in the power sales contract now but would revisit this if the adequacy standard development effort fails to reach consensus on sustainable RA standard and implementation approach by the publication date of the Long-Term Regional Dialogue Policy and ROD.

### **B. RESOURCE ADEQUACY PROPOSAL**

Under the assumption that the standards and implementation approach are completed before contract negotiation begins, BPA proposes the following limited contract and rates provisions:

#### **1. Data Provision**

Customers would agree in the new Regional Dialogue contracts to provide data on a confidential basis for regional resource adequacy assessments to a neutral third party, such as the Pacific Northwest Utilities Conference Committee (PNUCC). Load following customers who purchase all their power supply from BPA would be excluded from this requirement as BPA would provide data for them.

#### **2. Clear Responsibilities**

The Regional Dialogue contracts would clearly delineate between power a customer commits to buy from BPA and power the customer commits to supply from other sources, including which party, BPA or the utility, would have responsibility to serve load growth. Customers would acknowledge their responsibilities for power amounts

they commit to procure from sources other than BPA requirements power priced at Tier 1 or Tier 2 rates.

**3. Notice Provisions**

A default Tier 2 rate power service product would include a minimum notice requirement of three years to purchase or to stop purchasing the Tier 2 rate product. This notice period is consistent with the planning horizon for which the key resource adequacy assessment is performed in the regional forum. This notice provision means that BPA would not be the short-term supplier of last resort, if a customer fails to secure resources to meet its load growth either through a Tier 2 rate power purchase, or through procurement of non-Federal resources. The customer would have to arrange a short-term purchase from the market to cover its load in the short-term.

## **XI. LONG-TERM COST CONTROL**

### **A. INTRODUCTION**

#### **1. Why a Cost Control Process Is Needed**

BPA customers have a reasonable expectation that they will have significant input into cost decisions, since they will be signing 20-year, take-or-pay contracts that obligate them to pay the costs, even in the event BPA rates go above market prices. Other stakeholders have strong interests in BPA's cost decisions as well. BPA welcomes the enhanced accountability created by public scrutiny of its cost management and has found that fresh eyes applied to decisions through public review can lead to new insights that improve decisions.

#### **2. Recent History**

BPA has a long history of public involvement in its decision making, including setting cost levels. Since the power rate increases in 2002, BPA has significantly increased the transparency of its decision making and the transparency of its costs and cost management. Such transparency efforts include the Power Function Review, TBL's Programs in Review, monthly financial reviews sponsored by the Public Power Council, the Customer Cost Collaborative, the Constituent Collaborative, the Sounding Board review in 2004, the Financial Choices process in 2003 and the General Manager Workgroups in 2003. While these efforts have been well-received, many customers want even greater opportunities for input. They want an approach that provides good information about costs before and after decisions on cost levels are made, creates strong accountability for BPA and resource agencies responsible for BPA's wholesale power supplies (U.S. Corps of Engineers, Bureau of Reclamation, Energy Northwest, Northwest Power and Conservation Council) (Resource Agencies) to manage to established cost levels and gives them some recourse in the event BPA staff disagrees.

#### **3. Goal**

The goal is to develop a cost control process that meets the above needs in a manner consistent with statutory requirements, while staying consistent with the Regional Dialogue's simplicity interest and without adding excessive administrative costs and without delegating decision making authority on costs and programs to third parties. This includes continuing to build cost management accountability by providing regular information on the extent to which BPA and the Resource Agencies are managing their costs as well as informing the region of cost issues that apply to future periods.

#### **4. Key Cost Control Concern**

BPA will not delegate decision making authority on costs and programs to third parties. But it can make its decision making and cost information open and transparent with ample opportunity for input.

### **B. ALTERNATIVES CONSIDERED**

In its Concept Paper, BPA proposed a Cost Management Group (CMG) (or groups) as the best way to meet the cost management process goal. Through the subsequent Regional Dialogue discussions, a workgroup further refined the CMG proposal. Increased specificity pointed to

other issues that needed more discussion. A separate subgroup of senior customer representatives and other stakeholders met to discuss and resolve the outstanding issues with the CMG proposal. The concerns described below emerged in those discussions. Other cost control alternatives were proposed and discussed. Three alternatives attracted the most support: (1) a Regional cost review (RCR) process that would be an enhancement of the Power Function Review process; (2) the Cost Management Group; and (3) inclusion of costs in BPA's rate proceedings.

## **1. The Regional Cost Review (RCR)**

- a. The RCR would address all agency capital and expense costs and would replace the Power Function Review (PFR) and TBL's Programs in Review (PIR).
- b. This review would examine all costs and major policy decisions that affect costs and explore potential alternatives.
- c. The review would feature long- and short-term aspects of cost management and control.
- d. The review would be ongoing and would include intense focus on rate period costs immediately in advance of rate cases.
- e. When not reviewing costs, the RCR would focus on long-term cost trends and implications for both expense and capital programs. These review discussions could occur monthly or quarterly.
- f. BPA would, to the extent practicable, bring major issues that can affect short- and long-term costs to the RCR forum for input before a BPA decision.
- g. BPA would develop detailed cost information (for example, multi-year cost forecasts of capital and expense), including analysis of impacts of alternative spending levels and policy decisions.
- h. The RCR would be open to all interested parties and would be structured to facilitate both technical input and manager-level input.
- i. BPA and the Resource Agencies would supply information necessary for participants to render quality input, limited only by proprietary issues and the goal of not becoming overly administratively burdensome.
- j. BPA would actively coordinate and encourage the participation of Resource Agencies.
- k. The process would be structured to facilitate regional consensus-building around best choices.
- l. BPA and the Resource Agencies would retain final decision authority.

- m. In the event of significant disagreement with a proposed BPA decision, recourse would be provided in the form of informal debate before the Administrator. Any participant could propose specific issues for debate. BPA would endeavor to schedule time for debate of all suggested issues. In the event of time constraints, BPA would prioritize issues in consultation with participants, taking into account such factors as overall level of interest of participants and financial impact of issue involved.
- n. BPA would establish the RCR through a separate policy decision.

