REGIONAL DIALOGUE TECHNICAL WORKSHOP NOTES
Benefits for the Residential and Small Farm Customers of IOUs
Wednesday, January 29, 2002
BPA Rates Hearing Room, Portland, Oregon

1. Purpose of Today's Meeting.

Fred Rettenmund welcomed everyone to today's meeting, and led a round of introductions and a review of today's agenda. He said BPA's hope is to continue to encourage a collaborative approach to this topic; we continue to appreciate the effort put forth by the joint customers and to find value in your proposal, he said, and feel that truly was an accomplishment. Nevertheless, we do have some questions and issues we would like to explore further, said Rettenmund; that is the spirit in which we approach this topic today. We don't have all of the answers, he said, but perhaps through further dialogue, we can find them. This is obviously a key part of any approach to allocating the long-term benefits of the federal system, he said. We certainly recognize its importance to any long-term agreement.

2. Benefits for Residential and Small Farm Customers of the IOUs.

Larry Kitchen reminded the group that Bonneville made a presentation on this issue last December. In that presentation, Kitchen said, we emphasized that we are exploring a number of options with respect to long-term contracts for residential and small farm customers of the IOUs. We feel the risks and benefits of those contracts should be similar to those allocated to our preference customers, he said.

With respect to specifics, said Kitchen, Bonneville feels that those contracts must provide all BPA customers to an appropriate share of the risks and benefits of the Federal Columbia River Power System, similar to the benefits received by our preference customers, second, that any settlement must be grounded in a numerical analysis of forecasted residential exchange program obligations; third, that any settlement must keep Bonneville's wholesale power rates competitive under a range of market conditions, fourth, that the option chosen must set the level of benefits based upon external information, outside a BPA rate case. That was the gist of our presentation in December, said Kitchen.

Is the fourth point a legal issue? one participant asked. It's actually an attempt to respond to some of the concerns raised by the investor-owned utilities about the residential exchange program, Kitchen replied – they would like the formula used to calculate the benefits of the residential exchange program settlements to be based on externally-observed facts, as opposed to something more subjective, and we were trying to respond to that concern.

Kitchen said he had distributed two graphs at today's meeting – essentially, this is what we've presented to BPA's management in terms of our analysis of how the joint customer proposal might play out, he explained. We probably spent more time analyzing the joint customer proposal (JCP) than any other proposal received during the recent public process, Kitchen said, primarily because we've had it longer, and it is the most detailed proposal. In general, he said, all of the proposals have their own attributes and problems; there is no one perfect proposal that meets all of Bonneville's needs.

Kitchen went briefly through the contents of his first set of pie charts, which described how the benefits of the federal system would be allocated under various alternative scenarios. Basically what we did here was look at three different proposals, Kitchen said – the JCP, subscription assuming perfect forecasts of market conditions, and subscription with rates set with medium gas-price forecasts. We're looking less at specific numbers than we are at relationships, Kitchen said; these pie charts are intended mainly to illustrate the changing relationships that occur under each of these scenarios. As you can see from these charts, he said, under the JCP proposal, the allocation to the IOUs is highly sensitive to market prices. Under the JCP proposal, when markets are in the 40+ range for the five-year period analyzed, the IOUs would receive only a quarter of the federal system benefits; under the medium gas and market price scenario, the ratio would be in the 45%-55% (IOU share) range; and under the low gas and market forecast assumption, the IOUs would receive 100% of the benefits from the federal system.

Various participants offered clarifying questions and comments. At the close of this exercise, Kitchen noted that the numbers underlying this analysis are available upon request.

Moving on, Kitchen noted that the second column, "Subscription," assumes that the forecasts are perfect; if they are, a nice steady distribution occurs under the low, medium and high gas and market forecasts, with the IOU share of the federal system benefit a consistent 23%-25%. Under the final column, as you can see, there is a wide variation in the allocation of benefits, with the IOUs receiving 98% when prices are low, 23% when prices are in the medium range, and only 9% when prices are high. The pie charts illustrate problems in the implementation of Subscription.

One questions, said Geoff Carr – using the same dynamic and analytical approach you used here, what benefits are the IOUs receiving now, under this type of scenario? With respect to the current subscription contracts, for at least the first year or two, we essentially forecasted a high market, and got a low market, Kitchen replied -- we forecast 57, and got 22-23 instead. And the "medium" scenario is essentially Bonneville's current best guess about what the future holds? another participant asked. Yes, Kitchen replied.

Jim Litchfield noted that, in his analysis, Bonneville's "high" scenario is equivalent to the Council's "medium" scenario. There are differences between the Council's and Bonneville's analytical approaches, Kitchen replied; our overall goal is to develop a contract structure that will endure. The point is that there are legitimate different views throughout the region, he said; the bottom line, however, is that, in Bonneville's view, an allocation of benefits to the IOUs when BPA prices exceed market prices will not endure.

