

# Tiered Rates Costing Methodology

## Preliminary Draft for Discussion

### I. Cost Allocation

#### A. Costs Allocated to Tier 1 - Same as current existing cost structure.

- All FBS operating costs (includes Slice operating costs and recovery of slice implementation costs from Slice customers)
- Direct transmission and related delivery costs (GTA costs) of providing Tier 1 products
- All balancing purchase costs
- Limited augmentation power purchases including needed capacity to support load growth
- Resource Adequacy Reserve additions
- All FBS and third party debt service costs
- Conservation costs
- BPA's public responsibility costs: fish and wildlife, costs for the facilitation of renewable resource development
- Residential Exchange Program (REP) costs including related Settlement costs
- Risk/reserve additions, PNRR and other measures used to meet TPP standards
- All other costs incurred (DSI costs, LDD, IRMP, Minimum Required Net Revenues) with the exception of direct Tier 2 costs

#### B. Costs Allocated to Tier 2 - All incremental costs associated with Tier 2 products are allocated to Tier 2 products.

It is envisioned that the amount of incremental costs would change over the 20-year contract period in relation to the level of direct costs required to support the sale of Tier 2 products. The specific types of direct costs being allocated should be stable over the 20-year contract period. Examples of specific costs that would be allocated to Tier 2 products:

- Direct power purchase costs entered into with sellers of market power and resource providers (including debt service costs and operating costs associated with resource acquisitions).
- Direct transmission and related delivery costs of providing Tier 2 products.
- Resource integration costs and related shaping/capacity costs related to firming renewable resource purchases used to support Tier 2 power sales.
- Market value of Tier 1 power (Firm and Secondary used to serve Tier 2 loads)
- All direct (salary) and indirect (employee benefits) staffing costs associated with providing Tier 2 service:
  - Tier 2 Power/portfolio manager, allocation of time spent by trading floor personnel and other personnel time that is material (greater than \$100,000) spent supporting Tier 2 products.
- Could include a Risk Premium that would be refundable through periodic true-ups.

## C. Incremental Costing Methodology

### What does incremental costing of Tier 2 products mean?

- Only costs with a direct cost relationship of supporting the sale of Tier 2 products would be allocated to Tier 2 products.
- No allocation of BPA Indirect overheads to Tier 2 business (building rent, utilities, insurance, etc.) would be applied to Tier 2 products.
- No allocation of BPA Administrative costs; no allocation of front office expense, or corporate overheads. Overhead costs would only be allocated by direct cost assignment if there is a clear direct relationship (resulting in a material cost greater than \$100,000) of supporting Tier 2 service. Example could be an allocation of legal overheads, accounting, and contract administration provided by corporate personnel directly related to the time spent in support of the Tier 2 business.

## II. BPA Power Purchases Post FY 2011

### A. Tier 1 Product Purchases:

- Balancing Purchases
- Augmentation Purchases, - market purchases first 5 years, could be resource acquisition subject to NWPCC's policies pertaining to N.W. Power Act's Section 6 (c ) provisions.
- Resource Adequacy Reserve Additions
- REP In-lieu Purchases (Fall Back Proposal Only)

**B. Tier 2 Product Purchases** – The following product descriptions (Portfolio Guidelines) are being developed via the Power Product Catalog efforts. The following descriptions are illustrative only. BPA's policies surrounding power purchases and market risk might need to be revised. Power purchase policies would need to address N.W. Power Act Section 6 (c ) provisions.

- New Renewable Products – Product Portfolio Guidelines:
  - 90% Wind Resources - contract duration 5-10 years
  - 10% Hydro thermal – contract duration 10-17 years
  - Product Term 10-17 years,
  - Notice provisions – terminate at end of 10<sup>th</sup> year with notice before end of 7<sup>th</sup> year, purchase is take or pay, remarketing and crediting of customer purchases not taken to load.
- Default Pricing Product – Product Portfolio Guidelines:
  - Melded Market purchases: 20-30% are 1-2 years terms, 40-60% are 3-4 year terms, and 20-30% are 5 year terms, in addition, in addition up to 20% of the product can be purchases from the Tier 1 business line (Firm and Secondary).
  - Product Term - rolling 5 year period
  - Notice Provisions, 3 years notice to buy or be removed
  - Purchase is take or pay, remarketing and crediting of customer purchases not taken to load.