## **2. The Cost Management Group (CMG)**

The CMG would have the same features as the RCR, but with the following differences:

- a. Membership in the CMG would include defined numbers of representatives from each of several customer and non-customer interest groups. These members would be selected either by the interest groups themselves or by BPA.
- b. Other interested parties could attend meetings and provide input on costs directly.
- c. The CMG would provide input on costs as a group after reaching consensus on issues.
- d. Members would serve for a minimum 2-year term.
- e. Recourse in the case of disagreement between the CMG and BPA would include a third-party panel of knowledgeable people who, in the Administrator's presence, would listen to the various positions on an issue and provide a written recommendation to BPA.
- f. Final decision authority would remain with the BPA Administrator.

## **3. Inclusion of Cost Levels in BPA Rate Cases**

- a. Like other issues in BPA rate proceedings, the level of costs to be included in rates would be subject to testimony, clarification, and rebuttal, cross examination, oral argument and BPA decision.
- b. Only parties to the rate case could provide comments on the cost projections.

## **C. ASSESSMENT OF ALTERNATIVES**

The Regional Dialogue subgroup addressing these alternatives did not conclude which is best. All three of these alternatives go well beyond anything BPA has done historically in BPA cost reviews.

### **1. Advantage of both RCR and CMG**

Either of these would be extremely powerful and would provide significant incentive for BPA to provide transparent information and exercise prudent cost control:

- a. The RCR and CMG would magnify the impact of public input by making it part of a highly visible well-attended and continuous process.
- b. Decisions that drive costs would be addressed well before rate cases.
- c. Either would continue and build on the recent development of a strong base of understanding of BPA costs already attained through the PFR and PIR. This would make input more informed and therefore more valuable and effective.
- d. Either would provide for formal debate on contested issues provides recourse in the event of disagreement, without running afoul of legal prohibition on BPA yielding decision-making authority.

## **2. Advantages of RCR over CMG**

- a. In regional discussions of CMG, it became apparent that deciding how many seats each interest group would have on the CMG would be highly contentious, as would selecting individuals for those seats. Both states and tribes, for example, are sovereigns that are generally not willing or able to be represented by another person or entity on such a body.
- b. Although the CMG meetings would likely be open to the public and would not be the exclusive means to provide input to BPA, the selectivity of membership would not be as conducive as the RCR to open regional sharing of views on major cost issues.
- c. Some interest groups and individual utilities are highly affected by particular decisions and have a legitimate interest in providing strong and direct input on those decisions. The RCR is more conducive to such self-selection on strength of input.

## **3. Advantages of CMG over RCR**

- a. A group with defined and limited membership such as the CMG could have more incentive to reach compromise agreements on difficult issues.
- b. If the CMG were able to reach consensus on major issues, its views would have considerable weight.

## **4. Assessment of Inclusion of Costs in BPA Rate Cases**

Although BPA cost decisions are inputs to BPA's cost of service in rate cases, the cost decisions are not issues in the rate case. Some customers see significant advantages to this alternative, mainly because it puts these decisions into a formal and structured decision forum, creating more accountability. BPA recognizes this advantage, but sees other disadvantages that outweigh it. These include: failure to address cost levels in advance of the rate case when they are most subject to influence; lengthy rate proceedings which are generally adversarial and complex; reduced public visibility of the process; full access to the process only by rate case parties; loss of the collaborative nature of the other two alternatives; loss of participation by manager-level representatives of customers and other groups; and, the potential for exposure of program cost decisions



to litigation and FERC review. In addition, BPA continues to believe rate cases are not the appropriate forum to make programmatic decisions.

#### **D. BPA'S PROPOSED ALTERNATIVE: REGIONAL COST REVIEW**

BPA believes the above-described Regional Cost Review process would be the best cost control process. It shares most of the advantages of the CMG process but lacks the feature of selecting a limited numbers of representatives of each customer subgroup and non-customer interest group. As the CMG proposal was further explored, this feature appeared increasingly problematic as described above. The RCR should be nearly as powerful a public input forum, but without equity issues connected with electing members and deciding on voting rules. It provides opportunity for equal participation and involvement without an appearance of exclusivity. The RCR also consolidates existing cost review forums. While embracing many of the successful aspects of recent cost review processes, this also expands the process to include ongoing and long-term components and opportunities to debate areas of disagreement in front of the Administrator. To be effective, the RCR will require sustained commitment and investment of time by participants.

In addition to the RCR, BPA proposes to continue providing frequent additional opportunities to stakeholders to review BPA's ongoing financial performance. BPA would continue to discuss on-going financial performance, cost drivers and cost management efforts in the following forums or their successors:

- Customer Collaborative
- Constituent Collaborative
- Public Power Council-sponsored quarterly technical meetings

Though for administrative efficiency, BPA would try to concentrate the discussion in the RCR forum, BPA would also discuss cost management and financial performance with other interested groups. BPA is committed to ensuring regular access to clear and transparent financial information and frequent opportunities for meaningful input into BPA cost and program decisions.

#### **E. CONTRACT OFF-RAMPS**

In the Concept Paper, BPA proposed that customers would have an aggregate 15 percent off-ramp to remove a portion of their load service from BPA in their contracts that they could exercise if BPA failed to meet its cost targets or if costs escalated beyond a defined rate. To some extent, this was not viewed as a sufficient deterrent to BPA to affect cost control, and it may lead to higher Tier 1 rates. Ensuing discussions made it clear that most customers did not place a high value on off-ramps as proposed in the Concept Paper. In view of this, and because off-ramps would add complexity and cloud the certainty created by the long-term contracts, BPA is proposing to drop this off-ramp feature from its proposal.

