

**Bonneville Power Administration's  
Long-Term Regional Dialogue  
Concept Paper**

**September 2005**



# LONG-TERM REGIONAL DIALOGUE CONCEPT PAPER

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# Long-Term Regional Dialogue Concept Paper

## I. INTRODUCTION

### A. GOALS

The Regional Dialogue is an opportunity to define BPA's power supply and marketing role for the long-term and to do so in a way that meets many key regional and national goals. Fortunately, there is a great deal of agreement between BPA, its customers, Northwest states, the Regional Council, public interest groups, and even the U.S. Government Accountability Office on the broad goals BPA should pursue. Based on literally years of discussion, the following goals for BPA's long-term power supply role have very broad support:

1. **Promote Development of Regional Infrastructure by Enabling Non-Federal Development:** Lack of sufficient electric infrastructure was a contributing factor 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. Many public utilities and resource developers say they are motivated and able to develop new power resources, but they say their ability to commit to new power sources in the Northwest is impeded by uncertainty about how much low-cost power each utility will receive from BPA in the long-term and how BPA will price its power. New 20-year BPA contracts and rate structures that create that certainty are key ingredients in the development of the infrastructure needed to sustain the Northwest economy and avoid price volatility. Twenty-year contracts are necessary because capital recovery periods for new generation are long and utilities need the long-term certainty to back up their financial commitments to new resources. Having willing utilities responsible for resource acquisition decisions also enhances competition in the market place. Since some of the responsibility to develop new resources would be spread from BPA to many additional utilities, clear resource adequacy standards and accountability for meeting them are also key ingredients to regional infrastructure development.
2. **Limit BPA Costs, Rates, and Risks:** The Northwest Power Act (Act) creates an open-ended obligation for BPA to meet the growing net requirement loads of Northwest utilities. The Act also authorizes, though it does not require, BPA to meld the costs of new resources with lower-cost existing resources. This creates a huge incentive for public utilities to place all their loads on BPA, which they have generally done. This melding of new resource costs, if continued, keeps BPA in the role of the region's primary new resource provider, which means increasing BPA costs, greater BPA financial risks, and higher average BPA rates. Many BPA customers have expressed interest in taking on the responsibility for new resource development, which would take much of the resource cost and risk off BPA. But to do so, these customers need a change from the current melded cost ratemaking approach. BPA believes this barrier can be

removed under current law through new 20-year contracts and a long-term rate methodology that limits purchases at the lowest-cost-based rate to the output of the existing system, and by charging a higher rate for increments of power service above that. The result of a bifurcated cost service would be a much-reduced resource acquisition role for BPA thereby reducing BPA costs, risks, and power rates. It would also foster more competitive wholesale power markets. BPA views simplification of contracts and rates as another key means of reducing risks and administrative costs.

3. **Enhance the Probability of Payments to U.S. Treasury:** There is broad recognition in the region that meeting BPA's obligations to U.S. taxpayers to repay Federal investment in the power system, on time and in full, is essential. Thus a key goal of the proposals in this Concept Paper is to provide enhanced assurance that this obligation will be met. The proposals seek to provide this enhanced assurance in three ways. First, BPA proposes a significant reduction in the resource acquisition role that has historically created the greatest threats to BPA's ability to meet obligations to Treasury—most notably commitments to three nuclear plants in the 1970s and increases in load commitment in 2002. Second, by fostering non-Federal development of electric infrastructure, these proposals reduce the risk of market price instability driven by regional resource insufficiency. This insufficiency was in part responsible for the West Coast electric price run-up in 2000-2001 that was a primary source of BPA financial setbacks in those years. Third, this paper proposes new 20-year take-or-pay contracts that would ensure a revenue stream to cover BPA's financial obligations to Treasury even if BPA's costs again exceed market prices.
  
4. **Align Regional Interests and Reduce Regional Conflict:** Disputes over BPA rates and contracts currently absorb much effort from the region's electric industry. There are longstanding conflicts over the proper level of benefits to investor-owned utility (IOU) residential customers, service to direct-service industries (DSIs), rates to public utilities, and between public utilities buying different products from BPA. The effort going into these disputes could be redirected to more productive purposes. Perhaps more importantly, the region's ongoing access to the Federal hydro system could be jeopardized by conflict among regional parties. Virtually all of the regional parties agree that reducing this conflict is important and that a long-term agreement, secured through simplified 20-year contracts and rates that fairly resolve these disagreements, is a key part of the solution. To create alignment and reduce conflict, most BPA customers agree that these contracts and rates must meet the basic needs of each customer group and respect the interests of each, including:
  - **Product choice for public utilities:** Public utilities need a reasonable range of power service choices from BPA that respond to their varying needs, without creating excessive complication in the business relationship.
  - **Fair and predictable benefits for IOU residential customers, consistent with law:** Most parties agree with this broad goal, though there are deep disagreements about the specifics.
  - **Support to DSI-dependent communities:** Though there is much disagreement on this goal, many in the region agree that it is appropriate for BPA to provide some

level of ongoing support to DSIs, to give them a chance of preserving family-wage jobs in specific communities.

5. **Ensure Conservation and Renewable Resource Development:** The Northwest Power Act puts strong emphasis on development of cost-effective conservation and renewable resources, and the region has a proud history of accomplishment on both. There is broad agreement that the region builds on this legacy even as we change the responsibility for resource acquisition.
6. **No Impairment of Other BPA Responsibilities:** Though the proposals in this Concept Paper do not address BPA's other responsibilities, such as those for fish and wildlife, there is also broad agreement that changes in BPA's power supply role must not impair BPA's ability to meet these financial and operational responsibilities.
7. **No New Legislation:** BPA intends to accomplish the goals above without going to Congress to change current law. There is not complete agreement within the region on this no-legislation goal. Some doubt that the other goals can be accomplished within existing law, while others agree with BPA that going to Congress for help is a last resort. BPA's view, and that of many other regional parties, is that seeking legislation would put achievement of many of the other goals stated here at risk, because the outcomes of the legislative process tend to be hard to predict and would bring in many other parties into the discussion who would not share the same goals. In addition, the timeline for legislation can be protracted. Also, the legislative process is not a good remedy for the inability of parties in the region to agree on compromises, since the legislative process itself relies on the ability of parties to compromise on difficult issues. Finally, BPA's view is that spending years developing contracts that require Congressional approval is a brittle strategy given the difficulty of accomplishing Federal legislation, and if legislation does not occur BPA and customers are left with no replacement for contracts that expire in 2011. The proposals in this Concept Paper are aimed at achieving the other goals stated here, without change in law. This will require a spirit of compromise on the smaller issues in the interest of achieving larger goals—the same spirit of compromise that would be required in any attempted legislative effort.

## **B. ACHIEVING THE GOALS: PLAN AND SCHEDULE**

The high degree of regional alignment on the broad goals of the Regional Dialogue is cause for optimism that these goals can be met, and that today's generation of Northwest power interests can leave a strong legacy for the next generation. As is often the case, the devil of disagreement is in the details. All the parties, including BPA, will need to actively seek acceptable compromise on the details in the interest of achieving these broad goals.

There have been numerous proposals, forums, position papers, regional meetings, and workgroups on the various specific issues over the last 3 years. These efforts have affirmed the broad goals stated above, but have not broken through to agreement on the specific issues. This Concept Paper represents an as-yet untried step to achieve greater alignment on the specifics. With this Concept Paper, BPA is putting out a package of proposals on all the key issues as a

starting point for an intensive 90-day regional effort to finally close the gaps among regional parties. BPA sees this package of preliminary proposals as a reasonable way to achieve the broad goals, but we are also very interested in other ideas generated by the regional discussions. This paper does not constitute an agency final action and is solely intended to stimulate the regional discussion around the issues addressed herein and to hopefully lead to a formal proposal this winter by BPA of a Long-Term Regional Dialogue policy that has broad support.

The broad goals described above ultimately must be achieved through new BPA contracts and rates. BPA's schedule for the next 3 years (shown below) has been modified from the schedule published in the February 2005 *Policy for Power Supply Role for Fiscal Years 2007-2011* to include the addition of this Concept Paper and the public workshops this summer and fall. BPA anticipates publishing a formal policy proposal in the Federal Register in January 2006. Publication of the policy proposal in the Federal Register will be followed by a public comment period, regional meetings, and a record of decision in the spring of 2006.

### Schedule

| <b>Milestone:</b>   | <b>Date:</b>            |
|---|-------------------------|
| BPA Long-Term Concept Paper   | August 2005             |
| Regional Dialogue Consensus Building (see below)                                      | September-November 2005 |
| Formal BPA Policy Proposal  | January 2006            |
| Public Comment on Formal Proposal   | February-March 2006     |
| BPA Regional Dialogue Record of Decision (ROD) on Long-Term Issues                    | May 2006                |
| Negotiate New Contracts, Based on ROD   | June 2006-April 2007    |
| New Long-Term Contracts Offered   | May 2007                |
| New Long-Term Contracts Signed  | August 2007             |
| Complete Long-Term Rate Methodology (Section 7(i) Process) to Accompany New Contracts | October 2008            |
| New Contracts Go Into Effect When Signed  | October 2008 or Later   |

### C. NEXT STEPS

BPA plans a different public process on the Concept Paper than has previously been used. BPA intends to conduct intensive collaborative sessions in the 3 months following the release of the Concept Paper. These sessions will use the Concept Paper as a starting point and are designed to

create an opportunity to reach as much alignment as possible between BPA, its customers, and all other interested parties on the content of the formal Regional Dialogue policy proposal. Details of these sessions will be provided separately, but BPA envisions the following key characteristics:

- Participation by individuals who are committed to participate consistently through the 3-month period, and who have authorization from the organization they represent (if any) to speak for it.
- Participation by individuals who commit to seek broad agreement on the key issues addressed in this Concept Paper, and who are empowered to make such commitments, subject to final approval by their respective governing bodies.
- A technical track, which reports to a principals track.
- An explicit goal of alignment on the basic content of BPA's formal policy proposal in January. Although the formal BPA policy proposal will be subject to public review and comment before the final BPA decision in May 2006, a regional process leading up to it would greatly enhance BPA's understanding of the region's needs and the probability of a final outcome that is supported by customers and other stakeholders.

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

BPA has estimated the firm output of the Federal Columbia River Power System (FCRPS) for FY 2012, net of all pre-existing firm system obligations, to be approximately 7,300 aMW. A key question for the Regional Dialogue is the extent to which customers aggregate net requirement load placed on BPA in FY 2012 will exceed or fall below the firm capability of the system. This question is relevant to several issues, including the amount of lowest-cost-based service that may be available to serve new publics and the anticipated amount of time before customers would be exposed to BPA service at a marginal cost-based rate for their incremental power supply.

One way of answering this question 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, DSI customers, investor-owned utilities and other BPA contractual obligations. The timing of individual utility updates to this forecast varies. Some of the load forecasts are current, while others are several years old. The SOU forecast indicates that BPA's firm load obligations will be less than firm Federal resources by about 200 aMW in FY 2012. According to this forecast, this surplus amount of power exceeding loads will then decline by about 100 aMW per year until about FY 2015, when obligations are projected to exceed existing FBS resources for the remainder of the forecast period. See Table 1. For purposes of Table 1 and Table 2 below, no IOU or DSI firm loads are assumed.

**TABLE 1**

| Product  | Current Projected Net Requirements<br>(assuming no change in Resources for Block and Slice) |              |              |              |              |
|--|---|--------------|--------------|--------------|--------------|
|  | FY2012  | FY2013       | FY2014       | FY2015       | FY2016       |
| Full   | 2,264   | 2,293        | 2,321        | 2,350        | 2,374        |
| Partial  | 1,093   | 1,106        | 1,119        | 1,132        | 1,144        |
| Block  | 817   | 830          | 842          | 855          | 867          |
| Slice (incl Block)                                       | 2,905   | 2,951        | 2,987        | 3,028        | 3,059        |
| <b>TOTAL</b>   | <b>7,079</b>  | <b>7,179</b> | <b>7,269</b> | <b>7,364</b> | <b>7,444</b> |
| <b>Resources<br/>(Net of Other Firm<br/>Obligations)</b> | <b>7,300</b>  | <b>7,300</b> | <b>7,300</b> | <b>7,300</b> | <b>7,300</b> |
| <b>Surplus/(Deficit)</b>                                 | <b>221</b>  | <b>121</b>   | <b>32</b>    | <b>(64)</b>  | <b>(144)</b> |

**Notes:**  
 Douglas Co. PUD, Central Montana and Southern Montana loads have been excluded from all totals.  
 Port of Seattle loads are included in current projections.  
 Contingent contract net requirements are included in all forecasts.  
 Net requirements are estimated as Total Retail Load forecast minus Rate Case (RC) Resources for FY2002.  
 RC Resources for FY2002 are estimated as RC TRL Forecast minus RC Sales Forecast.  
 "Current" data extracted from Study 26, which includes PNUCC updates for some customers.