Scott Brattebo said the joint customers have asked every customer up and down the West Coast that uses the Aurora model to share their view of what the future holds; Bonneville's forecast is at least 10 mils below what anyone else is predicting, in terms of energy prices over the next rate period, he said. Kitchen replied that it will be possible to update BPA's forecast as market conditions change.

Litchfield asked whether it would be possible to attach dollar amounts to each of these pie charts; Kitchen replied that the size of the federal system benefit changes dramatically depending on which gas and market price scenario one assumes. In response to another question, Kitchen said that BPA would prefer to see an approach whose results more closely resemble the middle column, not the more extreme ends of the scale, with IOUs receiving a disproportionately large share of the federal system benefit. However, as you're all aware, it will not be easy to achieve that goal, he said.

One of the political problems I see with the center column would occur if energy prices suddenly shoot upward, said Brattebo – even if the investor-owned utilities are only getting 23% of the benefits of the federal system, the value of that 23% would be huge – are people really going to want to see that? One answer is certainly no, another participant replied.

One other thing to bear in mind is that, if gas prices really do head toward the high level, said Kitchen, other less-expensive fuels could take gas' place. We don't necessarily want to lock into a formula based solely on combustion turbines, he said.

You've said one of Bonneville management's objectives is to ensure that the allocation of benefits among the IOUs, publics and DSIs is stable across a wide range of market conditions, another participant observed -- is the metric for deciding whether or not stability has been achieved going to be dollars, or a percentage of the federal output? Right now, we're looking mainly at a percentage of benefit, Kitchen replied. Also, said the participant, your point about the dangers of hitching our wagon solely to the cost of a CT is a valid one, but that's simply one of the dangers of trying to do a long-term forecast. One thing that would be helpful to take away from this meeting is, is it better for Bonneville to provide the other parties with a change mechanism, or does it make more sense to allow them to come up with their own?

I want to share the other three options Bonneville is still considering, Kitchen said; once we have that discussion, we may well head straight back to the JCP, but we should go over the attributes and benefits BPA sees for each of these alternatives:

Alternative 1: different financial formulas based on wholesale power prices
Alternative 2: power sale at an RL rate basically equal to PF Preference rate
Alternate 3: a revised residential exchange program.

With respect to Alternative 1, said Kitchen, the attributes include keeping the benefits share of the IOUs, publics and DSIs roughly proportional over a range of market conditions, minimizing BPA's needs to build new resources, and clear identification of who is responsible for building new resources – the IOUs would build their own resources. The detriments of Alternative 1 include the way it would (or would not) deal with the past, in particular, the financial impacts of the 2000-2001 price spike, Kitchen said; also, any theoretically sound financial formula will eventually produce unacceptable results at implementation, because the realities of the market and the system change over time. Just when you think you've got the perfect formula, he said, the market shifts, and your formula is no longer valid. In a sense, Kitchen added, the JCP is a version of a financial formula.

With respect to Alternative 2, Kitchen said, the attributes Bonneville sees include that it exposes publics, DSIs and IOUs to the same range of risks and benefits under a wide range of market conditions; it also clearly identifies who would be responsible for building new resources. The detriments we see with Alternative 2 include the way it would (or would not) deal with the past, in particular, the financial impacts of the 2000-2001 price spike, as well as the fact that it would result in the need to further develop the BPA residential exchange program for public utilities, Kitchen said. To the extent that we develop an RL rate that is approximately equal to the PF Preference rate, the impact of that action on the PF Exchange rate and the amount of public exchange load we would see could also be problematic, he said, because it would potentially mean we need to buy more power.

Various participants offered clarifying questions and comments regarding the 7(b)2 and FPS replacement impacts of Alternative 2. You also have the question of durability when the distribution of benefits is tied to rate divisions, noted one participant – those have proven themselves to be extremely elusive when it comes to nailing them down contractually. Every time you have a rate process, the distribution of benefits ends up in a place that makes some happy, and others less so, he said.

There may also be problems with at least two of the principles Bonneville has articulated, another participant observed; the first is the concept that any settlement must ensure that Bonneville is competitive under a wide range of market conditions. One of the reasons the customer group has been trying for a solution that keeps Bonneville out of the market is the concern that the primary problem that has reduced Bonneville's competitiveness in the past is the requirement that BPA purchase new resources, he said. The second problem has to do with the concept that benefits be based on external facts, rather than BPA rate cases, he continued.

With respect to Alternative 3, said Kitchen, the benefits Bonneville sees include the following: it would offer the potential to design the program to minimize regulatory aspects in favor of competitive safeguards; also, it would put a heavy reliance on the use of the in-lieu provisions of the statute to sell power to the IOUs. In addition, no customer would be required to forego statutory benefits; we also think it would keep the IOU benefits in rough proportion to the benefits received by the publics under a range of market conditions. Under Alternative 3, also, the benefits would be tiered to direct the cost of new load and exchange obligations to the customers who placed those obligations on BPA. In addition, it has the potential to deal effectively with price spikes such as those seen in 2000-2001, Kitchen said.