## **XII. DISPUTE RESOLUTION**

### **A. INTRODUCTION**

The overall Regional Dialogue Policy Proposal is aimed at giving BPA and its customer's certainty, stability, and durability over the 20-year contract period. Nevertheless, despite the best attempts of BPA, its customers and other stakeholders to implement all elements of the proposal in a clear and unambiguous fashion, it is still realistic to assume disputes will occur. Many details cannot be determined until rates are established and power sales contracts are written. BPA recognizes that many customers would like a specific and known dispute resolution process that applies uniformly, and this is an understandable desire. However, it would be disingenuous of BPA to suggest such a process is possible at this point or that a single process can be used to resolve all disputes.

Disputes vary in nature ranging from debates over interpretation of facts to disputes of judgment or interpretation of intent. Some involve policy judgments, issues of law or factual or technical determinations. The scope can range from narrow and discrete issues affecting a small set of parties to hugely complex and judgmental issues affecting many parties. Some issues will create precedent, while others will not. Subjects are as varied as the application of tiered rates and high water mark methodologies, cost migration between the rate tiers, Federal resource size, matters of cost recovery, reliability, resource operation, environmental significance and more. Because of these huge variations, a one-size-fits-all dispute resolution process would not be workable or likely legally enforceable. If it is to be effective and equitable, dispute resolution should be tailored to the type of dispute, the issues, and parties involved.

It is BPA's intent to approach disputes in good faith and to engage in resolution processes that provide the maximum simplicity, clarity and equity while still respecting BPA's statutes and the Administrator's legal responsibilities. While BPA wants to develop and implement expedient, efficient and fair dispute resolution mechanisms, this does not mean that any or all disputes would be subject to one means of resolution, such as arbitration. For example, there are clear instances where statute dictates the Administrator must retain his/her authorities to make determinations, and this obligation cannot be legally ceded. In addition, it is important to recognize that few disputes will be matters of private concern between BPA and a customer or group of customers; rather, since, BPA is self-financing, most disputes will at base concern the issue of cost and benefit allocation among BPA's various customer groups.

There are however principles, criteria and factors that BPA can lay out at this time that will help define a clearer direction for future dispute resolution, and these are discussed in greater depth in this section.

Overall, BPA proposes that its contract could empower the rate case hearing officer in specified cases to make a determination as to whether any BPA-proposed rate change is a contractually prohibited change. Such determination would be binding on the Administrator except in matters where the change was necessary because the Administrator could not otherwise reasonably recover BPA's costs or comply with a court order. For certain issues of a narrow and purely factual nature, BPA is proposing resolution by a neutral third party. For other identified issues,

BPA is proposing to continue the current practice of administrative determination by BPA, with the possible exception of identifying certain neutral sources of information that BPA must rely upon. These issues are discussed more fully below.

## **B. BPA'S BASIC SERVICE OBLIGATION AND THE NEED FOR A RATIONAL ECONOMIC ALLOCATION**

Prior to passage of the Northwest Power Act, BPA served as the statutorily designated marketing agent for the power output of the Federal dams constructed by the U.S. Corp of Engineers and by the Bureau of Reclamation in the Pacific Northwest. The Northwest Power Act was passed in order to avoid the need for an administrative allocation of that power, and ensuing litigation, when it appeared that demand would far outstrip the low-cost supply from the dams. The Act expanded BPA's load-serving responsibility substantially by placing a duty to serve on BPA, and gave BPA the means to meet that load service obligation by acquiring resources, including conservation. More specifically, under section 5(b)(1) of the Act, whenever requested, BPA must offer to sell Federal power to meet the regional firm load of a public agency, or investor-owned utility, net of the customer's resources used prior to 1980 to serve its load and its post-1980 resources declared to serve its firm load. Under section 6(a)(2) of the Act, BPA is obligated to acquire resources, in addition to making short-term purchases (up to 5 years), to meet its firm contract obligations under section 5 (16 U.S.C. § 839d(a)(2)). The Act does not permit BPA to "allocate" power, except in the extreme circumstance of a power insufficiency. Rather, BPA is obligated when requested to serve the loads of each utility customer not served by the utility's own resources; that load is referred to as customer's net requirements.

Experience has shown that BPA's open-ended supply obligation and current pricing structure create significant risks of cost increases and price hikes for BPA's power. BPA's proposal addresses these risks and proposes a much more certain and predictable construct, not by trying to change BPA's statutory power supply responsibilities, but by focusing on a more rational pricing structure. Clarity about the amount of power BPA would provide at what price in the future enables market participants—purchasers, marketers, and developers—to understand their economic choices and to better pursue rational economic investment alternatives. Thus, BPA developed the basic concept of limiting its sales of firm power at its lowest-cost-based rates to not exceed approximately the firm capability of the existing Federal system, and of providing additional retail load service at a higher rate that reflects the marginal cost of purchasing power to meet those additional loads. This is fundamentally designed to "encourage regional actions that ensure adequate, efficient and reliable power service."

The pricing construct that BPA has articulated—in part a matter of which costs should and would be allocated to which class or subclass of customers—would involve an exercise of the Administrator's rate design discretion under Northwest Power Act Section 7(e) to provide efficient pricing signals, consistent with the cost allocation and other requirements of Section 7. At the same time, Section 7(a) provides that the Administrator shall establish, and periodically review and revise, rates to assure recovery of BPA's costs and repayment of the U.S. Treasury over a reasonable number of years. Hence, the Administrator must establish the long-term pricing methodology so that it allows for periodic reviews to assure that the methodology is working in a fashion that assures BPA's recovery of costs and repayment to the Treasury. BPA

believes it can establish, and obtain approval of a Tiered Rates Methodology for 20 years. Beyond that, there is general agreement that purchase power rights and attendant power rates must be secured in a fashion that is durable and predictable (i.e., long-term), and thus subject to change only when necessary, based on pre-specified criteria. Effective communication protocols and dispute resolution mechanisms such as mediation and arbitration will be necessary to ensure that BPA and other participants in this new regime abide by what they conceive as “the deal.”