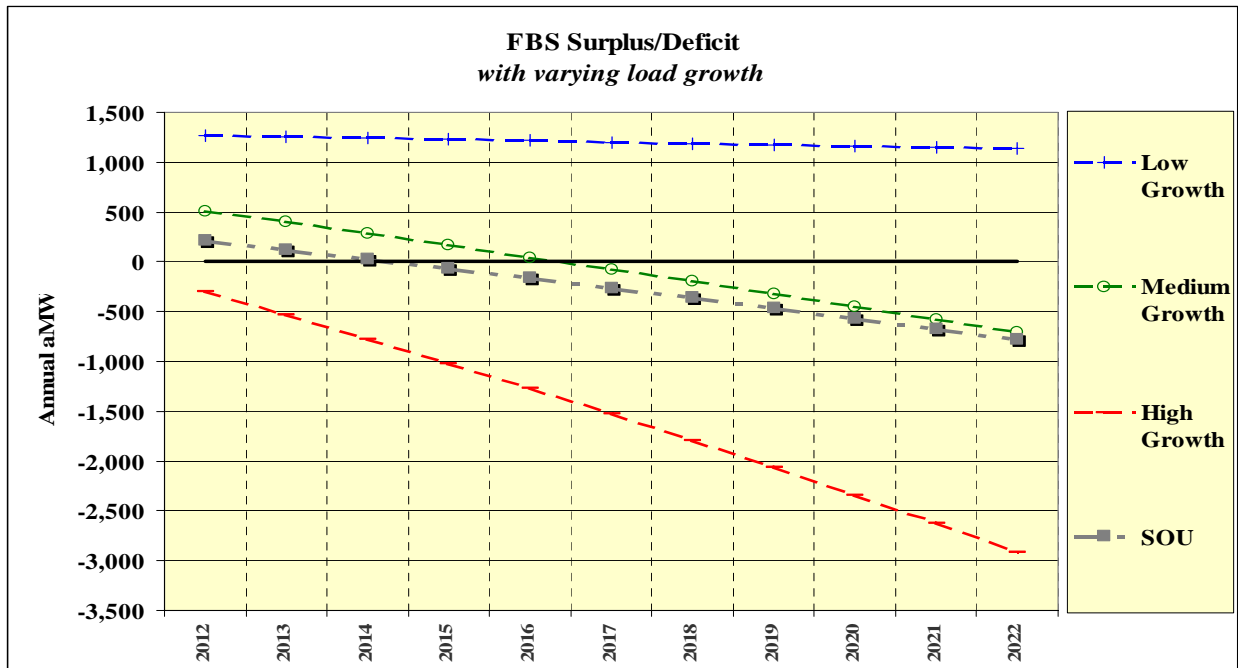
Because of the importance of these results, BPA recently revisited these numbers with particular focus on how its FY 2004 net requirement load compared to the SOU forecast. The SOU forecast projected net requirements loads in FY 2004 of about 6,700 aMW. The FY 2004 historic net requirements loads were checked by subtracting the customer's 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. In order 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 Northwest Power and Conservation Council's Fifth Power Plan) to FY 2004 actual loads and kept dedicated resources constant. The resulting forecast for surplus FBS power in FY 2012 ranges from 1,300 aMW surplus to 300 aMW deficit. Using the medium load forecast yields a 500 aMW power surplus. See Table 2. Extending these growth rates over time, the amount of surplus power is reduced to zero by FY 2012 in the high load growth case, in FY 2017 for the medium load case, and not for the foreseeable future in the low load case. See Figure 1.

The key point for purposes of this Concept Paper is that, under a "most likely" load forecast, the net requirement load of public customers is expected to roughly equal the available firm capability of the existing Federal system by FY 2012, with a 200 to 500 aMW surplus remaining. Given the uncertainties of both loads and resources, a 200 aMW or even 500 aMW surplus is well within the error band of these estimates. Thus, an equally important conclusion is that there remains considerable uncertainty about the amount of surplus firm power that will be available in FY 2012 beyond that needed to meet public utility net requirements loads. With robust load growth the total public utility net requirements load could exceed Federal system output before FY 2012. With low load growth the 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 BPA 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 Rates |                 |                |                  |              |
|---|---|--|-----------------|----------------|------------------|--------------|
|   |   | Low<br>0.2%  | Med-Low<br>0.9% | Medium<br>1.3% | Med-High<br>1.8% | High<br>2.5% |
| <b>Estimated Load</b>   | 7,800                                   | 7,900  | 8,400           | 8,700          | 9,000            | 9,500        |
| <b>Dedicated Resources</b>  | 1,900                                   | 1,900  | 1,900           | 1,900          | 1,900            | 1,900        |
| <b>Net Requirements</b>   | 5,900                                   | 6,000  | 6,500           | 6,800          | 7,100            | 7,600        |
| <b>FBS, Critical</b>  |   | 7,300  | 7,300           | 7,300          | 7,300            | 7,300        |
| <b>FBS-Net Requirement</b>  |   | <b>1,300</b>                                       | <b>800</b>      | <b>500</b>     | <b>200</b>       | <b>-300</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 Contract                         |   |  |                 |                |                  |              |

**FIGURE 1**



### III. SERVICE TO PUBLIC UTILITIES

There is broad agreement among BPA, our 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 our sales of firm power to public preference customers to meet their firm requirements loads at the lowest-cost-based rate to approximately the firm capability of the existing Federal system. The way we are proposing constructing the limit is based on the concepts advanced by our public power customers through the Public Power Council (PPC) "allocation" proposal. BPA proposes to establish, for every existing customer, a contractually defined level of access to power service that is priced based on the low-cost existing Federal system. For ease of discussion we are calling this level a customer's "high water mark" (HWM). The HWM is one of the most important aspects of this Concept Paper. The HWM gives each customer 20 years of certainty about the maximum amount of its loads BPA will meet at its lowest-cost-based rate. This is the long-term certainty customers need in order to move forward with their own resource development plans to cover loads in excess of the HWM, or to ask BPA to meet those loads at a higher rate.

As generally described in the PPC "allocation" proposal, BPA proposes that each customer's HWM would be based on the level of purchases that each customer was entitled to make for FY 2002 under current Subscription contracts. BPA is also proposing to adopt the PPC's customer-specific modifications to the FY 2002 levels. Additionally, just as with the PPC "allocation" proposal, if the total of these FY 2002 amounts are less than the firm power produced by the existing Federal system, each individual HWM would increase proportionately up to the firm power capability of the existing Federal system. The HWM amounts would be established in long-term contracts and a tiered rates methodology. The only reason that a customer's HWM could change over the contract period would be due to changes in a customer's service area through annexation or similar actions.

By establishing the amount of power available for customers priced at the cost of the existing Federal system, BPA is minimizing the "dilution" of the low-cost existing system with higher-cost resource/power purchases. We think that this structure only works well if the low-cost existing system is not burdened with the potential high costs of the Residential Exchange Program (REP). Therefore, we are proposing that either a disincentive be created to discourage public customers from utilizing the REP or that public customers settle their Residential Exchange rights for the term of the contract.

In BPA's proposal, the essential complement to giving customers a contractually defined HWM is establishing a long-term tiered rates structure whereby rates that reflect the low-cost existing Federal system (or "Tier 1") would be distinguished from rates that reflect the costs of power from incremental resources (or "Tier 2"). This tiered rates structure is necessary to send the appropriate price signal to customers who need to meet load growth beyond their HWM access to the low-cost existing Federal system. Sending this price signal would better enable them to

make efficient and economically rational resource choices as their load grows than would otherwise exist were BPA to continue to meld the costs of new resources into rates that include the costs of existing lower-cost resources.

BPA agrees with customers that it is important to understand how the tiered rates structure would work over time. To that end, BPA is proposing to conduct a separate 7(i) process to establish a long-term tiered rates methodology to work in conjunction with the long-term contracts. BPA's concept for how to provide the greatest possible assurance that this rates methodology will stay constant through the full contract period is described in the Dispute Resolution section of this Concept Paper.

Consistent with customer sentiments, BPA proposes to provide customers product choices for their HWM amount and for serving their load growth. BPA is proposing to integrate these products in a way that clearly defines both BPA's and our customers' ongoing obligation to meet regional load, allows customers to develop or purchase resources, and is relatively simple to administer. Similar to today, BPA proposes to offer Full Requirements and Partial Requirements products that follow load. BPA also proposes to offer the Block product. As a part of our discussion over the next 3 months, BPA and its customers will be evaluating several alternative approaches we could take to the Slice product for post-2011 service, consistent with BPA's Draft Slice Report issued in June and comments received on that report. However, consistent with what we have heard from our customers and the PPC "allocation" proposal, BPA proposes that the cost-basis for our products would be roughly the same for all public customers. This should reduce the potential for dispute and conflict over BPA rates.

If customers want to purchase power priced at the marginal cost of BPA acquiring or purchasing for serving their load above their HWM (a "Tier 2" rate), BPA proposes to offer a number of alternatives to choose from. BPA is proposing to provide this firm power service at Tier 2 rates that reflect the full underlying costs of the new resources or market purchases used to provide them. BPA would make its best efforts to keep the costs of buying power to serve Tier 2 load as low as possible but would not intend to "subsidize" the Tier 2 rate with the existing system. Examples of the kind of resources BPA is proposing to serve as the basis for Tier 2 rates are new renewable resources, short-term market purchases, long-term market purchases, and melded market purchases.

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

## **A. 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 our 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 customer would agree that it would not seek service from BPA in excess of its HWM, except when it agrees to pay the incremental or marginal resource cost at a Tier 2 rate. The contractual limit for access to

power at the lowest-cost-based rates is referred to as a customer's "high water mark" (HWM) and denotes the customer's maximum amount of lowest-cost-based power in average megawatts that can be provided at a rate reflecting the cost of the existing Federal system.

2. **Mechanics of High Water Marks:** The total of the HWMs initially distributed among public customers would add up to the firm energy output of the existing Federal system. Assigning the full cost of the existing Federal system is consistent with the approach proposed by the Public Power Council (PPC). BPA's proposal is to base each customer's HWM on the purchase rights it established for each customer in FY 2002 under current contracts. BPA further proposes to adopt customer-specific modifications to the FY 2002 numbers suggested by the PPC "allocation" proposal. Even with these modifications, BPA expects the total of these FY 2002 amounts to be less than the firm energy available from the existing Federal system. If this proves to be true, each customer's HWM would be increased proportionately so the total of the HWMs equals the 7,300 aMW firm energy output of the existing Federal system. Each customer's HWM would be included in power sales contracts with no ability for it to be changed for the duration of the contract, except for changes in service territory created by annexation or similar actions. BPA recognizes that using the historic FY 2002 numbers creates varying circumstances among individual public customers in relation to their rights to lowest-cost-based power—some may exceed their HWM level immediately, others with load loss may never need their full amount.

The PPC proposal allocated a percentage of the firm output of the existing Federal system to each customer. BPA is proposing that each customer receive a firm aMW level as its high water mark rather than a percentage of the system. BPA does not view this use of aMWs rather than percentages as a fundamental departure from the PPC proposal. We are proposing this because we believe it makes the overall proposal simpler to administer and does not reduce the level of certainty each customer would have about their amount of service at the cost of the existing system.

**High Water Marks and Pooling:** The PPC proposal suggested that BPA allow customers to pool their unused HWM amounts. This is an aspect of the PPC proposal that BPA proposes not to implement. BPA is proposing that the HWM be established as an individual customer right to purchase at the lowest-cost-based rate for its individual utility net requirement and is reluctant to create a construct that muddies this distinction by having amounts shared among customers. BPA is concerned that pooling these HWMs would work against the goal of regional conflict reduction and simplification. Additionally, tracking these rights could become administratively burdensome.

However, BPA recognizes the concern among some customers that locking-in HWMs based on old net requirement estimates may disadvantage some. BPA is open to other concepts to address this problem, such as possibly a one-time update of HWMs before the new contracts go into effect.

1. **Amounts of Power a Customer Can Buy from BPA:** BPA proposes an answer to what is probably the key question for a public utility customer reading this document: how much lowest-cost-based power would it actually get to buy. The HWM would be an important factor in determining the rate a customer would pay for BPA power but would not determine the total amount of Federal power a customer can actually buy for its net requirement load. By law the amount of Federal power a public utility customer is eligible to purchase is determined instead by BPA's calculation of its net requirement (the difference between the customer's firm regional consumer loads and its resources dedicated for service to its loads under section 5(b)(1) of the Northwest Power Act and governed by BPA's 5(b)/9(c) policy). BPA would serve the amount of net requirement load a public customer chooses to place on us as determined by BPA's calculation.

### **Relationship Between HWM Limits and Tiered Rates**

The rates that the customer pays would depend on the relationship between the customer's net requirement load placed on BPA and its HWM. For discussion purposes this paper labels the rate for deliveries of power below the limits of the HWM as Tier 1 or lowest-cost-based rate. The price for power provided beyond the limits of the HWM is referred to as Tier 2 and would reflect the marginal cost of serving the additional load.

### **Annual Net Requirement Calculations**

BPA proposes to perform a net requirement calculation each year to determine the amount of power each customer is eligible to purchase from BPA. Power amounts available for Block and Slice customers are based on a BPA produced forecast of their net requirement loads. BPA would determine customers' initial purchase rights with a new net requirement calculation for FY 2012. Prior to FY 2012, BPA would run a regional process to establish a transparent and consistent methodology for determining new net requirements which will address customer rights to energy and capacity. Load-following customers would continue to be provided their full power needs less their predetermined resources. It is also worth noting that the net requirement calculation would have additional importance for all customers under the HWM framework since it determines when to apply Tier 1 and Tier 2 rates.