- Long-Term Product – Product Portfolio Guidelines:
  - Melded Market purchases: 20-30% are 4-6 year term, 40-60% are 7-9 year terms, and 20-30% are 10+ year terms, in addition up to 20% of the product can be purchases from the Tier 1 business line (Firm and Secondary).
  - Product Term – longer than 5 years,
  - Notice Provisions - no ability to change purchase amount
  - Purchase is take or pay, remarketing and crediting of customer purchases not taken to load
  
- Full Load Growth Coverage Product – Product Portfolio Guidelines:
  - Melded Market purchases: 20-30% are 2-4 year terms, 40-60% are 5-7 year terms, and 20-30% are 7-10 year terms, in addition up to 20% of the product can be purchases from the Tier 1 business line (Firm and Secondary).
  - Product Term 17 years,
  - Notice Provisions - no ability to change purchase amount
  - Purchase is take or pay, remarketing and crediting of customer purchases not taken to load

Elements of all of the above power purchases for both the Tier 1 and Tier 2 businesses can be aggregated into larger market purchases to achieve better economies of scale in the pricing of power purchases to lower both Tier 1 and Tier 2 operating costs. It is essential that at the time of an aggregate/pooling power purchase, that the quantity (MWs) and price be allocated at the time of purchase to Tier 1 and Tier 2 Products and to the various individual Tier 2 products. Allocated costs are inventoried as part of that specific product's cost. The cost is allocated using a simple unit average cost approach (the costs per unit associated with the aggregate/pooling purchase are all equal). This is essential to eliminating “gaming” and swapping of inventory products to advantage the Tier 1 or Tier 2 business at the expense of the other, as well as protecting the interests of the purchasers of the individual products within the Tier 2 business.

### **III. Tier 2 Power Sale Principles / Costing Principles**

- All of the incremental direct costs associated with providing Tier 2 product services will be allocated to Tier 2 products. There will not be any cross subsidies of Tier 2 products that will be borne by the Tier 1 business.
  
- Tier 2 products will be sold on a take or pay basis to ensure cost recovery while providing customers with the remarketing of power that they are not able to take. The product will have very clear terms with sufficient lead times surrounding the commitment to buy and to terminate the purchase to minimize cost under recovery risks. Other product specific design features to reduce the business risks associated with individual Tier 2 products will be incorporated into the power purchase contracts between BPA and power suppliers and between BPA and its customers.

- Contract provisions for the sale of Tier 1 and Tier 2 products will be clear and unambiguous in the terms of the sale of the product to assist in ensuring the legal enforceability of power contracts.
- Tier 2 products will be simple in their construct. The number of Tier 2 products will be few in number at the beginning of selling the Tier 2 product so that there is sufficient sales volume in the individual products to achieve economies of scale and to warrant the expense of managing the individual Tier 2 products. BPA will offer a Tier 2 Renewable Product.
- Tier 2 Products will be developed in strict conformance with the Power Product Guidelines outlined in the Power Product Catalog that define the composition of the product. Customers need to have a high degree of assurance that what they actually end up buying is consistent with the Guidelines and that it remains within the ranges specified in the Guidelines over the contract period.
- Cost allocations and the quantity of market purchases need to be assigned to Tier 1 and the individual Tier 2 products at the time aggregate/pooling power purchases are made. Sufficient procedures and internal controls surrounding the allocation of costs between Tier 1 and Tier 2 products, as well as the inventorying of individual Tier 2 product costs to their respective cost pools need to be established to prevent migration of product costs between Tier 1 and Tier 2 and between the individual Tier 2 products.
- Tier 2 product costs will be established within BPA's Power Rate Cases for each upcoming rate period and may include periodic (6 months, 1 year) true-ups.
- While it is anticipated that there will not be any under recovery of Tier 2 costs from the rates established to cover the costs of Tier 2 products, should there be a cost under recovery of Tier 2 costs, BPA will meet its financial responsibilities by recovering these costs from Tier 1 products.

Notice to Customers and Participants Concerning Regional Dialogue Workshops and Public Involvement Efforts

BPA staff will conduct informal discussions with interested parties regarding future implementing actions for certain Regional Dialogue issues, which stem from topics that will be addressed in the Record of Decision BPA plans to issue in January 2007. It is necessary to initiate these preliminary discussions prior to issuing a final ROD and Policy due to the time constraints in our schedule for signing new power sales contracts. Any comments given to us on the policy proposal during these preliminary discussions that are not duplicative of comments received from a party and which were not submitted to BPA by the end of the comment deadline of September 29th either in written form or at the public meetings will be considered by BPA in its ROD. Consideration of comments provided to BPA after the close of comment may not be considered, or if the comments are relevant to future implementing actions, then those comments may be held for later consideration in a future process. For purposes of these preliminary discussions on implementing actions only, BPA will use a working assumption that the July 2006 Regional Dialogue Policy Proposal as BPA proposed will be adopted. BPA assures parties that no decision has been made regarding the Policy at this time by the Administrator but a working assumption is needed to allow a context for the discussion on next steps and implementing actions.