### **C. PROPOSED CRITERIA FOR CONSIDERING ALTERNATIVE DISPUTE RESOLUTION**

As a preliminary matter, BPA agrees that it should first focus on efficient and effective processes for customer, constituent and stakeholder input into decision making, so that there is less need for and focus on alternative forms of dispute resolution. After that, numerous considerations should be taken into account in determining how disputes should be resolved. No single type of process necessarily fits all disputes. Disputes should be identified for resolution in a particular process only when the implications and consequences of that approach are thoroughly thought out, both for issue areas individually and as part of the entire structure of issues that could be at play.

Based on Department of Justice and other literature, major, generic considerations that should be taken into account are as follows:

- a. Important policy judgments necessary to interpret and administer Federal statutes and regulations must be retained by the Administrator and not turned over to a third party for final resolution.
- b. Alternative dispute resolution (ADR) can be most useful in disputes which are highly fact specific, and in which the decision is likely to be single issue and quantitative. Arbitration, mini-trials and determination by a hearing officer are examples of ADR.
- c. ADR may also be attractive when the dispute is highly factual or technical and the parties can pick a decision maker with mutually accepted expertise, thus obviating the need to educate the decision maker to reduce technical arguments.
- d. Arbitration is also useful when finality is a desired result, and there is little concern over the risks or costs of remedies impacting other parties (for example, resolving a small dollar figure dispute that has been ongoing for a long period).
- e. ADR should be seriously questioned when:
  - o a definitive or authoritative resolution of the matter is required for precedential value, and a binding third-party determination is not likely to be accepted by all interested parties generally as an authoritative precedent;
  - o the matter involves or may bear upon significant questions of government policy that require additional procedures before a final resolution may be made, and a

binding third-party determination would not likely serve to develop a recommended policy for the agency;

- maintaining established policies is of special importance, so that variations among individual decisions are not increased, and a binding third-party determination would not likely reach consistent results among individual decisions;
- the matter significantly affects persons or organizations who are not parties to the proceeding; or
- a full public record of the proceeding is important, and a binding arbitration proceeding cannot provide such a record.

In the context of BPA's proposed policy, certain more specific considerations are particularly important to BPA:

**First**, BPA must ensure that it maintains the ability to, and does, fully recover its costs and repay Treasury; it must also retain the ability to demonstrate that over time its rates and cost allocations are consistent with statute.

**Second**, there will be many instances where a determination is common to all Tier 1 or Tier 2 customers, or affects all or many of them in some fashion. BPA's past practice of melding all costs had the effect of dampening the effects of many BPA actions. That will no longer be the case since Tier 1 will essentially be a zero sum game. For example, resource removal, net requirements determinations and FBS capability determinations are decisions that will potentially affect all customers but have different impacts and consequences for each customer eligible to purchase at Tier 1.

**Third**, determinations regarding system and operational characteristics are highly technical, often changing, and judgmental. These are not the kind of decisions that should be entrusted to an adversarial process.

**Fourth**, process should not unduly delay efficient, economical, and reliable operation of the system. Timely decision making needs to be preserved, particularly in the areas of emergencies, operating decisions, and cost recovery. Process paralysis must be avoided.

**Fifth**, BPA, its customers and constituents should not be forced to repeatedly expend significant resources in arbitrations and other proceedings. Efforts should continue to be devoted to seeking consensus on the type of process to be pursued, and when.

**Sixth**, the consequences of a decision must be such that there is no inequitable shifting of costs to customers not party to the dispute resolution process.

**Seventh**, BPA must ensure that its stewardship obligations (e.g., fish and wildlife, tribal trust, treaty) are not frustrated or compromised by processes for resolving disputes.

*Eighth*, the need for dispute resolution by third parties is stronger where BPA is acting in its business interest (e.g., say it wants to be the preferred supplier for a Tier 2 product), rather than in the public interest.

One-size dispute resolution does not fit all disputes. The criteria and considerations above should be flexibly applied so that the dispute resolution process fits the particular issue. Also, the criteria and considerations should not only be considered and applied at or around the time the parties are deciding what should be said in the 20-year contracts and the Tiered Rates Methodology regarding dispute resolution, but should also be considered when unanticipated disputes arise and a decision is needed regarding how they should be resolved.

## **D. PROPOSED DISPUTE RESOLUTION FOR TIERED RATES CONSTRUCT**

Apart from the construct of tiered rates itself, there are a number of elements to the construct that, if changed, could cause the overall construct to fail and, with it, the predictability and certainty the region is seeking. These are identified below, with an indication of how greater certainty might be achieved. Decisions on these and other matters should, as appropriate to the issue, be made through this process, public contract negotiations and attendant rate cases.

### **1. The Overall Construct**

To address the concern that BPA statutorily can and, in certain situations, must change its rates, BPA could in the rate itself state that the overall construct of tiered rates would not be abandoned or changed for a period of 20 years, that each customer's contract would include a guarantee against identified changes, and that the contract would provide for a binding process to ensure that the guarantee was enforceable. The protection would be subject to very narrow qualifications that, notwithstanding the contractual guarantee, the identified changes could be made if and to the extent (a) BPA were effectively required by court order to make them, or (b) the Administrator determined he/she could not timely and reasonably recover BPA's costs without the change. Criteria should be specified for actions that the Administrator should or must pursue before resorting to a change in the tiered rates construct, or an element of it, to ensure cost recovery. These criteria or disputes over them should not be allowed to frustrate the Administrator's responsibility to recover costs and timely repay the U.S. Treasury.

The contract should clarify that it is the parties' intent to structure a durable commercial relationship based on existing statutory requirements, and to provide customers as much protection against change in those requirements as possible. However, BPA would not warrant or represent that the contract is immune from subsequently enacted legislation.

Given the rates nature of the construct, any BPA proposed change to the construct would have to be done through a rate case. Therefore, BPA's contract could provide that the hearing officer would be empowered to make a determination as to whether any proposed change was a contractually prohibited change. The determination would be binding on the Administrator except where the Administrator has determined, after a mini-trial directly to the Administrator within the rate case, that the change was necessary because BPA could not reasonably recover costs or comply with court order without the change. BPA cannot lock itself into any pricing scheme that precludes full and timely cost recovery.