### **Rights to Remove Resources for Net Requirements Load Loss**

Net requirements calculations determine the amount of firm power a customer may purchase from BPA by subtracting a customer's resources dedicated under section 5(b)(1) from its firm regional consumer loads. When a customer loses consumer load, the amount of firm power it is entitled to purchase from BPA is reduced unless the customer's existing non-Federal resource/power amounts are somehow decreased. The PPC "allocation" proposal suggested that customers be provided a contract right to temporarily remove resources each year to retain their level of BPA service. BPA supports this proposal to temporarily remove only those customer resources that were developed to meet Tier 2 loads and avoid a BPA purchase at Tier 2, since otherwise customers would have a serious disincentive to develop new resources. This would clearly conflict with BPA's goal of regional infrastructure development. However, BPA is proposing to require that other non-Federal resources continue to be applied to load for purposes of annually determining the customer's net requirement, unless such resources were "lost" consistent with the statutory definition of resource loss. BPA recognizes that this is a significant departure from the PPC proposal. Allowing customers with existing dedicated resources the

ability to remove those resources in the case of lost load thereby retaining the same access to the low cost existing Federal system allows those customers to capture the value of the difference between the existing Federal system and market. This difference could be very large in dollar value. BPA is concerned that a resource-removal right would create equity concerns that could threaten the stability and durability of the construct. BPA proposes that this temporary “excess” Tier 1 power, if not needed to meet BPA’s other regional load obligations, be sold by BPA and the proceeds be used to hold down the rates of all Tier 1 purchasers. Because our proposal disallows Slice/Block product purchasers from removing resources to retain their net requirement levels, BPA would first reduce these customers’ Block purchases. If a customer’s Block purchase was not large enough to cover the load loss we would then reduce the Slice product sale and also credit the sale of this “excess” Tier 1 to the Slice customer if the Slice product is continued. To accomplish this part of the proposal, BPA would have to make a modification to the current 5(b)/9(c) policy to reflect this treatment of a customer’s existing dedicated resources and its Tier 2 alternative resources (modification of the 5(b)/9(c) Policy would also be required to implement the PPC proposal on this topic). An important note is that, with possibly a few large exceptions, most utilities will eventually be able to use their full HWMs without removing existing resources.

### **Customer Rights to Add Non-Federal Resources**

BPA proposes that customers would have a right to add non-Federal resources to serve their net requirements load in excess of their HWM limit, subject to rules yet-to-be-developed on the resource shape and consistent with their obligations under any Tier 2 purchases made from BPA. To ensure the goal of meeting obligations to the U.S. Treasury, customers would generally not have rights to add resources to reduce their Tier 1 purchases, except for the off-ramp rights described in the Long-Term Cost Control section of this paper.

### **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, and the rate impacts of billing credits on the Administrator’s other customers are to equal the rate impact the customers would have experienced had the Administrator been obligated to acquire the resources. Under the proposed tiered rates construct, a customer should be insulated from the resource costs BPA would incur to serve another customer; in other words, the fact that a customer has acquired its own resource or undertaken conservation to serve its Tier 2 load should have no impact on the resource costs BPA would incur to serve other Tier 2 customer load. Hence, there would be no basis for affording billing credits to a customer. To avoid any cost exposure to other customers and as a condition of the customer giving notice that it elects to supply sufficient resources to serve its Tier 2 load growth instead of BPA, we propose that customers agree to forego a request that BPA provide billing credits for those nonfederal resources.

### **Access to the Public Exchange**

A cornerstone of our discussions with our customers and the region has been to minimize the “dilution” of the low-cost Federal system with higher-cost purchases or resources. This construct 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 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. This is a difficult problem to solve but we think that in order for this new paradigm of providing a contract that includes a defined access to BPA's lowest-cost-based rate and a differentiated rates structure to work, BPA and our public customers need to find a way to ensure that the low-cost Federal resources are not exposed to potentially high Residential Exchange Program costs. BPA is proposing two alternatives to address this problem. First, as part of offering a HWM and a long-term contract, BPA could ask public customers to settle their rights to Residential Exchange Program benefits. We would expect that most, if not all, public customers would agree to a settlement. However, if enough public customers decide not to settle their rights, then it is unclear whether the HWM approach would continue to achieve its intended goals. Alternatively, the customer could still have access to the existing Federal system through either a melded tiered rate pool of all preference customers that elect not to settle their exchange or a rates structure that is accompanied by a new tiered-ASC methodology that would apply to its exchange resources and loads. Customers in this pool would face additional risk, possibly including bearing all costs of the public exchange. In both alternatives, these arrangements would be for the term of the Regional Dialogue contracts. Both of these alternatives and any others that resolve the problem of the REP impact on tiered rates should be considered in the comment process.

### **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. New public customers are likely to form and request service during the term of the Regional Dialogue contracts. Large amounts of new public load are possible but not likely. BPA must meet requests from new public customers for service under section 5(b) of the Northwest Power Act if they meet the terms of our policy on standards for service. Under the PPC "allocation" proposal, if a new public customer requests BPA service it would face the marginal cost of new resources until the contract term ends, which would be 20 years. Unfortunately, this approach exposes the existing Federal system to excess costs through the REP. A new public customer, like an existing one, would be able to request a residential purchase and sales agreement to exchange their high cost resources for a product price-based on the existing Federal system. This result is incompatible with the goal of avoiding cost increases due to having an open-ended obligation. Therefore, BPA proposes that a new public customer be offered a HWM contract if existing customers with HWMs are not purchasing all of the lowest-cost-based FBS power available. The new public customer would have the same access to the Residential Exchange Program as an existing public customer. BPA also proposes that substantial notice periods be established before any new public begins taking deliveries of Tier 1 power to give both BPA and existing customers time to adjust rates and financial and operating plans to reflect the new load.

Another aspect of the proposal is when a new public customer forms from an existing public customer with a HWM, the new public customer with a HWM contract would proportionally reduce the HWM of the former customer. The new public customer would be offered the HWM amount relinquished by the former customer even if existing Federal system amounts would otherwise not be available.



## **When Service Requests at Tier 1 Exceed the Existing Federal System**

Under BPA's proposal there are two ways that Tier 1 requests based on HWMs could exceed the amount of lowest-cost-based power available:

1. **Caused by Load Growth and Additional HWMs for New Public Customers:** The total HWM amount starts at the size of the existing Federal system and can grow if HWM amounts are provided to a new public customer that settles its exchange obligations. Under BPA's proposal a customer's HWM would not change during the term of their Regional Dialogue contract, except due to service territory annexation or similar events. Adding new HWMs makes it possible that loads eligible for Tier 1 rates could grow beyond the existing Federal system. If this were to occur, all customers with HWMs would see power deliveries at the Tier 1 price proportionally reduced. BPA considered several other alternative approaches to the proportional reduction:
  - BPA considered not offering a HWM contract to new public customers but did not feel that this approach would actually limit dilution of the existing Federal system since the new public customer would be forced to seek benefits through the REP and therefore add costs to the low-cost system.
  - BPA considered keeping HWMs intact by augmenting the Tier 1 resource base but felt this was inconsistent with removing our open-ended load service obligation and not diluting the existing low-cost system with higher cost resources.
  - BPA considered setting HWMs based on FY 2002 net requirements without increasing HWMs to the 7,300 aMW capability of the existing Federal system. BPA could have then set amounts aside for new public customers but this would have been clearly inconsistent with the approach proposed by the PPC and could have resulted in many more customers having to buy Tier 2 power before the existing system was fully used.
  
2. **Caused by a Reduction in the Capability of the Existing Federal System:** BPA does not intend to increase the size of the existing Federal system in the future. Ongoing investments in the reliability and efficiency of existing generating plants, such as replacement of hydro turbines, could increase their total output over time, but most likely by a small percentage. BPA would calculate the annual firm capability of the existing FBS prior to each rate case and meet all eligible Tier 1 loads within that capability. Consistent with the PPC proposal, if FBS capability is reduced such that requests for Tier 1 power exceed the system's capability, power available under each HWM would be reduced proportionally as necessary to meet the revised firm capability of the FBS. This adjustment would occur in the rate case where the reduction is calculated.

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

### **Introduction**

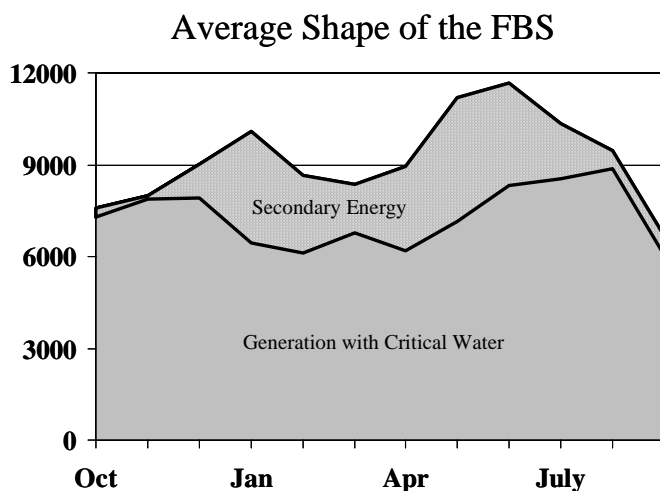
The fact that BPA proposes to limit sales of lowest-cost-based power would in no way restrict BPA's ability or obligation to meet our public customer's firm regional consumer load needs. BPA believes by limiting access to lowest-cost-based power offers new opportunities for

growing customers since they would be able to make their own choices on how best to serve their new loads without cutting themselves off from access to more melded-cost BPA power. BPA proposes to continue to make an array of products available that would meet our customers' diverse needs, offering comparable products to those available in current contracts. The products proposed do not include transmission needed to get the power from where it is generated to a customer's load. For load-following customers that do not have in-house expertise, BPA would offer a transmission management product at our cost of providing the service.

**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 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 what it costs to provide the products BPA proposes to offer it is important to start with some basics about the FBS which produces Federal power marketed by BPA. The HWM contract limits are based on the 7,300 aMW amount currently available from the FBS under critical water conditions. Critical water is essentially a near worst-case scenario for stream flows in the Columbia River Basin based on real-world experience from 1937. 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 actually available to create the power. BPA plans its system to meet loads under critical water. Power amounts above critical water are called secondary energy and it is the market value of this 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 its net requirements. Reshaping the FBS is illustrated in the sections below for both load-following products and block purchases. The costs for reshaping are discussed later in the Pricing section of this document

### **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 defined non-Federal resource amounts. A key difference between current Subscription contracts and the proposed new contracts would be the need to include the HWM limits to define when energy charges would be at Tier 1 rates and when they become Tier 2 rates. A brief description of Full and Partial Service 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, capacity and any shaping necessary to cover load variations due to temperature changes and load loss and/or growth, except when 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.

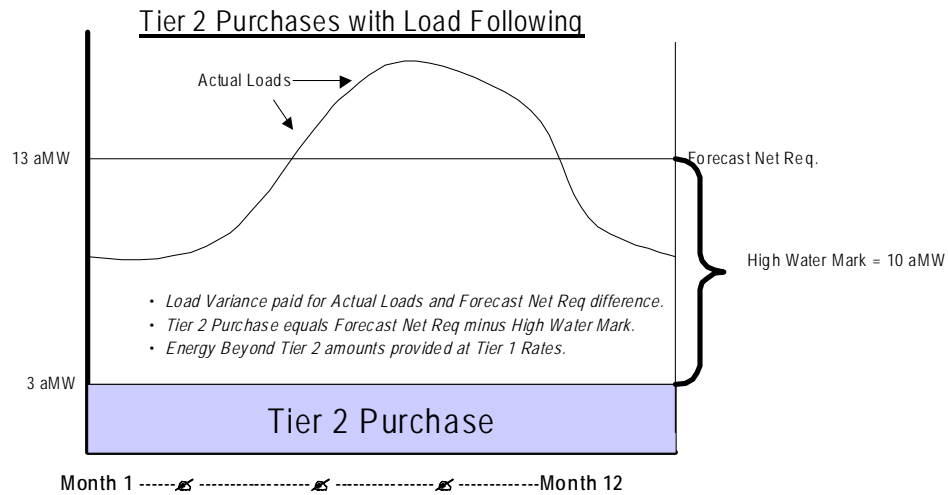
### **Reshaping the FBS for Load-Following Products**

Load-following products reshape the critical firm power of the FBS into the variable shape of the customer's net requirement. For Full Service, this represents a customer's entire load. For Partial Service, it represents the load that remains after pre-established customer resource amounts are provided. This reshaping is illustrated below for a Full Service customer.

In addition to reshaping the critical FBS to projected net requirements 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 Concept Paper. Load variance from the forecast load shape is depicted below:

### **Tier 2 Logistics for Load-Following Products**

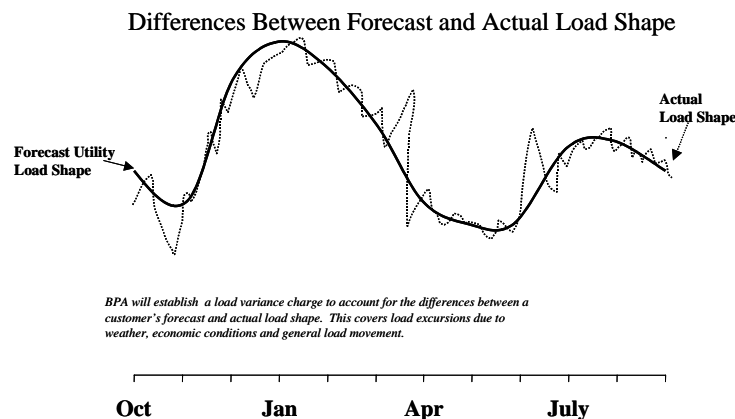
BPA proposes that the annual net requirement load forecast determines how much customer net requirement load is priced at Tier 1 and Tier 2. When a net requirement load is below the HWM limit, all power would be priced at Tier 1. If the net requirement exceeds the HWM limit, amounts above the limit would be priced at Tier 2. When Tier 2 applies, the amount of power provided at Tier 2 prices would be pre-defined at the time the net requirement is established. The rules for establishing the annual predefined shape of the Tier 2 purchases will be the subject of additional discussions, but as a starting point, they are proposed here as a flat annual block. Customers would be able to choose from Tier 2 pricing options discussed later in this document. The graph below depicts Tier 2 purchases for customers who purchase a load-following product.



