Power Function Review Background Paper
Residential Exchange Program Benefits and Settlement Benefits

I. CONTRACT HISTORY WITH THE INVESTOR-OWNED UTILITIES

A. Residential Purchase and Sale Agreement (1982 through 2001)

The Residential Exchange Program (REP) was established by section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act (Power Act). The REP is structured as a power exchange, but no power has ever been delivered. Instead BPA has paid qualifying utilities the difference between their average system cost (ASC) and BPA's Priority Firm (PF) exchange rate, multiplied by the utilities' eligible residential and small farm load. Both investor-owned utilities (IOUs) and public-agency utilities (PAs) participated in the REP by executing Residential Purchase and Sale Agreement (RPSA) contracts. From Fiscal Years 1982 through 1996 the IOUs received nearly $2.5 billion and the PAs received approximately $346 million, with the average total annual benefit exceeding $188 million.

BPA's Initial Proposal in the 1996 Rate Case indicated a large reduction of benefits under the REP starting in FY 1997. Concern about reduced benefits led to Congress specifying benefits of $145 million in FY 1997 in the Energy and Water Development Appropriations Act of 1995 (Public Law 104-46), and in which the Conference Report language encouraged BPA and its customers, among other things, to phase out REP payment for the period ending in 2001. Termination of the REP contracts was negotiated for the FY 1998-2001 period with negotiated 4-year benefit payments totaling $250 million among IOUs and PAs.

B. Subscription (Fiscal Years 2002 through 2011)

For the rate period beginning October 1, 2001, BPA implemented its Power Subscription Strategy. BPA offered all PNW IOUs the option to sign a new RPSA or sign a Settlement Agreement of the parties' rights and obligations under the REP. While Settlement Agreements were not offered to PA customers, these customers have the option to sign a new RPSA under the REP. The IOU Settlement Agreements provided for a total of 1,000 aMW of physical power sales at an RL rate that would be equivalent to the PF preference rate and 900 aMW of Monetary Benefit. Monetary Benefit payments by BPA were calculated to be equal to the difference between a "market value" for a forward purchase of a flat block of power established in BPA's rate case at $38/MWh and BPA's RL rate multiplied by the load allocated to Monetary Benefit. The distribution of power and Monetary Benefit to each IOU was established consistent with advice from the four PNW public utility commissions.

There have been numerous changes to the IOU Settlement Agreements. First, in response to a significant increase in BPA's forecast of its total 2002-2006 load serving obligation along with the increased market price volatility of the 2000-2001 West Coast power crisis, BPA "bought back" its physical power obligations to PacifiCorp and Puget at a discounted price of $38/MWh

($36.19 for FY 02 only) in spring 2001. Such payments contractually reverted to their negotiated risk-adjusted price of $47.17/MWh beginning FY 2003 if either or both utilities had not notified BPA by December 1, 2001, that they had entered a settlement agreement with any of BPA's publicly-owned utility and cooperative customers resolving legal challenges to the Settlement Agreement. Other later agreements deferred the notification date for the end of the Reduction of Risk Discount, deferred payment of the increase to the original purchase price equal to the Reduction of Risk Discount, and specified an interest charge for the deferred payment amounts of the Reduction of Risk Discount.

At or near the beginning of the FY 2002 contract period Avista, Idaho Power, and NorthWestern exercised their contract right to forego receipt of physical power in favor of receiving financial benefits calculated as the difference between $38/MWh and the PF-equivalent rate. During the FY 2002-2006 contract period, PGE was and still is the only IOU purchasing physical power under its Settlement Agreement.

Early in FY 2003 each IOU signed an Agreement Regarding Fiscal Year 2003 Deferral Amount. BPA deferred payment to the IOUs of $55 million with interest over the February-September 2003 period. Per those agreements, BPA would repay this debt during FY 2004-2006 in amounts equivalent to any Safety Net Cost Recovery Adjustment Clause (SN CRAC) charge imposed on the IOUs. Any balance still owed by September 30, 2006, would be repaid over the subsequent 60-month period.

The most recent changes to the Settlement Agreements are the contracts and contract amendments signed by all six IOUs in May 2004 that apply to the FY 2007-2011 period. These 2007-2011 Contracts specify that BPA will provide Monetary Benefit rather than physical power and specify a methodology for determining the Forward Flat-Block Price Forecast used (along with the "lowest cost PF rate") to determine the Monetary Benefit. The minimum Monetary Benefit to be paid by BPA during any fiscal year is $100 million. The maximum to be paid is $300 million.

In return, Avista, Idaho Power, NorthWestern, and PGE agreed to waive their share of the $55 million deferral not repaid as of September 30, 2004. The waived amount for these four IOUs is $3,516,355. PacifiCorp and Puget agreed to waive one-half of the balance of the deferred amount of the Reduction of Risk Discount plus accrued interest. PacifiCorp and Puget agreed that the deferral period ends September 30, 2006, and that they will waive one-half of the approximate $213 million owed at that time. PacifiCorp waived $43,217,377 and Puget waived $63,321,696. The balance owed, $106,539,073, will accrue interest on the unpaid balance and will be paid over the 60-month period beginning October 2006. In addition to the balance owed on the deferred amounts of Reduction of Risk Discount after September 30, 2006, PacifiCorp and Puget will receive their share of the $55 million FY 03 deferral payments not repaid as of September 30, 2006, during the FY 2007-2011 period.