## **2. Eligibility and Allocation**

BPA's rate setting directives identify rate pools, generally specifying which customers may be allocated which costs. Section 7(e) of the Act affords the Administrator latitude in the rates design to recover the costs from a class or one or more subclasses. Hence, under the current construct, Tier 1 rates would be available for customers with a high water mark and, within that, their net requirements. Tier 2 would be available for net requirements in excess of a customer's HWM. BPA could in the rate itself state what each customer's HWM is, and that the HWM would be included in the customer's contract and not subject to change except in contractually identified ways. The rate could also refer to net requirements as determined in a separate process. These eligibility features and the design of the rate methodology around these features—HWM and net requirements—would be subject to the qualifications and process for determining whether BPA is changing them, as identified above with respect to the overall construct. Apart from these kinds of fundamental changes to the construct of HWM and net requirements as eligibility and cost allocation determinants, HWM and net requirements are subject to many possible year-to-year variations. These are next discussed.

## **3. Subsequent Net Requirement Determination**

As indicated above, a customer's initial net requirements and the construct of relying on net requirements as an eligibility factor would be contractually locked in, subject to change for two specified circumstances. The focus is on BPA's determination of subsequent changes in a customer's net requirements. Customers have asked for an open and transparent process for determinations of net requirements, which define BPA's service obligation and are based on statutory requirements. A similar but not necessarily identical method to that contained in the current contracts would be used to make a periodic net requirement determination. The net requirement determination would involve at least the following elements:

- a. A utility's current retail load and its forecast load.
- b. Non-Federal resource declarations. This includes the annual and monthly energy amounts and any changes to non-Federal resource amounts (plus or minus).
- c. Consumer-owned resources. This includes the listing of consumer-owned utilities, changes to such information, and consequences of the listing and changes.
- d. Decrements to net requirements under section 9(c) of the Northwest Power Act.
- e. Non-Federal resource changes under contract and any pursuant to section 5(b)(1) of the Northwest Power Act (e.g., consent of Administrator, obsolescence, retirement, loss of resource or loss of contract rights).

Each of these areas involves substantial policy and factual determinations that warrant more discussion before any particular mode of dispute resolution should be specified. The contracts need to clearly identify the particular processes for resolving each, and where possible the sources of data, such as the utility's financial forecasts. This should be done in a manner that ensures transparency and inclusion of all interested, affected customers. While the process for

determining individual utility load and resource changes should for the most part be an administrative determination by BPA, BPA is open to review of the whole area to determine factual determinations that might well be referred to a third-party neutral for resolution in an open and transparent setting. It is important that disputes be resolved in a way that the same results or approach can then be applied to all customers. It would be unworkable and unacceptable for separate dispute resolution processes to result in varying ways to determine net requirements.

#### **4. Subsequent High Water Mark Changes**

As indicated above, it is anticipated that the rate would refer to each customer's contract for an initial value that establishes the HWM. As also indicated above, that HWM and the HWM construct would be contractually locked in, and subject to change for two specified circumstances. Using this assumption, the rate and the contract are also likely to have the following provisions for changing the HWM that would require a process to resolve disputes:

- a. Factual circumstances that permit the HWM to either be increased or decreased (e.g., based on changes in the "size" of the FBS).
- b. Based on such factual circumstances, a method for calculating the amount of any increase or decrease for the HWM.
- c. A simple and readily calculable method for determining when the HWM has been exceeded.
- d. Changes in HWM based on new preference customers and other factors discussed in this proposal

As with net requirements determinations, the contracts need to clearly lay out the process for resolving each in a manner that ensures transparency and inclusion of all interested, affected customers since Tier 1 would be a zero sum game. In the case of disputes of a mathematical nature, third-party resolution would be appropriate. As with other matters, the criteria and considerations for dispute resolution alternatives need to be applied to determine how these matters should be resolved and by whom. Tier 1, or FBS resource, size is an important determinant of the total of HWMs and is discussed separately below.

#### **5. Cost Migration**

BPA's construct depends on the allocation of identified costs to Tier 1 and other identified costs to Tier 2. This is fundamental to tiering and to providing the certainty and predictability customers seek. The general identification of cost categories and their association with Tier 1 or Tier 2 are rate case matters. Notwithstanding that, the rate could provide that the cost categories and their association would not change—i.e., there would be no allocation of Tier 2 costs to Tier 1 for recovery, or vice versa—except in the same circumstances (court order or cost recovery) and subject to the same process, as identified above for the overall construct.

However, many issues may arise as to whether a cost fits within this or that category. Joint costs, such as overhead and labor, are a good example. Efforts to allocate these costs, such as



through direction of effort studies or labor ratios or some other method, should be subject to ordinary rate case procedures and not to special ADR processes.

Customers understand that the Administrator must recover costs. However, they have expressed concern that the Administrator might not take appropriate care to avoid creating situations where the consequence would be that BPA must allocate Tier 2 costs to Tier 1 in order to assure total cost recovery. They argue that such behavior would deprive them of the benefit of their Tier 1 bargain, and that safeguards should be developed to inhibit, if not preclude, such behavior. The customers' concern is very real, but also very difficult to address. Against the customers' concern BPA must balance its need to ensure that its ability to fulfill its public responsibilities is not compromised, taking into account that the tiered rate construct is itself a decision that constrains BPA's behavior. That being said, BPA believes a necessity test should be clearly articulated in the Tiered Rates Methodology and contracts as a condition to recovery of Tier 2 costs from Tier 1, or vice versa. The test would articulate a set of safeguards (hurdles) that must be met before costs could be reallocated between tiers. BPA proposes to develop a set of safeguards in collaboration with its customers and constituents that (a) BPA would follow when entering identified transactions (e.g., a Tier 2 sale) and (b) that, once put in place, would be used by the Administrator to satisfy the necessity test. A third-party neutral, likely the hearing officer, would determine whether the necessity test was satisfied. If not, the Administrator could proceed with the proposed action to reallocate costs if he/she determines after a mini-trial to him/her in the rate case that it is necessary to recover costs or to satisfy court order.