### **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 the Slice product (subject to the product review) provided under current Subscription contracts. 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 with their own resources to follow their actual loads throughout the year. A brief description of Block and Slice follows below:

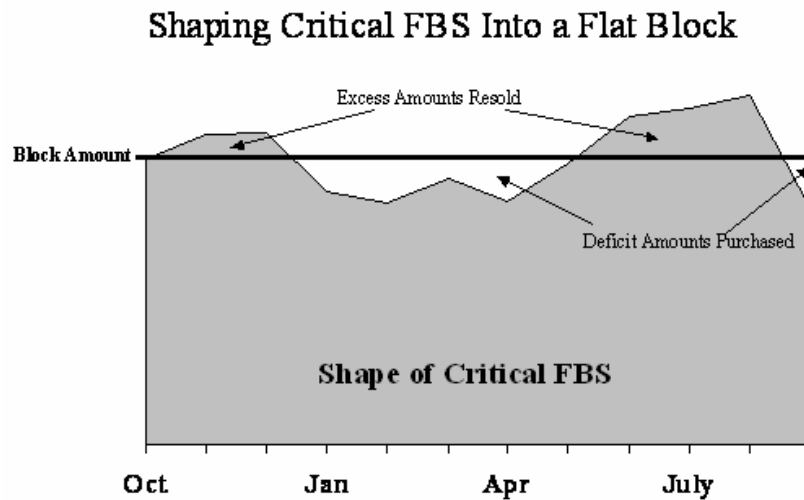
- **Block.** This product provides pre-defined amounts of power to meet a customer's forecast net requirement load, often in a constant shape in all hours of the year. Other predefined shapes may be possible, subject to product rules that still need to be worked out. The ability to increase block amounts during the contract term would be subject to notice provisions in the contract to ensure the customer's choice to place more load on BPA 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 only purchase the block product or pair it with a Slice product.



- Slice.** The Slice product as currently defined provides firm power for a customer net requirements load and an advanced sale of surplus energy based on the generation shape of the Federal system during an operating year. The amount of power purchased from BPA is set by a percentage of the customer's net requirement load compared to the total FBS critical water system output. Slice also provides some limited operational flexibility in return for a guaranteed payment of the same percentage of BPA's actual costs. The Slice product does not require any payment for FBS shaping costs since the customer takes on the responsibility to take and shape FBS output within the limits set by the contract. In addition the product allows the customer to monetize secondary energy directly because the secondary energy is a component of the actual system output provided under the product. The Slice product is only available to serve Tier 1 purchase rights since it ties directly to the size of the FBS. As a result, any Tier 2 purchases would need to be made in the form of a block product. The Slice product is undergoing further review as discussed later in this document.

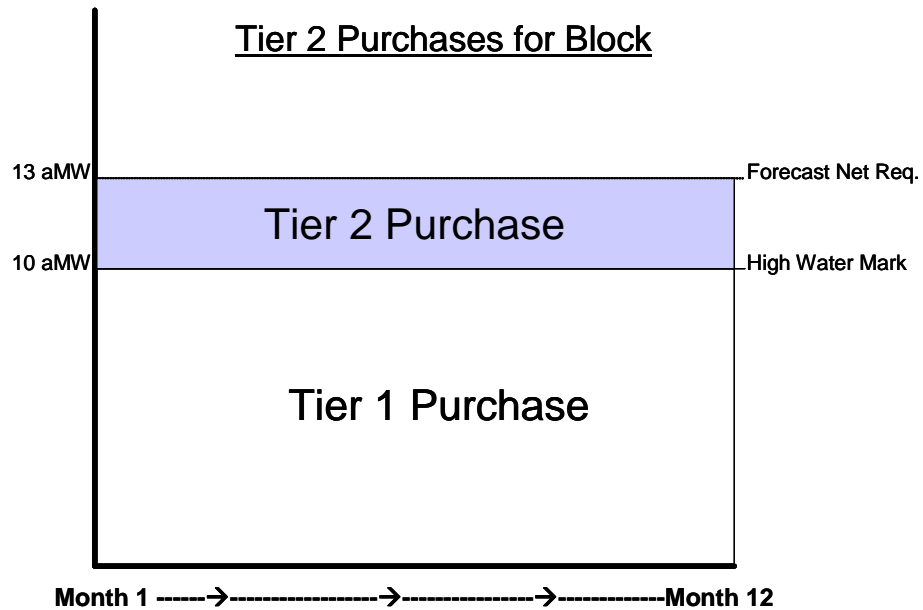
**Reshaping the FBS for Block Products**

The Block product reshapes the critical FBS into the fixed shape of the customer's monthly purchases. The amount of shaping required would generally be less than for a load following customer. The charges for this reshaping are discussed later in the Pricing and Rates section of this Concept Paper. This reshaping is illustrated above for a flat monthly Block but other block shapes are possible.



## Tier 2 Logistics for Non-Load-Following Products

BPA proposes that net requirement calculations would be performed annually to determine how much power for firm consumer load a customer may purchase from BPA. When annual net requirement load amounts are lower than the customer's HWM limit, all power provided would be at Tier 1 rates. If the net requirement exceeds the HWM limit, amounts requested by the customer above the HWM limit would be provided as a Tier 2 block. This is illustrated in the graphic below.



## Tier 2 Purchase Alternatives

For customers who want to place their Tier 2 service with BPA, we propose to offer customers a number of alternatives for Tier 2 pricing. BPA proposes to provide Tier 2 service priced to reflect the full costs of the resources or market purchases, or marginal costs in the event power is provided from the existing system. BPA would make its best efforts to keep the costs of resource acquisitions or purchases as low as possible, consistent with sound business principles. The rates for Tier 2 power are further discussed in the "Pricing and Rates for PF Service" section of this Concept Paper. At a minimum BPA proposes to provide the following options for Tier 2 pricing:

- **New Renewables:** Would offer power priced at the cost of purchasing and integrating new renewable resources to serve the Tier 2 load. The term of the purchase obligations would mimic the term of the renewable resource purchases made by BPA.
- **Short-Term Market:** Would offer power at a short-term market-index price and would have the shortest purchase term since it would not require BPA to make long-term purchase commitments. Minimum purchase commitments of a year would likely be required.

- **Long-Term Market:** Would supply power at a portfolio cost for longer-term market purchases. The details would be defined in the product and include purchase commitments consistent with the length of BPA's purchases.
- **Melded Market:** Would allow a customer to split their purchase between the short-term and long-term products. Would offer a mix of pricing and purchase commitment terms.

BPA also proposes to establish notice periods associated with providing Tier 2 service that would vary depending on the alternative selected by the customer.

BPA recognizes that the development of long-term products available to requirements customers that adequately address the risk of recovering costs will require significant effort, including an opportunity for additional public comment.

## C. PRICING AND RATES FOR PF SERVICE

### Introduction

As a cornerstone of this Concept Paper, and to give customers long-term predictability and certainty, BPA proposes to establish a long-term tiered rates construct that would limit the amount of power sold at our lowest-cost-based rate 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 case proceeding and specific decisions on rates would be made in each rate case. This section describes the process and three key rate constructs that BPA would put in place to meet the goal of minimizing the dilution of the low-cost existing Federal system: (1) a Tiered PF Preference Rate; (2) a Melded PF Preference Rate; and, (3) a PF Exchange Rate. This pricing section concludes by discussing the rate construct for reshaping the FBS into the available power products.

### Long-Term Tiered Rates Methodology

BPA recognizes that the rate construct discussed in this paper needs to be transparent and meaningful to customers in order to establish an economic climate that would 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 tiered rates methodology for the Regional Dialogue contracts. BPA proposes to complete this 7(i) process by October 2008. Through the combination of this tiered rate methodology 7(i) process and 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 a contract based on the tiered rates methodology would ultimately need to agree not to challenge that methodology.

### Establishing Rates for PF Preference Power

BPA proposes to establish a rate structure for power BPA sells at its preference rates that differentiates between the costs of 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 that would not change during their contract term and

which would define maximum access to Tier 1 rates. Tier 1 rates would continue to be adjusted for changes such as increases in the cost of the Residential Exchange Program (REP) benefits for REP loads with access to existing Federal resources, the cost of REP settlements, and the cost of public benefits, such as the fish and wildlife program, Endangered Species Act compliance, the acquisition of additional conservation and the costs of renewable facilitation activities. The level of the Tier 1 rate would be recalculated every rate period based on the costs of Federal Base System output and all non-Tier 2 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 requirements load below their HWMs resulting in fewer Tier 1 purchases than the available firm power output of the FBS. BPA proposes to retain the value and costs of the existing Federal system in Tier 1, including this temporary FBS power, to keep Tier 1 rates as low as possible.

- **Tier 2 Rates for PF Power:** BPA is proposing that power provided to meet a customer's purchase rights beyond its right to lowest-cost-based power (that is, beyond its HWM, or its reduced rights to buy in the event of a proportional reduction in Tier 1 purchase ability due to the advent of new public loads) would be provided at Tier 2 rates. BPA would set rates to fully recover Tier 2 costs from those customers who request Tier 2 service. To the extent that FBS power is provided to serve Tier 2 loads, it would be priced at BPA's marginal cost of power with the value above the average FBS cost being credited back to Tier 1. Customers would have choices about the types of resources reflected in the Tier 2 rate. BPA proposes to establish notice periods associated with providing Tier 2 service that would vary depending on the alternative selected by the customer. BPA intends to keep Tier 2 costs as low as possible, but also fully recover Tier 2 costs from those customers who request Tier 2 service. BPA will establish rates to assure full cost recovery. However in order to meet the cost recovery requirements of Section 7(a) and (g) of the Northwest Power Act, BPA must preserve the ability to reallocate costs to Tier 1, in the unlikely event that the Tier 2 revenue recovery is not enough.

### **PF Rates for Preference Power Sold to Publics without an Individual HWM**

If we adopt the approach that in order for a public customer to receive an individual HWM it must settle its Residential Exchange Program (REP) benefits, we need a way for public customers to still access the existing Federal system. We have thought of two ways we could structure this "default" service for those public customers who choose not to settle their rights to the REP.

In the first approach, the same HWM amount a public customer would have been provided would be used in a melded PF rate that will apply to all public customers that choose not to settle their REP benefits, including new public customers where a HWM cannot be offered due to power from existing FBS resources not being available. The amount of power from FBS resources associated with the HWMs assigned to the melded PF rate would be used to serve the contracted obligations of the members of the group, as part of each rate case. Existing public



customers in the group would have equal access to BPA's lowest-cost-based power rates at the initial establishment of tiered rates, but the size and composition of the group and, therefore, the access to that amount of the existing FBS resources would not be limited and could change over time. The melded rate for each rate period would take into account changes in net requirement loads and addition of new public exchange customers. Additional marginal costs of resource acquisitions would be added to the melded rate as necessary to serve the contract obligations under that rate. In addition, BPA is considering ways to include all public exchange costs in this pool.

A second approach, and less preferred approach, would be to treat them the same as all other public customers that did not settle.

### **Rates and the Residential Exchange Program**

BPA customers can access benefits from the Federal system through both direct power purchases and through the Residential Exchange for their residential and small farm loads. Comparable with the approach already discussed for Tier 1 rates, BPA proposes to structure the REP to accomplish the region's goal of minimizing the dilution of the benefits of the existing Federal system. The HWM approach earmarks access to the entire low-cost Federal system, yet public REP customers have additional access to rate benefits from the same resources. This means that for ratemaking purposes loads with access to low-cost resources will exceed the capability of that system. Under BPA's statutes, the preference and REP loads are served with the REP resources priced at their average system cost when the amount of these combined loads exceeds the capability of the Federal system resources. The cost of the resources included in BPA's rates for Tier 1 power will be a combination of existing Federal resource costs and exchange resource costs.

Currently when REP loads grow their access to existing Federal system resources also increases. Continuing this practice would dilute the FBS value to other customers since load growth for REP customers would experience greater access to lowest-cost-based power while PF power amounts would be capped by HWMs. For consistency with the HWM approach, BPA proposes to limit REP access to low-cost Federal resources to the FY 2002 REP loads of each customer that chooses to participate in the REP. PF Exchange rates would be based on the melded costs of the FBS resources they have access to plus, to serve the remainder of the loads, the cost of resources REP customers exchange with BPA. Through this approach REP loads would be provided guaranteed but limited access to lowest-cost Federal system resources comparable to that proposed for PF power purchasers.

Another approach would be to establish a tiered ASC methodology comparable to the HWM-tiered rates construct for net requirements purchases. This effectively provides a comparable HWM to residential exchange loads and provides a principled cost match between the costs of Tier 1 and the costs included in the exchanging utility's ASC. This option would require a change in the ASC methodology and the exchange contract.

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

The HWM concept sets a limit on a customer's contractual right to buy a specific amount of firm power at BPA's lowest-cost-based rates. The starting load shape for that power sold is the

forecast monthly shape of the FBS under critical water. This results in an inflexible shape that has little correlation to the customer's actual consumer load needs. To meet load needs, the monthly shape of the FBS under critical water must be transformed to a more 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 monthly shape of the FBS under critical water with cost to provide the same amount of energy in the shape required by the customer. 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 any marginal costs incurred by BPA for shaping. Customers that purchase load-following products would pay an additional charge for the cost and risks BPA faces covering 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 adopted in the PPC Proposal. Charging less than our 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. Under the BPA proposal, the value of the flexibility is provided equitably to all customers by maximizing the value of BPA's secondary energy, providing rate-reduction benefits to all non-Slice customers. The Slice product would not be affected by the reshaping since a purchaser can use its percentage of system flexibility within contractually established limits directly and manage with its other resources its own loads. At this time, BPA believes this approach to pricing would not make the average price per MWh for all Tier 1 service any higher than an alternative pricing approach but will send appropriate price signals to customers as they consider Tier 2 resources. Nor does BPA believe that this pricing approach would not create cost shifts between Slice and non-Slice customers.