IOU Benefits ($millions)[1]	
FY 02	$356
FY 03	$304
FY 04	$365
FY 05	$361
FY 06	$358

C. Projected IOU Benefits

IOU monetary benefits in the next rate period will range between $100 and $300 Million according to the methodology described below, plus an additional “Reduction of Risk Discount Payment” of $23M/year and a “Repayment of FY03 Deferral” of $3M/year.[2]

II. CONTRACTS IN FY 07-11 WITH THE INVESTOR-OWNED UTILITIES

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

Under the REP Settlement Agreements, monetary benefits are determined by the difference between BPA’s Forward Flat-Block Price Forecast (FBPF) and the RL rate (or lowest PF rate in appropriate circumstances) multiplied by the amount of the investor-owned utility’s benefits as stated in annual aMW.[3]

The proposed contracts replace the use of a rate case power price forecast with a mark-to-market methodology that is functionally similar to the rate case forecast used during FY 2002-2006, yet provides a desired transparency for determining the forecast. The new methodology uses an independent survey of market prices. The survey will use the prices for a flat block of firm power delivered at the Mid-C trading hub for each contract year.

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[1] 1/ Actuals are through FY 04. FY 2005 and FY 2006 are based on CRAC forecasts published 12/17/04. Figures do not include revenues from the power sale to PGE or any estimate of the benefit of such power sale.

[2] Reduction of Risk Discount payments to PacifiCopr and Puget are $9,339,468 and $13,684,104, respectively. Repayments of FY2003 Deferral to Pacificorp and Puget are $108,936 and $2,679,516, respectively.

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

	FY2002-2006	FY2007-2011
Avista Corp.	90	149
Idaho Power Company	120	224
NorthWestern Energy	24	28
PacifiCorp (Total)	473	586
PacifiCorp (UP&L)	*140*	*140*
PacifiCorp (PP&L – WA)	*80*	*108*
PacifiCorp (PP&L – OR)	*253*	*338*
Portland General Electric	490	560
Puget Sound Energy	700	648
Total	1897	2195

B. Qualified Third Party/Eligible Data Providers

As a first step to implement the new methodology, BPA has hired a qualified third party (QTP) to collect the necessary market data. BPA selected a QTP from among the Big 4 accounting firms with expertise in financial and risk accounting for the electric power industry. For each Contract Year, the QTP randomly selects 6 to 8 Eligible Data Providers (EDPs) to provide price information. EDPs are entities that routinely buy and sell bulk power for resale in the Pacific Northwest (PNW) and use risk accounting for reporting in the regular course of business.

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

C. Floors and Caps

A separate concern involved the potential that the mark-to-market methodology could result in very high or very low benefit levels for the residential and small farm customers depending upon the differential between the market price and the RL rate. As a result, BPA and the investor-owned utilities included provisions that both guaranteed a minimum level of benefits and at the same time capped the upper level of monetary benefits. The proposed contract establishes a floor and a cap for IOU benefits of $100 million per year and $300 million per year respectively. Through the floor, BPA ensures the residential and small farm customers of the region's investor-owned utilities receive a specified minimum level of benefits. Similarly, through the cap, BPA's other customers are assured that investor-owned utility benefits will not exceed a specified amount.

III. ESTIMATE OF FBPF IN BPA RATES FOR FY 2007-2009

A. Estimate of FBPF for Power Function Review

BPA has made an estimate of the price for a flat block of firm power delivered at the Mid-C trading hub for each contract year. BPA used a broker quote to estimate a price for FY 2007. BPA then adjusted the FY 2007 number based on the rate of price increase for natural gas at Henry Hub. Since natural gas prices are forecasted to decline, BPA estimated lower prices for FY 2008 and FY 2009.

B. Estimating the FBPF in the Rate Case

The FBPF is established for each contract year based on a survey conducted between 21 and 9 months prior to the start of a contract year. When BPA publishes its Record of Decision for the rate case for FY 2007-2009 in the spring of 2006, BPA will know the FBPF under the contract for the first year. BPA will have to forecast the level of benefits for FY 2008 and FY 2009.

C. Impact of FY 2007-2011 Contracts on BPA Risk Profile

Under the new settlement methodology, IOU monetary benefits are calculated 9 months in advance of the beginning of each fiscal year. Under previous methodologies the monetary benefits were established for complete rate periods. This means for FY 2007-2009 rate setting purposes there is likely to be a variance between rate case forecasted monetary benefits and actual benefits as calculated each year for FY 2008 and FY 2009. This potential for changes between forecast to actual will have to be considered in rate case risk management mechanisms. If the initial forecast is close to the maximum level of benefits, the contracts do not substantially increase BPA's risk of meeting Treasury payments. As the difference between the initial forecast of FBPF for a year and the maximum level of benefits increases, BPA faces increased risks. Once two-year rate cycles are established, this variance-from-forecast risk will diminish. How BPA handles that risk is a rate case issue.