## **6. Tier 1 Resource Size**

Under the current concept, customers with HWMs would be eligible to purchase at the Tier 1 rate that portion of their net requirements equal to or below their HWM. The amount of power available at the Tier 1 rate, and the customers' yearly HWM, would be constrained to the output of the Federal Base System resources. This construct should be afforded the same contractual lock, and follow-on process, as is identified above with regard to the overall construct. Beyond that, however, resource determinations are subject to considerable year-to-year variations due to a number of factors, including water and fish and wildlife measures. Resource determination would likely include the following elements:

- a. Specific Resource Output/Capability – many sources of information, standards, and determinations would be involved.
- b. Adjustments to Resource Output/Capabilities – many sources of information, standards and determinations would be involved.
- c. Federal Operating Decisions – sources of information and process for establishing what constitutes a Federal operating decision, the impacts on the availability of FBS power, both prospective and during the year, need to be established.
- d. Resource Additions and Removals – sources of information and process for establishing circumstances when an FBS resource can be permanently removed, and when a resource can be added for Tier 1 purposes, and in what amounts, need to be established.

- e. Issues concerning the integration or separation of Tier 2 and Tier 1 resources need to be identified.

BPA currently believes that these matters should continue to be determined administratively by BPA, but is open to further discussion of the matter. Each of these areas involves substantial policy and factual determinations that must be identified before agreement could be reached concerning the appropriate alternative resolution process or processes. BPA proposes to work with regional parties to determine if there is a resource, such as the PNCA process or otherwise, that could serve as a neutral, trustworthy source of information.

#### **7. Unanticipated Resource Costs**

BPA currently, and under the construct under discussion, establishes its power rates to recover costs of the service provided. The Bonneville Refinancing Act protection against provision of additional returns of or on old capital investments must be included in the contracts. This provides customers substantial protection against imposition of an unrelated “tax” that would deprive them of the economic certainty that BPA seeks to provide.

#### **8. Implementation of the Rate Methodology**

A topic discussed at some length has been what happens when the Administrator proposes a change to the rate methodology or some element of it. What will more likely occur is the situation when the Administrator proposes to take an action pursuant to the methodology and one or more customers asserts it is contrary to the rate methodology. In such a case, there is no proposed change to the methodology, but rather a difference in interpretation regarding what the methodology permits or requires.

Because implementation of the methodology affects all customers, resolution should be done in an open administrative process, subject to appeal by any party. Some suggest that it would not be acceptable for the Administrator to be the final decision-maker regarding BPA compliance with the rate methodology because it places one of the “contending parties” in the role of judge. BPA disagrees with this characterization, because the Administrator in this context is not in the position of an ordinary party to “gain” by another’s “loss.” He is acting in his statutory role as Administrator of the laws on behalf of all parties. That being said, however, it could be possible to specify that if a substantial majority of customers and constituents opted for a non-binding determination of the matter by a third party, the Administrator would participate in that process.

### **XIII. NEW LONG-TERM CONTRACTS**

BPA expects that the Long-Term Regional Dialogue policy would be implemented through long-term contracts and a tiered rates methodology. This section addresses general contract elements and clarifies BPA's proposed intentions with regard to the process for developing Long-Term Regional Dialogue contracts.

#### **A. TIMING OF REGIONAL DIALOGUE CONTRACTS**

Subscription contracts with public customers and investor-owned utilities do not expire until September 30, 2011. BPA's "Policy for Power Supply Role for Fiscal Years 2007-2011" (February 2005) proposed that customers would be offered replacement contracts, which would go into effect (begin power deliveries under associated rates) as early as October 1, 2008, at the option of each customer. In June 2005, some customers indicated that they wished to retain their Subscription contracts until 2011. Thus, some customers could be operating under Subscription contracts and others operating under Regional Dialogue contracts at the same time.

Some stakeholders also expressed concerns about the feasibility of BPA's plan to provide power service under new Regional Dialogue contracts and rates in FY 2008 for some customers and, at the same time, continuing Subscription contracts and rates for different customers. These concerns included a risk of confusion, cost shifts and litigation among customers if two sets of contracts and rates are in effect for 3 years. BPA explored this issue in the technical workshops held between October 2005 and February 2006. Workshop participants supported signing new contracts as soon as reasonably possible but suggested that the schedule be adjusted to have power service begin for all Regional Dialogue contracts on October 1, 2011. BPA agrees, and BPA's schedule shown in Section I.E. of this proposal reflects this change.

#### **B. CONTRACT TERMS AND CONDITIONS**

##### **1. Duration of Contracts**

The duration of Regional Dialogue contracts is critical to BPA's policy proposal. Although BPA is authorized by law to enter into contracts as long as 20 years, BPA is not obligated to do so. Shorter-term contracts can provide more flexibility if there are major changes in the market place or regulatory environment. However, short-term contracts have significant drawbacks in today's market-based electric utility environment. BPA serves 130 public utilities in the Pacific Northwest. Most rely on BPA for over 90 percent of their supply. These customers and the Pacific Northwest power markets demand predictability and certainty in their power arrangements. A lesson from the West Coast power crisis is that it is imprudent for utilities to rely upon short-term markets for their load serving obligations. Long-term certainty is needed to promote regional electric infrastructure development. Two facts stand out:

- BPA customers lack economic incentive to invest in new power sources, so the power sales contracts and a tiered rates methodology must be long-term and provide customers the assurance that its power purchases from BPA will not substantially change, and its pricing construct and resulting price signals will also not substantially change;

- Long-term capital commitments for new power sources require long-term certainty. Ten years is not enough, especially for the most capital-intensive resources. The contracts must be long enough to allow full amortization of the large capital investments some utilities expect to make in new generation facilities.