### **Slice Product**

BPA began implementation of the Slice product in October 2001. In late 2004, BPA initiated a review of the product performance and released a draft report in May 2005. BPA evaluated its experience with Slice against the original five principles that were used to guide development of the product. The evaluation was challenging, and BPA has not yet come to any definitive conclusions. In general, BPA found the implementation of the Slice product has been successful and consistent with the principles, but there are areas of concern that warrant further examination. BPA is forming a Slice Regional Review Team, with members from BPA, Slice, and non-Slice customers, and other interested parties, to examine the Draft Slice Report results and assess options for the future of the Slice product. The team will work within the Long-Term Regional Dialogue schedule to develop information to inform BPA's decision on the Slice product. BPA intends to make a decision on the future of the Slice product as part of the Long-Term Regional Dialogue.

The concerns stated in the report include: potential for cost shifts arising in the true-up dispute; friction between Slice and non-Slice customers; contract exhibit amendments; issues surrounding rights to capacity and operating flexibility; and, potential legal issues. The Regional Review

Team's work would include examining these concerns, while considering the comments offered on the report.

The Draft Slice Report included three options for the future of the Slice product:

- Replace the Slice product with flexible power and capacity products at appropriate cost-based rates. BPA views this option as very likely if the current litigation regarding true-ups is resolved in a manner that leads to significant cost shifts, capital access problems, or debt de-optimization.
- Continue sales of the Slice product at approximately the current amount, with some modest reductions in the current level of operating flexibility and/or clarification of the nature of the capacity rights and flexibility.
- 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:

- Offer an expanded quantity of the Slice product, leaving the operational flexibility similar to current practice and address administrative terms and issues that are the perceived to be the cause of customer friction and dissatisfaction.

## **D. OTHER ISSUES**

### **Transfer Service**

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 built their own transmission facilities in the region. In many cases, it was more economical and efficient for BPA to contract with one of these other transmission owners to deliver Federal power over their facilities, rather than BPA building duplicate facilities. This service 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 BPA currently has 80 preference customers that receive all or part of their Federal power through transfer service.

In early 2005, BPA signed 20-year contracts with Transfer service customers that require BPA to: (1) continue to arrange for Transfer service with the third-party transmission owners; (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 contract requires the Transfer service customers to work with BPA to reasonably limit the cost of Transfer service. The contract also describes the intent of the parties to address other Transfer service issues in the future. These other issues would be addressed in upcoming months in a separate process. One transfer service issue of particular relevance to the Long-Term Regional Dialogue is whether BPA should cover the costs of transfer service for deliveries of non-Federal power. If BPA pays for transfer service for Federal power deliveries and not non-Federal deliveries, there could be significant cost advantages to the customer for buying Tier 2 power from BPA. On the other hand, paying for non-Federal deliveries would increase BPA's cost of service to GTA customers. Although BPA has not made

a decision on this issue, such an outcome could create a cost differentiation that would be inconsistent with broader objectives associated with tiering BPA's rates.

BPA proposes to resolve the issues associated with transfer service in a separate process and not as part of the Long-Term Regional Dialogue. Discussions on transfer service are expected to begin in fall 2005, with resolution of issues anticipated in by mid-2006.

### **Low Density Discount**

BPA began offering the Low Density Discount (LDD) in 1981 pursuant to section 7(d)(1) of the Northwest Power Act. The Act requires the Administrator to provide discounts 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 to a customer based on the criteria adopted. BPA currently has 55 customers who receive a discount under the LDD, and the annual cost is about \$18.4 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. Under this proposal, it would continue to be revised in future 7(i) proceedings. Also established in BPA's future 7(i) rate case proceedings would be implementation details relating to eligibility, including whether to apply the LDD to load growth purchases, as well as the discount level, applicable rates, and cost allocation.

### **Irrigation Rate Mitigation**

BPA has long provided some form of assistance to regional seasonal irrigation load through either surplus firm power sales or rate mitigation to customers serving irrigation consumers. There have been times when spring/summer intensive irrigation loads could have borne an inordinate burden because of the way BPA shapes its seasonal rates. The goal of irrigation rate mitigation is to address this issue and support the continued economic health and competitiveness of irrigated agriculture in the region. BPA recognizes the importance of irrigated agriculture to many rural communities throughout the region, and eliminating irrigation rate mitigation could have a serious adverse impact on the economic viability of these communities.

BPA proposes to continue to offer rate mitigation to customers that serve irrigation consumers that would be inordinately impacted by BPA's rate design, in particular the shaping of seasonal rates. Beginning with the FY 2012 rate period, BPA proposes offering irrigation rate mitigation in the form of a fixed mills-per-kWh discount 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 the months of May, June, July, and August.

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. Any discount, if adopted by the Administrator, would be included in BPA's general rate schedule provisions for BPA's FY 2012 power rates or successor rates.

For determining the amount of mitigation, BPA proposes the principle that May-August irrigation loads should experience percentage rate increases no higher than the rate increases of the September-April period, using the FY 2007-2009 rate period as the baseline for this determination. For determining this baseline, May-August irrigation rates would include the effect of the current irrigation rate mitigation product.

BPA further proposes to cap the overall program cost and limit the kWh participation at the annual FY 2007-2009 program levels, and to apply an irrigation discount only to eligible irrigation loads of customers participating in BPA's irrigation rate mitigation product during FY 2007-2011.

BPA also proposes requiring that participating customers implement cost-effective conservation measures on irrigation systems in their service territories.

### **New Large Single Loads**

BPA developed a New Large Single Load (NLSL) policy in 2001, and the Administrator issued a ROD on the policy in 2002. BPA again addressed NLSL issues in its February 2005 *Policy for Power Supply Role for Fiscal Years 2007-2011* ROD.

BPA proposes to continue its current NLSL policy with two clarifications. First, BPA proposes to clarify the definition of renewable resources in the NLSL policy so the definition does not include existing hydroelectric resources that were online prior to May 1, 1999. This clarification will eliminate any confusion with the Conservation and Renewable Discount standards. The February 2005 policy gives a customer the option of applying a renewable resource or on-site cogeneration to a large load that would otherwise be an NLSL to reduce the load on the utility to less than 10 aMW. The proposed change would make it clear a consumer cannot reduce a potential NLSL with power from a hydroelectric or other renewable resource that was constructed and online prior to May 1, 1999.

Second, BPA proposes to clarify how a consumer's on-site cogeneration and renewable resources must be shaped and applied to facilities that would otherwise be considered an NLSL. As stated above, the NLSL policy allows a consumer to provide an on-site cogeneration or renewable resource on a permanent basis to serve all or a portion of a large load that would otherwise be considered an NLSL. A consumer using its on-site cogeneration or a renewable resource must apply it in the shape of its load.

#### **IV. BENEFITS TO RESIDENTIAL AND SMALL FARM CUSTOMERS OF INVESTOR-OWNED UTILITIES AND PUBLIC AGENCIES**

A sustainable package of proposals for BPA's future power supply role requires the region to come to agreement on an appropriate level of Residential Exchange Program (REP) benefits to residential and small farm customers of IOUs and public agencies. Consistent with the goals stated in the Introduction to this paper, BPA is seeking a way to implement the REP that:

- Provides an equitable level of benefits to residential and small farm customers of investor-owned utilities, and to high-cost public utilities and that is consistent with current law;
- Ensures that BPA's lowest firm power rate reflects the cost of the undiluted existing Federal system; and
- Is predictable, objective, and minimizes administrative costs for BPA and customers.

Successful resolution of the REP is vital to the goal of aligning regional interests and reducing conflict.

BPA has developed estimates of REP benefits in FY 2012 if BPA were simply to resume implementation of the REP program rather than settling it. These estimates are 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 the impact of several legal interpretations that are not the subject of current litigation and must be decided in the FY 2007 rate case. Variations in the assumptions on ASC levels, BPA costs, and outcomes of the legal interpretations used for the estimates show REP benefits for residential and small farm consumers of investor-owned utilities ranging from \$94-\$491 million per year and REP benefits for residential and small farm consumers of public utilities with high ASCs ranging from \$46-\$117 million per year. The investor-owned utilities have estimated their payments under the REP to exceed \$600 million per year based on an REP implemented in accordance with their litigation positions. At the same time, a number of public utilities believe the payments under the REP for investor-owned utilities should be \$140 million or less. This disparity in the expected outcome is the source of ongoing regional conflict over the REP. This conflict diverts the resources of the region's utilities away from their core mission of serving the electric power needs of the region's consumers. The time and effort involved in litigation over the REP diverts those resources away from other projects and makes cooperation on other goals much more difficult.

As a result of the uncertainty surrounding the payments BPA would make under the REP, BPA proposes to pursue settlement of the REP for those utilities with a high ASC. The settlement would provide benefits based on a financial formula and would reduce the uncertainty surrounding payments under the REP. Absent a settlement, BPA would move to implement the REP under the Northwest Power Act. To do so, BPA would initiate a consultation process to revise the ASC methodology, develop an in-lieu policy, and update and simplify the 7(b)(2)

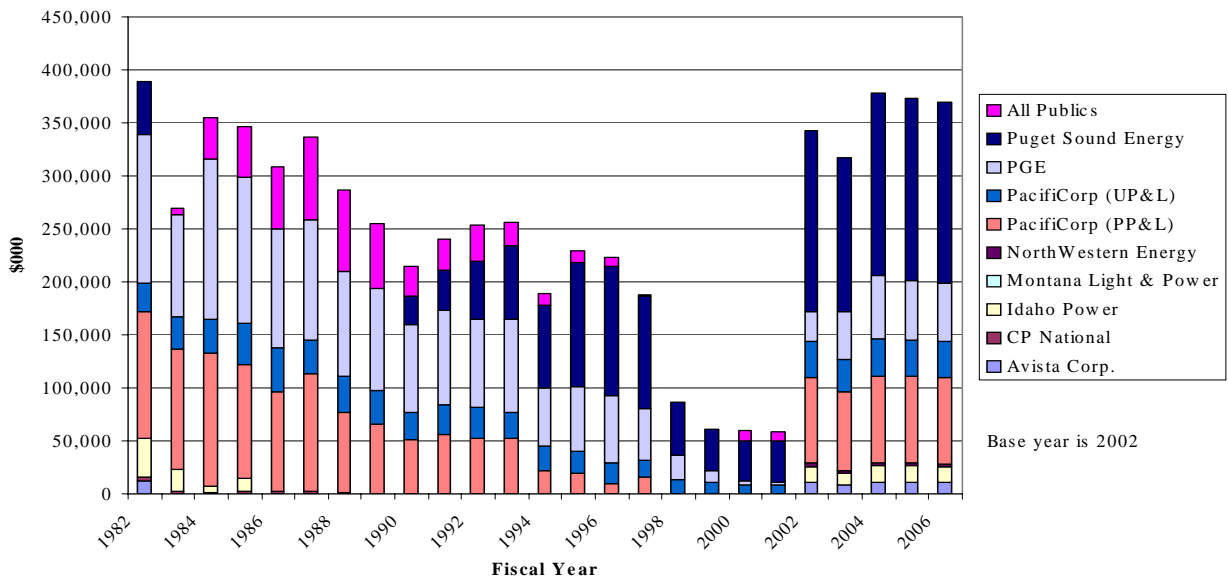
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<sup>1</sup> These estimates are rough approximations of potential REP benefits based on a simplified 7(b)(2) rates model and are meant for comparison purposes only. BPA believes these results reasonably replicate the results of rate case models.

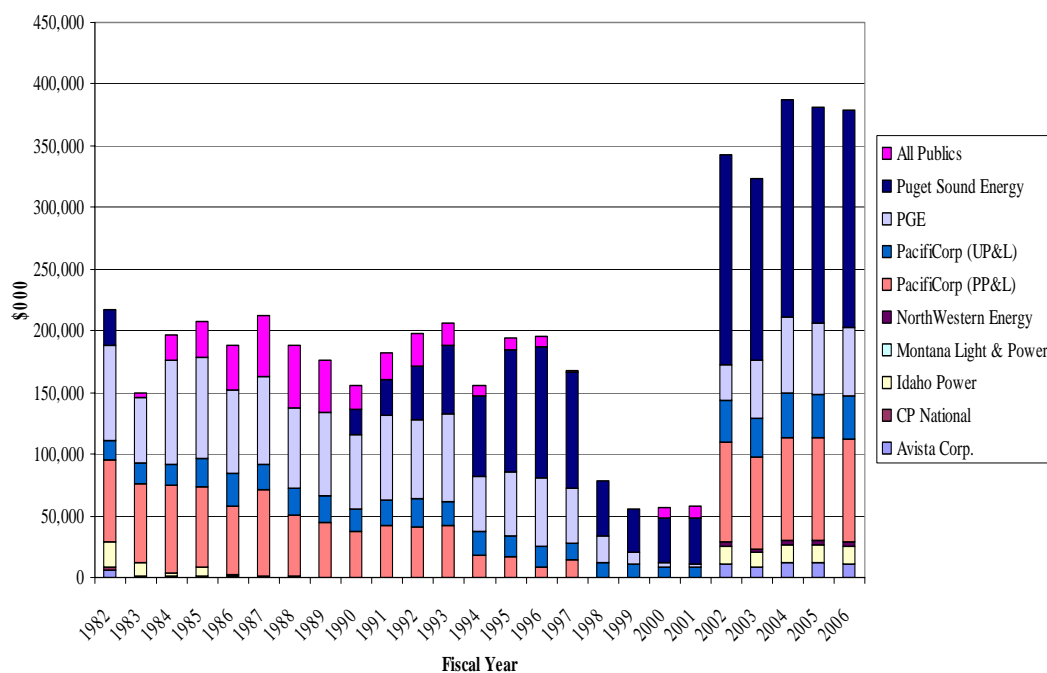
methodology. This default path would create large administrative costs and leave a large range of uncertainty for BPA and customers about the level of REP benefits. Given the uncertain outcome associated with implementing the REP and the impact of that uncertainty on rates paid by all customers and the cost of developing generation in the region, BPA believes it is in the best interests of the region to arrive at a settlement that the agency and the region's utilities can endorse.