The group devoted a few minutes of discussion to the nuances of this analysis. Kitchen explained that the phrase "...minimize the regulatory aspects in favor of competitive safeguards" essentially means that the current paper exchange would be converted to an actual power exchange -- the IOUs would actually offer power to BPA for a specified period of time.

At least in theory, then, this option would include IOU load growth over time? one participant asked. That's a piece we're trying to understand, Kitchen replied; there is a question about whether this would be done under an average or a tiered exchange rate – the other question is how you would tier the ASC if you tier the rate, Kitchen said.

In response to another question, Kitchen explained that the meaning of the phrase "no customer would be required to forego statutory benefits" is essentially that BPA would not sign contracts that required public utilities to waive their exchange rights.

I was trying to follow the math associated with the utilities offering ASC power to Bonneville, and BPA rejecting that and buying on the market, said Brattebo – it seems to me that if you follow the math out, what that means is that the utility would always have to sell to Bonneville at the lower end of the market for their ASC. That's what it's always meant, another participant replied. So if my Bonneville's cost is $30 per MWh, my ASC is at $40 and the market is at $50, and I make an offer to Bonneville at $40, what happens? another participant asked. I would buy it from you at $40 and sell it back to you at $30, Kitchen replied.

Also, what's the difference between traditional exchange and the exchange process you've laid out here? Brattebo asked. The difference is that exchange, under this alternative, would involve an actual power exchange, Kitchen replied.

Another participant asked about the broad distribution of benefits offered by the JCP; Kitchen replied that this is an issue, because one of the goals of the current set of proposals essentially is to use the exchange program to promote stability in exchange benefits.

Kitchen then moved on to the detriments BPA sees with respect to Alternative 3: first, it would be a major restructuring of all aspects of the residential exchange program; second, there is an uncertain result from the application of 7(b)2; third, it does not clearly assign the long-term obligation to serve new load; and fourth, it may underestimate the difficulty of the allocation process to determine which load and exchange obligations are directly assigned costs.

Would the exchange program staffs at the utilities still be needed under this proposal? Carr asked, or would the need for that expertise go away? One of the problems we wanted to get away from is the need for BPA to maintain a large staff to oversee this program, he said. We don't anticipate the need for a large Bonneville exchange staff, because there would be fewer filings, Kitchen replied – we would probably have only a small exchange program staff, just to see that the rates for the IOU offers matched up to the IOU rate cases.

One important detail, said another participant -- it seems reasonably clear that you could set up a means of administratively determining the offer price from the IOUs. What's less clear is the transparency of the process by which Bonneville would determine what the market is, he said. The vision under this type of contract is that it would be a lot more like the 1981 contracts, Kitchen replied -- you would have the right to come on, and you would have the right to leave. Right, but there is a need to give some thought to the mechanics here, the participant replied – frankly, we spent a year talking about this option among the utilities, and we foundered on the rate test issue.

Does the process work both ways? another participant asked. Under this concept, BPA has the option of taking or not taking the power, but would the utility also have the option of foregoing the exchange for a period if they felt Bonneville's prices were too high? There would have to be some form of off-ramp for customers when the section 7(b)(2) rate test applied, Kitchen replied. The idea, again, is to put the IOUs on an equal footing with all of our customers, he added.

Given that objective, I don't understand why the JCP option isn't viewed more favorably, Litchfield said. It stems from BPA's need to impose cost discipline, Kitchen replied – under any scenario, Bonneville has a need to operate as cost-effectively as possible. But you know as well as we do that the problem is that the market gyrations have nothing to do with the resource base, said another participant -- all this really does is give Bonneville the option of choosing whatever is lower -- cost or market. That's true, Kitchen concedes, but we see the JCP in the same light – when Bonneville's rates are high, customers will find a way out of their contracts, just as they did in 1996.

Steve Weiss said that, in his view, there is a good chance that FERC will require a resource adequacy standard, which means that regulated utility rates will always be higher than the market. The market will be very thin, he said, basically a variable rate or hydro, whichever is cheapest. If everyone is avoiding the market, he said, it isn't really going to be a market, so you need to design something that doesn't depend on whatever the market price is. Have you considered the possibility of using, say, a phantom combustion turbine, rather than "the market" as your in-lieu price? Weiss asked. We haven't looked at that, Kitchen replied. I think that makes more sense, said Weiss. Another participant said that, in his view, such an approach would be extremely unworkable.

What's the process from here? Litchfield asked – is BPA going to go through a winnowing process? That process started today, Rettenmund replied. Somehow, we have to get down a single alternative, said Litchfield. This is the topic, within the structure of the overall BPA proposal, on which we've probably spent the least amount of time, Rettenmund said – do we need to discuss it further next week? Would it be beneficial to hear, from the customers, which of the three alternatives we discussed today seems most promising? one participant asked. There was general agreement that this would be useful.

We have scheduled another meeting on this topic for next Wednesday morning, if the group sees value in such a discussion, said Rettenmund. It was agreed that such a meeting would be welcome.

With that, the meeting was adjourned. Meeting notes prepared by Jeff Kuechle, BPA contractor.