The volatility of electricity prices makes short-term contracts financially risky. It is in the interest of the U.S. Treasury to have long-term assurance that all of BPA's costs will be paid. Today, BPA's cost-based rates are far below market prices, but in the 1990's BPA rates were above market. Long-term contracts lock in customers' obligations to cover BPA costs even in periods in which those costs may exceed market prices for power, thereby enhancing BPA's assurance of meeting its obligations to pay Treasury.

While 20- or 10-year contract terms can be considered "long-term," 10-year terms are not long enough to foster infrastructure development, which is a fundamental goal of long-term contracts. Capital funding commitments require longer-term purchase agreements, especially for the most capital-intensive resources. The contracts must be long enough to allow full amortization of the large capital investments utilities and independent power producers expect to make in new generation. Because BPA intends to execute contracts 4 years before actual deliveries would begin, the actual duration of power deliveries would only be 6 years for a 10-year contract and 16 years for a 20-year contract. (See next subsection.)

Uniform 20-year contract terms have the dual advantage of providing certainty to customers on their rights to purchase BPA power and providing BPA certainty of cost recovery for actual FBS costs, regardless of the vagaries of market prices. This certainty provides BPA's public power customers a foundation to make long-term capital commitments to new resources. It also allows BPA to establish a cohesive regional package with certainty for IOU and DSI customers during the same term, securing their benefit levels and assuring those costs are paid within BPA's power rates and do not create risks for interests outside of the region.

BPA considered staggering contract terms to avoid risks inherent in having all contracts expire at the same time and to provide additional choices for customers. However, staggered terms would not create the long-term certainty the proposal is fostering. Customers with a shorter BPA commitment to a HWM would not have the certainty to invest in regional infrastructure. More than one set of contracts would also run counter to the administrative efficiencies BPA intends to create through contract standardization. BPA's recent experience with staggered contract terms resulted in the artificial creation of separate customer classes (pre-Subscription and 5-year Subscription contracts) and resulted in additional equity and administrative challenges.

In summary, 20-year contracts promote regional electric infrastructure development, reduce the Federal role in the region and promote the private sector role, provide market-based pricing of incremental BPA power sales, and enhance BPA stability and assurance of making payments to Treasury. These advantages, combined with regional alignment, make offering 20-year contracts the preferred course of action.

## **2. Duration of Power Service**

In the Concept Paper, BPA noted that the 20-year period would begin on the date of contract execution. But, because BPA plans to execute the contracts in 2007, the actual period of power service would be only 16 years (2011-2027).

During technical workshops in late 2005, participants asked BPA to explore ways to ensure power service would extend for a full 20 years. Participants and BPA quickly concluded that, since the contracts will expire on September 30 to coincide with the end of BPA's fiscal year, an additional year of service could be gained under the new contracts if they are executed after the start of the new fiscal year rather than August 2007 as previously planned. This still falls short of meeting the overall objective of maximizing the service of the Regional Dialogue contracts to the full 20 years and workshop participants asked BPA to continue to search for a solution. Unfortunately, BPA has not been able to identify any options likely to be acceptable to customers and that also provide the long-term certainty needed to encourage power resource development. Section 5(a) of the Bonneville Project Act specifically precludes contracts, including renewals or extensions of contracts beyond 20 years.

## **3. Standard Contracts and Limited Bilateral Negotiations**

BPA proposes to create standardized Regional Dialogue power sales contracts with limited bilateral negotiations. The process would be similar to that used for developing standardized Subscription contracts in 1999-2000. BPA's current Subscription contracts are largely standardized. Most contract provisions are identical for similarly situated customers. All customers' contracts, for example, include the same "Uncontrollable Forces" provision. BPA offered several choices of requirements products in Subscription, and customers who chose the same product received the same basic provisions and associated billing factors. These standard provisions ensured that similarly situated customers are treated comparably and improved BPA's ability to efficiently administer 125 separate contracts for public customers.

BPA developed standard Subscription contracts in two phases. First, prototype contract templates were developed and refined in consultation with customers, then, when near completion, offered for public review. Second, when the standard prototypes were finalized, only issues that were unique to a customer (generally resource issues, metering information, etc.) were negotiated bilaterally. Contract provisions that had been standardized as the prototypes were developed could be changed only with approval of management and in consultation with internal stakeholders. BPA proposes a similar process for Regional Dialogue contracts.

Most participants in the technical workshops supported the principle of standardized contracts. They also suggested that BPA use the provisions of the current Subscription contracts as the starting point for drafting the Regional Dialogue contracts. BPA agrees the new contracts will retain provisions that have worked well for all parties and which are expected to work well in the future. However, the proposed Regional Dialogue policies are new and distinctly different. BPA proposes to draft the standard Regional Dialogue contracts to reflect changes in policy and products, as well as improved business practices.

Some constituent groups, including the Northwest Energy Coalition, Natural Resources Defense Council, and the Washington Department of Trade, proposed in 2004 that BPA conduct Regional Dialogue contract negotiations in a public forum. BPA addressed this issue in its February 2005 Regional Dialogue policy stating, “Draft standard contracts will be available for public review before they are finalized.” After the Long-Term Regional Dialogue policy and ROD are published, BPA would develop draft standard contract prototypes in consultation with customers and make these prototypes available for public review before they are finalized.

## **XIV. FALLBACK POLICY PROPOSAL, IN THE ABSENCE OF REGIONAL CONSENSUS**

Subject to further regional discussion and comment, BPA believes this proposal best meets the region's goals. In the interest of meeting specific customer needs and fostering regional consensus on the entire proposal, BPA's proposal includes some provisions that work against keeping Tier 1 rates as low as possible and creating the earliest possible certainty about load obligations. These provisions include limited augmentation of the existing system for both existing and new public utilities, waiting until 2011 for the final adjustments to high water marks, limited resource removal rights for public utilities, and special provisions for new public utilities.