BPA proposes that a settlement providing benefits ranging between \$100 million to \$300 million per year for the six investor-owned utilities appears to be a reasonable basis for discussions. BPA proposes this because a settlement in this range appears to reasonably reflect the likely range of actual payments if BPA were to implement the REP. A settlement in this range also appears consistent with the historical level of benefits under the REP. The following graphs show the historical benefits under the REP in 2002 dollars and nominal dollars.

**IOU and Public Agency Residential Exchange Benefits 1982 - 2006 (Real \$)**



### IOU and Public Agency Residential Exchange Benefits (Nominal \$)



A settlement eliminates the cost to the region of administering an REP program. These costs could add tens of millions of dollars to BPA and customer rates. A settlement structure based on market minus BPA’s PF Preference rate replicates an REP program where ASC costs are capped by “in lieu” power purchases and the PF Exchange rate is established without the section 7(b)(2) rate test triggering (though actual REP payments in this in-lieu scenario could be higher or lower than the proposed \$100-300 million range). In-lieu is a BPA policy determination on when it will purchase power from the market or other resources instead of exchanging power with the utility for its eligible exchange loads.

It is intended that this settlement would provide REP benefits to the region’s investor-owned utilities in the range of expected outcomes under the REP. Payments under the REP are normally impacted by changes in market conditions. The proposed formula also would make payments higher when market prices are high, since REP payments would be high in such circumstances because BPA’s costs are reduced through increased secondary energy credits and the ASCs of customers are increased due to increased resource costs. It also appears likely that the 7(b)(2) rate test would cap benefits under the REP in the range of \$300 million. The \$100 million floor also appears to represent a reasonable estimate of the minimum payment that would be provided under the REP in low price market conditions. During low market conditions, BPA costs tend to increase due to lower secondary energy credits and the ASCs of customers decrease due to lower resource costs. A floor level of payment in the formula also represents a tradeoff for capping the benefits of the REP and using only 40 percent of eligible REP loads in the formula.



There are, however, large and complex issues to resolve in settling the REP, and BPA believes it is necessary to have an alternative under consideration in the event a settlement cannot be reached.

Such alternative could be to return to the traditional REP. Under this option, BPA would consult with stakeholders to develop a new ASC methodology. In the 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. During the consultation, BPA would probably address the source of information used in developing individual utility ASCs and the timing for updating ASC calculations. BPA might propose to establish 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 would require the ASC consultation to also address forecast parameters for loads and variable costs that would occur during the period for which benefits are provided, following the historical period used in the accounting documents. Public utilities that participate in the REP would be required to file equivalent accounting and financial statements for purposes of an ASC calculation.

To implement the traditional REP, BPA would publish an in-lieu policy, establishing BPA's right to buy resources from the market or other resources in lieu of buying an exchange resource from an exchanging utility. Such policy would likely 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.

BPA might propose to calculate ASCs once every 2 years parallel to the section 7(i) process establishing BPA's wholesale power rates. BPA would calculate ASCs based on the documents described above. BPA might propose that in-lieu decisions be made on a customer-by-customer basis prior to each rate period where BPA would decide whether to purchase the customer's exchange resource and provide financial benefits under the REP or purchase an in-lieu resource and offer power for sale at the PF Exchange rate to a customer under its Residential Purchase and Sale Agreement.

BPA would also need to review its section 7(b)(2) methodology in a section 7(i) proceeding and determine whether it could be modified to make it simpler and apply more specifically to current factual conditions.

### **Additional Detail on Settlement Options**

#### **Option A**

BPA's proposed settlement option would be similar to the existing settlement between BPA and the investor-owned utilities. The annual benefit would be a financial payment based on the difference between an independently established forward market price and BPA's lowest cost PF rate for a 2,200 aMW flat block of power. The 2,200 aMW is derived from the 4,400 aMW of REP loads in FY 2002. The total benefit, assuming no publics accept the offer, would be subject to a cap of \$300 million in FY 2012, which would escalate at 2 percent a year to account for

inflation. The floor would be \$100 million, which would not escalate. Each participating utility would receive a minimum annual benefit.

Points to consider during workshop discussions would include: Should the cap be lowered from current levels, and whether lowered or not, should it escalate? If so, should escalation be limited to 2 percent a year?

If BPA's proposed approach were adopted, it would be necessary to determine the amount of benefits to be provided to individual investor-owned utilities. The state utility commissions have indicated they would collaborate on a recommendation on allocation of the benefits, which BPA would welcome. BPA would ultimately decide the appropriate amounts after consideration of comments.

Benefits under the settlement would not be assignable if another entity takes over the distribution system of an investor-owned utility and would be retained by BPA. Public agencies taking over investor-owned utility service territory that elect not to take an offered HWM and existing public agencies that elect not to accept a HWM would be eligible for the REP (as described in the section of this paper covering service to publics). BPA would offer a settlement of the REP to such public utilities with high forecasted ASCs (above a specified level such as \$45/MWh). This settlement would provide the average amount of the investor-owned utility benefit for 50 percent of the public utility's REP loads in FY 2002.

### **Option B**

An alternative approach to settlement would be to establish a total annual benefit of \$250 million per year for the region's six investor-owned utilities. This amount would be fixed for the term of the settlement, which would be based on the term of the public utility contracts. BPA and any investor-owned utility would have the right to terminate the settlement on 2 years' notice.

A key component of this settlement option would be allocation provisions that direct the benefits primarily to high-cost utilities. All investor-owned utilities would receive a minimum benefit. The policy would base the allocation methodology on a simplified description of ASC minus lowest-cost-based PF rates. If the allocation resulted in benefits less than the minimum benefit, the investor-owned utility would receive the minimum benefit and the remainder of the settlement amount would be allocated to the remaining utilities.

As with settlement Option A, benefits would not be assignable to public utilities taking over the distribution system of investor-owned utilities. As in Option A, BPA would offer an REP settlement based on the average amount of the investor-owned utility benefit for 50 percent of the public utility's REP loads in FY 2002 to new publics taking over investor-owned utility service territory or to publics with high ASCs. Any public utility accepting the REP settlement would be included along with the investor-owned utilities in the allocation of REP settlement benefits and would receive a minimum benefit if the allocation resulted in less than the minimum benefit. All settling REP customers would receive a minimum benefit of \$1/ or \$2/MWh of REP load as an inducement to settle. If the allocation formula resulted in a lower payment, this minimum payment amount would apply for publics as well as for IOUs.

BPA considered adjusting the benefit amounts in this option to reflect increases and decreases in the PF Preference rate. Issues raised by that concept included which year to use as the starting point for the PF rate, whether the actual rate level in that year or a target rate level would be the appropriate number, what level of escalation in costs should be assumed for the PF Preference rate and its relationship to the expected increases in utility ASCs over time, and what share of any excess costs or benefits should be used to adjust REP settlement benefits. BPA felt such proposal would add an unacceptable amount of uncertainty making any agreement on such parameters extremely difficult, if not impossible.

As a condition of receiving the REP settlement under either option, all exchanging utilities would agree not to challenge the long-term tiered rates methodology or other REP settlements.

**Background: Estimated REP Benefits in FY 2012**

The tables below show a range of REP benefits that BPA has estimated under high and low rate scenarios. These high and low rate scenarios were not selected to represent the complete range of potential BPA costs but a reasonable estimate of the range of the majority of expected BPA cost levels in FY 2012. These scenarios examine potential benefits using different assumptions on DSI service and the resources included under the 7(b)(2) rate test. The estimated ASCs for the low, middle, and high ASCs are \$46/MWh, \$49/MWh and \$55/MWh for public utilities and \$37/MWh, \$45/MWh, and \$53/MWh for investor-owned utilities. The total public utility REP load is assumed to be 830 aMW and the total investor-owned utility REP load is assumed to be 5,360 aMW. The shaded scenarios are estimates where the 7(b)(2) rate test did not trigger.

Table 1 provides an estimate of REP benefits under a low BPA rate in FY 2012 (which is assumed to be \$26/MWh without any REP costs). Dollars are in millions.

**Table 1  
Estimate of Traditional REP Benefits  
under Low BPA Rates**

| No DSI Service w/ Mid-C Res In     |         |      |       | No DSI Service w/ Mid-C Res Out     |         |      |       |
|------------------------------------|---------|------|-------|-------------------------------------|---------|------|-------|
|                                    | Publics | IOUs | Total |                                     | Publics | IOUs | Total |
| ASC low                            | 87      | 109  | 196   | ASC low                             | 109     | 212  | 321   |
| ASC med                            | 58      | 137  | 195   | ASC med                             | 92      | 295  | 387   |
| ASC high                           | 46      | 149  | 195   | ASC high                            | 82      | 309  | 391   |
| 500 MW DSI Service w/ Mid-C Res In |         |      |       | 500 MW DSI Service w/ Mid-C Res Out |         |      |       |
|                                    | Publics | IOUs | Total |                                     | Publics | IOUs | Total |
| ASC low                            | 108     | 206  | 314   | ASC low                             | 108     | 206  | 314   |
| ASC med                            | 95      | 307  | 402   | ASC med                             | 108     | 381  | 489   |
| ASC high                           | 85      | 326  | 411   | ASC high                            | 117     | 491  | 608   |

Table 2 provides an estimate of REP benefits under a high BPA rate in 2012 (which is assumed to be \$32/MWh without any REP costs). Dollars are in millions.

**Table 2**  
**Estimate of Traditional REP Benefits**  
**under High BPA Rates**

| No DSI Service w/ Mid-C Res In |         |      |       | No DSI Service w/ Mid-C Res Out |         |      |       |
|--------------------------------|---------|------|-------|---------------------------------|---------|------|-------|
|                                | Publics | IOUs | Total |                                 | Publics | IOUs | Total |
| ASC low                        | 82      | 94   | 176   | ASC low                         | 82      | 94   | 176   |
| ASC med                        | 65      | 171  | 236   | ASC med                         | 83      | 254  | 337   |
| ASC high                       | 50      | 190  | 240   | ASC high                        | 92      | 385  | 477   |

| 500 MW DSI Service w/ Mid-C Res In |         |      |       | 500 MW DSI Service w/ Mid-C Res Out |         |      |       |
|------------------------------------|---------|------|-------|-------------------------------------|---------|------|-------|
|                                    | Publics | IOUs | Total |                                     | Publics | IOUs | Total |
| ASC low                            | 82      | 93   | 175   | ASC low                             | 82      | 93   | 175   |
| ASC med                            | 84      | 256  | 340   | ASC med                             | 84      | 256  | 340   |
| ASC high                           | 83      | 338  | 421   | ASC high                            | 104     | 449  | 553   |

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

## **V. SERVICE TO DIRECT SERVICE INDUSTRIES**

### **Background**

Historically, the Direct Service Industries (DSIs) have been an important BPA customer group creating family-wage jobs and comprising 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 Northwest PNW, and increases in Northwest power prices have put the viability of the Northwest's aluminum smelters at risk. At present, the smelters confront a market where aluminum prices are up sharply but are offset by the fact that input costs (alumina) are at historic highs. The combined effects of world aluminum and alumina prices and higher power prices in the Northwest have caused BPA service to the region's smelters to drop from 3,000 MW in calendar year 2000 to below 300 MW today. Many former companies have faced bankruptcy and several aluminum 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 the potential to be the economic mainstays of their communities which 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 to offer contracts for service benefits to four DSIs for the FY 2007-2011 period. These contracts would provide a maximum of 577 aMW, or the financial equivalent, with a cost cap of \$59 million per year for the aluminum DSI portion. How much of this 577 aMW the companies will actually 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 one or more company is unable to use its portion. The 577 aMW total could also be permanently reduced if one or more companies cannot use its allocation and it is not picked up by another company.

### **Proposal for Regional Discussion**

The question of whether to offer continued service after FY 2011 to the DSIs raises many difficult policy issues. BPA is not required by law to offer contracts to DSIs but has the 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, though the post-2011 issues are very 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.

Subject to further regional discussion, 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 standards, which derive from the goals stated at the beginning of this Concept Paper:

- Minimize rate impacts to other customers;
- Strictly limit risks to BPA and other customers;
- Not reduce amounts of power available to other customers, as customers need as much certainty as possible about their HWMs to make necessary infrastructure investment decisions;
- Not require BPA to acquire power, consistent with the risk limitation goal; and
- Minimize regional conflict.

Subject to regional discussion, BPA's view is that an extension of the FY 2007-2011 DSI service construct into the post-2011 period would best meet these goals. This would mean offering the DSIs 20-year contracts with a financial cap on the annual level of benefits. BPA is working on the implementation details for providing capped benefits for the FY 2007-2011 time period and expects those details to inform how comparable benefits would be provided in the years that follow. 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. Thus, 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 considered other alternatives for post-2011 DSI support. BPA considered but is not proposing to increase overall DSI benefits since doing so would increase the level and risk associated with BPA's rates. BPA also considered resuming power sales at the IP rate, as was BPA's past practice. This alternative appears to conflict with several of the goals for DSI service. It would require either reducing sales to public utilities or additional BPA acquisitions that would tend to increase BPA financial risks and costs by creating additional load obligations. Since the IP rate is affected by the 7(b)(2) rate test addressed in the Residential Exchange section of this Concept Paper, it would also leave the DSIs and BPA with significant uncertainty about the level of the rate they would pay.

Another alternative considered was to cease any service or support to DSIs. This is legally supportable because BPA has authority but not a legal mandate for continued service. It would also support cost, risk, and rate minimization goals. However BPA is concerned that it would likely mean termination of DSI operations that are still the mainstays of several communities around the region. BPA cannot guarantee that these businesses will survive, but in view of the long historic relationship with them, and the fact that aluminum industry conditions and high power prices have already created an 80 percent reduction in service to them, BPA is reluctant to propose an alternative that offers no chance of service.

As with the rest of this Concept Paper, BPA offers this proposal as a starting point for the regional discussion leading up to BPA's formal Regional Dialogue proposal later this year.

## VI. CONSERVATION

### **Background**

Conservation and energy efficiency is a core part of BPA's stewardship role. The agency's conservation program has been an intrinsic component of its business since the passage of 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 recently decided how much conservation it would be responsible for in the FY 2007-2011 period and how it would pursue these savings. This proposal does not affect those decisions but instead addresses the post-2011 period.

In the post-2011 period, there are questions about BPA's appropriate role in developing conservation, and how that role should be carried out, since BPA's overall resource acquisition responsibility would likely be reduced, and customers would have greater incentive to conserve when they face a higher BPA rate (or market prices) for load growth.

### **Proposal for Regional Discussion**

BPA proposes that its fundamental approach to conservation in the post-2011 period should be the same as it is now—encouraging the development of the cost-effective conservation in the load it serves, while keeping the costs and rate impacts of doing so as low as possible. This approach is consistent with the overall Regional Dialogue goals stated at the beginning of this paper. First, BPA is likely to have an ongoing need to acquire some resources to meet Tier 2 loads. BPA has an obligation to acquire the least-cost resource, which is likely to be conservation. Second, the goal of developing regional infrastructure is complemented by encouraging development of cost-effective conservation. Third, development of cost effective conservation would extend the period of time in which the existing system is sufficient to meet public utility loads, thereby reducing their need to purchase Tier 2 power from BPA or make other resource/market purchases.

In addition to the threshold question about BPA's conservation responsibility addressed above, BPA considered five major questions with regard to its future approach to conservation. As a basis for further regional discussion, our proposal on these questions follows:

**How much conservation would BPA be responsible for in the future?** BPA proposes to continue to pursue an amount of megawatts of conservation equivalent to all cost-effective conservation in the load it serves at Tier 1 after 2011. Currently, we suggest that the loads we serve should drive the share of conservation BPA is responsible for. By taking responsibility for our share of the Council-defined regional cost-effective conservation targets (which is proportional to the percent of total regional load served by BPA), BPA would reduce its need to acquire new resources to serve that load. A key question is whether or not BPA should be responsible for conservation on IOU exchange and DSI loads. As we are not proposing to serve

IOU residential loads with firm power, our proposal is to not include those loads in determining BPA's conservation target. Similarly, because BPA is proposing a service construct for DSIs that would likely result in a financial benefit rather than a power sale, such loads would not be factored into BPA's conservation target. As is BPA's current policy, BPA proposes to continue to count all conservation achieved as a result of BPA funded efforts toward meeting our target.

**What general approach should BPA use for achieving conservation?** We are seeking the approach that gets conservation done at the least possible cost, and least rate impact, to BPA. We also continue to believe that the bulk of conservation is best achieved at the local level because history has shown local utilities are one of the most effective delivery mechanisms. Based on the extensive Post-2006 Conservation Workgroup process involving over 70 customers and stakeholders, a portfolio of approaches was developed by the group and BPA to best meet the criteria and additional considerations. The portfolio approach proposed would include four components: (1) a rate credit component which provides steady funding for local programs and targets the conservation that is reasonably evenly distributed throughout the region; (2) bi-lateral contracts which provide the means to acquire additional cost-effective conservation where available in specific utility service territories; (3) third-party contracts and market transformation activities which 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.

The following options were also considered in preparing this Concept Paper: (a) making conservation a condition for service under a future contract, and (b) attempting to do all the needed conservation under a rate credit or surcharge mechanism. With respect to Option A, BPA did not believe that it could or should condition a customer's right to purchase preference power service on any single requirement when the goal could be met by other means. Option B would not necessarily get all the conservation at the lowest cost to BPA and would not facilitate regional programs and market transformation that may provide conservation at a much lower cost.

**How should the costs of conservation be recovered?** BPA proposes to recover costs of achieving conservation in Tier 1 rates, since achievement of conservation results in an increase in the availability of Tier 1 power and forestalls the need for BPA customers to purchase Tier 2 power. While we have developed a concept for applying conservation to Tier 2 loads (described below), attempting to recover costs of doing conservation in Tier 2 would not likely allow BPA to meet cost-effective conservation targets.

**What effect would conservation have on customers' rights to purchase up to a Tier 1 (HWM)?** There appear to be two key issues of concern to customers when rights to lowest cost power are limited to the output of the existing system: (1) would conservation affect a customer's Tier 1 HWM, and (2) would conservation developed after the establishment of a customer's HWM reduce the maximum amount of Tier 1 power a customer can purchase over the life of its contract.

Under BPA's proposal for determining the level of HWMs, and consistent with the PPC Proposal, conservation done after 2002 would not affect a customer's HWM. This would



remove what would otherwise be a major disincentive to conservation. However, a customer's right to purchase firm power in any particular year would be limited to the customer's net requirement loads in that year. If a customer's net requirement loads are below the HWM, conservation could reduce Tier 1 power purchases in that year. Over time however, most customer's net requirements load should exceed their HWM. Conservation would also postpone the time at which a customer's net requirement load exceeds its HWM and expose it to Tier 2 service.

BPA did consider whether conservation should be "added" back into a utility's net requirements load so that the conservation did not result in a decrease in net requirements load. BPA is not proposing to do this because (1) conservation is a reduction in load, and (2) trying to track how much higher a customer's load would have been without conservation is administratively complex and thus costly. This approach also would result in benefits being transferred to individual utilities within Tier 1 (from, for example, an individual utility's resale of the conservation resource). Any alternative that does not change net requirements load or that transfers benefits only to individual utilities within Tier 1 would likely be contrary to BPA's statutory obligations and would reduce the overall benefits to Tier 1 rates.

**Can conservation be used to serve Tier 2 load?** Under BPA's proposal, a utility with a HWM that does not exceed its firm net requirements load may request additional service from BPA at a Tier 2 rate. BPA retains the obligation to serve the load growth of preference customers, if requested to do so.

Though conservation does not appear to be a practical source of Tier 2 megawatt sales, conservation can help a utility avoid or forestall that need to make those more expensive Tier 2 power purchases. BPA could potentially assist a requesting utility in developing 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 utility would repay BPA fully for a specified number of years, contractually guaranteed should the customer leave the system. The long-term amortized cost of the conservation should provide load reduction at a much lower cost than market power. While a utility may undertake its own conservation investments, there may be reasons BPA would be called upon for assistance.

## VII. RENEWABLE RESOURCES

During the FY 2002-2006 rate period, BPA renewable resource spending has been guided by a \$15 million “management target” in which the agency incurs a net cost of *up to* \$15 million per year on renewable resource activities. BPA has determined its annual contribution toward this \$15 million target by calculating the *net* difference between the cost of the Agency’s renewable energy purchases and an equivalent amount of power priced at the long-run marginal cost of a combined-cycle gas turbine. This net expense, when added to fixed programmatic expenses such as wind and solar data monitoring, constitutes BPA spending toward the target. Given the fluctuations in the long-term price of natural gas and other variables, this approach has resulted in considerable uncertainty around BPA’s ability to fund renewable resource activities. It has also been a difficult approach to explain, not to mention complicated to administer from the rates, contract, and accounting perspectives.

In the post-2011 period, BPA proposes to maintain its long-standing commitment to supporting the development of renewable resources in the Pacific Northwest. BPA proposes a renewable resource strategy focused on two main activities: (1) the development of creative Tier 2 renewables products designed to meet the needs of a variety of customers in a cost-effective and flexible manner; and (2) continued spending on the facilitation of renewable resource development by BPA customers and others in the region. BPA proposes to continue funding its facilitation activities at the Tier 1 level. However, BPA proposes to transition away from the current \$15 million management target mechanism and to tie the amount of BPA Tier 1 renewables facilitation spending to the success of the region in meeting the Council’s targets for renewable resource development.

The transition to BPA’s new approach would work as follows: Beginning in FY 2012, BPA would eliminate the \$15 million “management target” mechanism. At that point, BPA would include all renewable energy projects acquired *before* FY 2005 as components of the FBS with costs recovered in Tier 1 rates. Since BPA intends to limit its sales of Federal power at lowest-cost-based rates to the existing capability of the FBS, the agency would not purchase any additional power from new renewable resources to serve Tier 1 loads. All incremental BPA acquisition activities with respect to renewables would be tied to meeting Tier 2 loads.

Prior to each rate period, BPA would identify the Council’s targets for renewable resource development for the next several years. The amount of progress toward meeting these targets would be used to determine the level of spending required by BPA on Tier 1 facilitation activities. If the region is successful in meeting the target, BPA would likely limit its spending to a pre-determined floor (to allow for consistent funding of long-term research and development (R&D) initiatives.) If the region were less successful, BPA would raise spending toward a pre-determined cap. BPA proposes to work with the region to determine the appropriate level of the floor and the cap as well as a sufficiently clear mechanism for measuring regional progress toward meeting the Council’s targets so that we do not recreate the funding uncertainty surrounding the current facilitation program.

Tier 1 renewable resource spending would be focused on specific, measurable facilitation and R&D activities, with explicit identified costs to be included in Tier 1 rates. The value of these expenditures would not fluctuate with natural gas prices or other variables. Facilitation and R&D activities may include: providing marketing services for customer-owned renewable generation and developing new variants of wind integration services; exploring alternatives to direct financing to reduce the cost of transmission upgrades for renewable projects; providing grants to offset upfront costs of new customer-sponsored renewable R&D projects; directing R&D projects that support the long-term growth of the regional renewables market, such as wind and solar monitoring; and, other suitable R&D initiatives. Evaluation criteria for prioritizing new spending activities would be developed as part of the Long-Term Regional Dialogue discussion, but should be based on maximizing the amount of new renewable generation built in the region per dollar of facilitation spending.

The Tier 2 renewable resource product would be developed in a manner consistent with other proposed BPA policies and practices on Tier 2 products. BPA proposes to work proactively with customers and others to help ensure economies of scale in new project development in order to help secure cost-effective renewable resources for Tier 2 service.

## VIII. RESOURCE ADEQUACY

BPA and the Northwest Power and Conservation Council have initiated meetings in recent months with customers, customer groups, state regulators, and energy offices to discuss the issue of resource adequacy in advance of convening a Regional Resource Adequacy Forum (Forum). BPA has observed strong support for developing a consensus-based methodology for assessing whether the region has sufficient resources to reliably meet electricity load.

Many of those with whom BPA has met support having a voluntary mechanism for implementing a resource adequacy standard and having a neutral third party, such as the Council or the Northwest Power Pool, track whether load-serving entities are in compliance with the standard. There is also significant support for pursuing the Forum through a Technical Committee that would propose options for assessing resource adequacy and a Steering Committee that would select a metric and target, and pursue consensus on an implementation framework.

BPA believes the region must be aggressive in developing and implementing a resource adequacy standard. BPA views resource adequacy as vital to the public interest, and on a practical level, the agency would likely be the default supplier if others fail to develop deliverable resources to meet their loads. While BPA would prefer to see an effective voluntary standard developed and implemented, the agency is not ruling out the need to include a mandatory resource adequacy provision in power sales contracts. The agency's view of whether a mandatory adequacy contractual provision is necessary depends on the outcome of the current Regional Resource Adequacy Forum to select metric(s) and target(s) that the region agrees constitute a regional resource adequacy standard and to agree upon a mechanism to implement that standard, whether it involves a voluntary approach or an enforceable mechanism.

At this time, BPA makes the following proposals:

1. Include a provision in power sales contracts that would require customers to provide data for regional resource adequacy assessments to a neutral third party, such as the Council or the Power Pool. BPA's full requirements customers would be excluded from this requirement as BPA would provide data for them. The provision would state clearly that the methodology for determining resource adequacy could be quite different from a customer's net requirement calculation, since a metric may be chosen for resource adequacy that is different from the firm energy standard used to calculate net requirements.
2. Link notice provisions for Tier 2 power service products that count toward meeting the regional resource adequacy standard to the planning timelines established as part of the adequacy effort. For example, if the outcome of the Regional Forum requires utilities to demonstrate 2 years out how they intend to procure sufficient physical or contractual resources to serve their regional consumer load obligations consistent with the regional resource adequacy standard, then BPA would require a 2-year notice period for customers to request firm load requirements service at Tier 2. This would allow

sufficient time, in cases of resource deficiency, for construction or acquisition of new resources.