### **A. IMPORTANCE OF REGIONAL CONSENSUS**

As discussed above, there is a great deal of alignment between BPA, its customers, the Northwest states, the Northwest Power and Conservation Council, public interest groups and others on the broad goals BPA should pursue. However, this proposal does not represent regional consensus because disagreements remain on some important details.

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

### **B. FALLBACK PROPOSAL**

If consensus on outstanding key issues cannot be achieved by the end of the comment period on this proposal, BPA proposes to implement a fallback approach that still accomplishes the key goals of limiting its buying and melding practice and providing customers the long-term certainty they need for infrastructure development. While it would not encompass all the aspects of the Regional Dialogue proposal, the fallback would likely result in lower Tier 1 rates and earlier certainty about load obligations. The fallback would not include settlements of residential exchange benefits, since such settlements would likely be subject to lengthy legal challenges in the absence of consensus on them. This fallback approach would be the same as the policy proposal presented here, but with the following modifications:

- No settlement of residential exchange rights for either IOUs or public utilities. BPA would reinstitute the exchange programs for both starting in FY 2012. BPA would develop an in-lieu policy, initiate a consultation process to revise the ASC methodology, and update the 7(b)(2) methodology, all prior to the rate period starting in FY 2012.
- Earlier final determination of high water marks. To increase planning certainty for BPA and its public utility customers, high water marks for each public utility would be based

on a determination of net requirements done in 2007 using a simplified process and/or historic data, without the later true-up.

- No augmentation of the existing system to serve existing or new public utilities, because augmentation costs can significantly increase the Tier 1 rate. BPA would acquire power as necessary to meet Tier 2 rate loads and would not augment the system to allow for higher high water marks for existing publics. Nor would BPA augment the system to serve new publics at a Tier 1 rate.
- No review of or change in the treatment of the shares of the Centralia Coal Plant previously owned by four public utilities in net requirements and high water mark determinations. Not changing Centralia treatment would hold down total HWMs and net requirements, assuming no other changes to loads, and would keep Tier 1 rates lower by making more BPA secondary power available and secondary revenues higher.
- No resource removal rights for load loss within a rate period. Resource removal determinations would be made on a case-by-case basis, consistent with new contracts and the 5b/9c Policy, which would also be updated. This change would keep Tier 1 rates lower than they would have been under BPA's policy proposal due to likely increases in BPA secondary revenues.
- No special provisions for new public customers. Details of how BPA would serve new publics and how much of their load is eligible for Tier 1 rate service are yet to be determined. One option is if existing public customers were not using the entire output of the existing system at the time a new public customer was formed out of investor-owned utility service territory, the new public would get a high water mark for Tier 1 rate service. If existing publics were using the entire output of the existing Federal system at the time such a new public were formed, the new public would be served at Tier 2 rates. The new public could participate in the residential exchange program under the same rules as other publics.
- Benefits to the DSIs would be based on outcome of the public process inviting comment on this Proposal.

### **C. PENDING LITIGATION**

The pending litigation over BPA residential exchange settlement agreements with IOUs makes regional consensus more difficult. BPA does not believe that the court's ruling will greatly reduce the current wide range of uncertainty about the correct level of residential exchange benefits, because the issues driving the level of benefits are not before the court. BPA believes that settling these benefits as part of the overall Regional Dialogue package is best for the region. Failing that, the court may rule before BPA makes final policy decisions, and this may help promote regional consensus.



#### **D. BPA INTENT TO STAY ON SCHEDULE**

Although BPA will continue to seek consensus on these issues, timely conclusion of this policy process is essential to the region's energy future so that new long-term contracts and rates can be in place to facilitate our customers' resource planning several years before current contracts expire in FY 2011. BPA has already delayed the process several times. Further significant delays do not appear wise in view of the shrinking lead time before new contracts go into effect. BPA's intent is therefore to make final policy decisions on the current timeline, hopefully including a broadly supported consensus, but if not, then moving to the fallback approach described here.

## **XV. ENVIRONMENTAL ANALYSIS**

BPA is currently reviewing the proposed Long-Term Regional Dialogue Policy under the National Environmental Policy Act (NEPA). Because this is a policy proposal, BPA is reviewing the proposal in light of BPA's Business Plan Environmental Impact Statement (Business Plan EIS) completed in June 1995 (DOE/EIS-0183). This EIS provides an analysis of potential environmental effects that could result from BPA's policy-level decisions. The EIS evaluates a range of business plan alternatives that could be varied by applying policy modules. Any combination of alternative policy modules should allow BPA to balance its costs and revenues. The EIS also addresses response strategies, including adjusting rates, which BPA could pursue if BPA's costs exceed its revenues.

In August 1995, the BPA Administrator issued a Record of Decision (Business Plan ROD) that adopted the Market-Driven Alternative from the Business Plan EIS. This alternative was selected because, among other reasons, it allows BPA to: (1) recover costs through rates; (2) competitively market BPA's products and services; (3) develop rates that meet customer needs for clarity and simplicity; (4) continue to meet BPA's legal mandates; and (5) avoid adverse environmental impacts. BPA also committed to apply as many response strategies as necessary when BPA's costs and revenues do not balance. Because the proposed Long-Term Regional Dialogue Policy likely would assist BPA in accomplishing these goals, the proposal appears consistent with these aspects of the Market-Driven Alternative. At this point it appears that implementation of the various aspects of this proposal, taken either individually or collectively, would not be expected to result in significantly different environmental impacts from those examined in the Business Plan EIS.

Therefore, BPA expects that the proposed Long-Term Regional Dialogue Policy will fall within the scope of the Market-Driven Alternative evaluated in the Business Plan EIS and adopted in the Business Plan ROD. As part of the Administrator's Record of Decision that will be prepared for the Long-Term Regional Dialogue Policy, BPA may tier its decision under NEPA to the Business Plan ROD. However, depending on the ongoing environmental review, BPA may instead issue another appropriate NEPA document. People interested in submitting comments regarding potential environmental effects of this proposal under NEPA may submit their comments along with other any other aspects of the proposal.