3. Include two options for resource adequacy provisions in BPA power sales contracts in the January 2006 Long-Term Regional Dialogue Proposal:
  - **Option 1:** This option assumes that the Regional Resource Adequacy Forum is successful in achieving the objectives listed below and only references the need to adhere to the agreed-upon regional resource adequacy framework in the contracts, which includes:
    - i. Consensus-based adequacy metrics and targets applicable at the individual utility level,
    - ii. A workable resource adequacy tracking mechanism, and
    - iii. An effective and regionally accepted implementation approach.
  - **Option 2:** This option assumes that the Regional Resource Adequacy Forum is unsuccessful in meeting one or more of the objectives listed above. Given this lack of regional agreement, contractual provisions would be included, which require or incentivize all, or some, of the following:
    - i. Define how to measure resource adequacy,
    - ii. Specify reporting requirements, and
    - iii. Establish an implementation mechanism.

## IX. LONG-TERM COST CONTROL

BPA acknowledges there are legitimate concerns regarding long-term control of BPA's costs when there are long-term take-or-pay contracts. Customers have noted that signing long-term contracts that commit them to pay the costs of the Federal system exposes them to the risk that those costs could rise excessively. These concerns have been voiced by customers in different forums for some time. BPA recognizes that customers must have a reasonable assurance of long-term cost control to make it prudent for them to sign such long-term contracts. BPA must continue diligently focusing its efforts on actions that lead to visible and measurable long-term cost control results.

BPA's proposal on long-term cost control is intended to promote direct involvement with customers and other interested parties, combined with contingent and limited off ramp rights within long-term power sales contracts. This Concept Paper assumes that a Cost Management Group (CMG) or groups would be formed and managed by customers, and/or any other non-customer groups, and would be actively functioning during the 20-year power sales contract period at the CMG's discretion. To be effective, such cost management group(s) would not form and dissolve with every rate case and, therefore, would require long-term stable membership and operate on a regular basis. The customer CMG membership should be high-level general managers or equivalents, and the organization would provide its own technical staff support.

### **BPA Cost Control Process Goals:**

- Assure effective control of BPA's spending, consistent with accomplishment of BPA's mission, both expense and capital;
- Respond to customers and/or constituent concerns regarding BPA cost decisions;
- Provide reasonable assurance that 20-year contracts will remain attractive through effective cost management;
- Stay within existing law;
- Build trust and confidence through BPA's management of its costs;
- Avoid creating excessive administrative costs;
- Support customers' understanding of BPA's processes, decision-making, and performance; and
- Recognize that this is a Federal system in which Federal officials must ultimately be accountable for decisions.

### **BPA would commit to incorporating the following components into long-term cost control:**

1. **On-going transparency in decision-making and financial reporting, including continued customer collaborative and PPC meetings.** All current efforts to explain and provide meaningful input to BPA's programs would continue to be a significant component of long-term cost management. Power Function Review-like processes would continue to occur prior to rate cases so all interested groups have public access to BPA's financial drivers, and have opportunities to comment on policy decisions that impact spending.

2. **Cost Management Groups/Collaborative Forums.** BPA proposes to embed in policy its decision to participate in the Cost Management Group process, e.g., this could be memorialized by publishing a decision in the Federal Register. BPA would:
- Provide information and reports at the level of detail necessary for the CMG(s) to give informed input on cost and policy decisions;
  - Provide reports on actual costs relative to budgets and reasons for deviations; and
  - Make senior BPA management available to confer on major policy decisions before they are made, if feasible, and overall financial performance.

The CMG(s) would:

- Provide input to BPA on cost levels used for rate setting, major policy decisions that drive future costs, and the capital program;
- Review financial performance of the Agency; and
- Provide input to Corps, Bureau, Energy Northwest and other entities that manage costs in BPA's rates as well as BPA.

3. **Contractual Off-Ramp Tied to Effective Cost Management.** Through HWM contracts and tiered rates, customers would have rights to access a Tier 1 price based on the low-cost existing Federal system. Power sales contracts would also contain a provision allowing customers to trigger limited off-ramp rights if the BPA rates exceeded a defined benchmark. The off-ramp proposal relates to cost control over the HWM and Tier 1 portion of a customer's net requirements power purchases, not other purchases. Utilities may be making other purchases from BPA to serve the balance of their loads based upon BPA's cost of serving that additional load.

During the 20-year power sales contract period, BPA would be conducting rate cases most likely every 2 years.

Specifically, BPA would set a Tier 1 Priority Firm rate for FY 2012-2013. This would become the "benchmark" rate for the contract period. During the course of the 20-year contract, if rates exceed the benchmark level by a percentage increase per year, customers would have a one-time right to remove up to an established amount of load or a percentage (we propose a total of 15 percent) of load placed on BPA that is served with power priced at the Tier 1 rate. It is unclear how potential stranded costs would be recovered and we are open to ideas to address this. We also propose that once the off-ramp has been exercised, the customer could not return the removed load to Tier 1 service for the term of the contract.

If the benchmark were not exceeded, then no off-ramp rights would be available. No off-ramps for power priced at Tier 1 would be available to customers during the first 2-year period—FY 2012-2013. Beginning in the FY 2014-2015 rate case, and for each subsequent 2-year period, customers would be able to exercise off-ramp rights in the event that the new Tier 1 power rate exceeded the benchmark rate for that period by more than the defined off-ramp percentage adjustment. Customers would be required to notify BPA of the amount of power priced at Tier 1 to be removed, up to but not exceeding the off-ramp amount or percentage in any rate period, and not exceeding the amount or the percentage cumulatively

for the customer during the contract term. Power service could be reduced at the end of the first fiscal year of the applicable rate period. Customers would have a specified time after its notice, that is the remaining year of the rate period, in which the load is removed. This will allow BPA adequate time to remarket the power made available by the off ramp election. It is anticipated that the limitations on power removed, the lead-time for removal, and the generally competitive expected Tier 1 price of power would create an economic set of circumstances where BPA should not incur stranded costs that would have to be passed onto other customers.

Any public customer taking load off of BPA would be reducing their amount of net requirements served at the Tier 1 rate and would forego returning such load to BPA during the remaining contract period under their HWM at the Tier 1 power rate, whether for requirements or REP service. This contract provision does not affect any new resource or market-based purchases made by BPA on behalf of the customer for its Tier 2 load growth. Customers reducing their HWM Tier 1 power purchases would not be precluded from returning retail consumer load to BPA service during the remainder of the contract period, but such service would be provided at a Tier 2 rate established by BPA to cover the additional cost of the returning load. Any adjustment to a customer HWM amount for power priced at Tier 1 would be effective for the remaining term of the contract.



## X. DISPUTE RESOLUTION

The future power supply arrangements that BPA has articulated in this Concept Paper are rooted in BPA's strategy to "encourage regional actions that ensure adequate, efficient and reliable power service." 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. BPA's basic concept of limiting its sales of firm power to its Pacific Northwest customers' firm requirements loads at its lowest-cost-based rates to approximately the firm capability of the existing Federal system, and to provide additional retail load service to a customer at a higher rate that reflects the marginal cost of purchasing power to meet those additional loads, is BPA's goal.

BPA believes 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. BPA believes that its customers and other market participants share BPA's belief in the need for a durable and predictable construct. We also know that customers believe effective dispute resolution mechanisms such as mediation and arbitration are necessary to ensure that BPA and other participants in this new regime abide by what they conceive as "the deal."

Arbitration, whether binding or non-binding, has been and is a key feature of BPA's contracts for resolving contractual disputes, particularly those that are highly fact specific. Arbitration was provided for in BPA's 1981 power sales contracts for specified contract disputes and was occasionally utilized. BPA has also arbitrated contract disputes with transmission customers, increasingly so over the last several years with the adoption of its open-access tariffs, and with suppliers, most notably Tenaska Washington Partners II and Calpine. Properly structured arbitration provisions should continue to serve as a cost-effective and speedy vehicle for resolving contract disputes.

However, there are limits to what disputes BPA can or should delegate to an arbitrator or other third person for resolution. Important policy judgments necessary to interpret and administer Federal statutes and regulations must be retained by the Administrator as an executive official not turned over to a third party arbiter for resolution. Other factors that should be considered in the decision whether to arbitrate are whether the outcome of the dispute could significantly affect persons or organizations who are not parties to the dispute, and whether the agency must maintain continuing oversight over the matter to alter its disposition in light of changed circumstances (for example, BPA must periodically review its rates to ensure continuing cost recovery). In addition, the Ninth Circuit Court of Appeals has ruled that final BPA actions and decisions subject to its exclusive jurisdiction cannot be arbitrated. BPA's establishment and implementation of rates are final actions subject to the Court's exclusive jurisdiction.

Those considerations and the following discussion of certain BPA statutory authorities put a spotlight on the task BPA faces in providing a durable and predictable supply and pricing construct, while at the same time ensuring the Administrator is carrying out his executive functions. Under section 5(b)(1) of the Northwest Power 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), for the purpose of meeting its firm contract obligations under section 5 (16 U.S.C. § 839d(a)(2)). These two sections, along with section 7 of the Act, avoided the need for BPA to allocate power from the then-existing Federal system by obligating BPA to meet customers' net requirements, acquire power to meet those requirements, and price all power sales pursuant to the ratemaking requirements of section 7. Northwest Power Act section 7 focuses in significant part on cost recovery and which customer class pays for which resources.

The pricing construct that BPA has articulated in this Concept Paper—in part a matter of which costs should and would be allocated to which class or sub-class 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, 7(a) of the Act 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 in a fashion that allows for these periodic reviews to assure that, indeed, the methodology is working in a fashion that assures BPA's recovery of costs and repayment to the U.S. Treasury.

In light of the foregoing, BPA believes the goals of certainty and predictability would be well served by the following dispute resolution construct. As to those matters involving matters of contract, particularly highly factual issues, BPA and the customers should carefully delineate in contract what matters would be subject to binding arbitration. Given that many contractual features of the overall construct would be common to all or many customers, any arbitration of those matters should be open to all customers, not just the parties to the particular contract. In that way, all parties would have fair and equal input into disputed matters that affect them. While BPA cannot engage in binding arbitration over matters concerning the establishment or implementation of rates, it can nonetheless provide significant certainty by establishing the pricing construct for 20 years and obtaining FERC approval for that time period; establishing precise conditions in the rate methodology for how the pricing methodology may be changed; and then providing in the rate for a contractual provision whereby an independent, third party determination would be made as to whether those conditions have been met, with the Administrator able to disregard the determination only on very narrowly specified grounds. As to other matters of rates implementation, BPA and others parties should explore the utility of the alternatives of non-binding arbitration, third-party fact finders, or other alternatives that ameliorate concerns parties may have that BPA enjoys unfettered discretion.

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

BPA expects that the Long-Term Regional Dialogue policy will be implemented through long-term contracts and a rate methodology. This section of the Concept Paper 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 February 2005 Regional Dialogue Policy and ROD proposed that customers would be offered replacement contracts, which go into effect (begin power deliveries under associated rates) as early as October 1, 2008, at the option of each customer. Some customers have indicated, however, that they wish to retain their Subscription contracts until 2011. This could result in some customers operating under the Subscription contracts and others operating under Regional Dialogue contracts at the same time.

Some stakeholders expressed concerns about the feasibility of BPA's plan to put new contracts into effect in October 2008, three years prior to the expiration of Subscription contracts. Some of the concerns emphasized the risk of confusion, cost shifts, and litigation among customers if there are two sets of contracts and rates in effect for three years. To address that concern, BPA is considering a change to the schedule, which it would like to discuss during the public workshops. This change would still have customers signing Regional Dialogue contracts as early as August 2007, but power deliveries and supporting rates would not take effect until October 2011, when existing Subscription contracts expire. This would also assure that all contracts expire simultaneously. However, customers should understand that BPA's power sales contracts are effective when signed and the contract's duration of up to 20 years runs from the date of execution, not the date of taking service.

Reaching agreement on contract terms—and signing contracts—as early as possible is critical to meeting our goal of enabling non-Federal resource development. Although the region is not currently short of generation resources, new resource development requires long lead times. We need to clarify BPA's and our customers' load obligation in order to give the region confidence to move forward with infrastructure and resource development.

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

#### **Duration of Contracts**

BPA stated, as part of the February 4, 2005, *Policy of Power Supply Role for Fiscal Years 2007-2011*, its intent to make new 20-year power sales contracts available to public agency customers for their net requirement loads. Contracts of shorter duration would not likely provide the certainty needed for utilities to undertake long-term electrical infrastructure development. BPA proposes that the duration of Regional Dialogue contracts be 20 years for all customer classes (publics, investor-owned utilities, and DSIs) and that the 20-year period would begin on the date of contract execution.

### **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 for the most part standardized. In other words, 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 for the product description and associated billing factors. These standard provisions ensured that similarly situated customers are treated comparably, and they improved BPA's ability to efficiently administer 125 separate contracts.

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

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 in May 2006, BPA is proposing to develop draft standard contract prototypes in consultation with customers. BPA would then make the standardized contract prototypes available for public review and comment before they are made final.

### **Contract Terms and Conditions**

BPA anticipates that most of the decisions made in the Long-Term Regional Dialogue will be captured in new long-term contracts and rates. There is a range of opinion within the region on the commitments that should be made in contracts versus those that should be made in rates. BPA's view is that customers, BPA, and other stakeholders must work together to develop a logically linked set of new contracts and rates, and that neither by itself would be sufficient to accomplish all of the long-term goals. The split between contracts and rates will be discussed in the upcoming workshops. These issues are in many cases inextricably linked and will have to be resolved in tandem.