REGIONAL DIALOGUE TECHNICAL WORKSHOP
Benefits for Residential and Small Farm Consumers of the IOUs
Wednesday, February 26, 2003
BPA Rates Hearing Room, Portland, Oregon

1. Purpose of Today's Meeting.

Fred Rettenmund (BPA) welcomed everyone to today's meeting, and led a round of introductions and a review of today's agenda. He said the main purpose of today's meeting was to discuss some of the questions and concerns BPA has about the formula proposed by the joint customers in their proposal, as well as to discuss next steps on other topics of concern including cost structure/cost control.

2. Discussion of BPA Questions and Concerns About the Joint Customer Proposal (JCP).

Larry Kitchen (BPA) said Bonneville is developing its own financial formula proposal; he noted that its intent is to preserve the benefits of the joint customers' financial formula while eliminating some of the areas of concern BPA sees.

Kitchen then described some of the benefits Bonneville sees in the JCP financial formula: first, that it ties the IOU benefits to BPA costs; second, that it also adjusts the IOU benefits to track changes in BPA's secondary revenues; third, that it protects BPA from the impacts of wholesale market price spikes.

With respect to the concerns BPA has about the JCP, said Kitchen, we're concerned that any financial formula, built to last for 20 years, that is not tied to a wholesale power market, will eventually not track with reality. For example, if you had high gas prices, the JCP formula would pay fairly high benefits to the IOUs, but other resources would be coming into the wholesale market because people would be investing in other lower-cost resources other than gas. By the same token, said Jim Litchfield, at a time when wholesale prices are through the roof, the virtual combustion turbine running on 10-year damped gas might be a much more attractive option. Granted, Kitchen replied, but we're mainly concerned with the other side of that coin – our main concern is that the formula proposed by the joint customers could lead to instability.

The second concern we have, which gets to the instability question, is that the JCP pays large dollars in years of low wholesale market prices, Kitchen said – we would still be paying out large dollars even when our rates exceed wholesale market prices. But wouldn't our benefits be capped under high market prices? Scott Brattebo (PAC) asked. Either of the concerns you've raised could cut both ways, but Bonneville is only concentrating on the scenarios under which they could suffer financially, Brattebo said. We're just saying that the "flatter slope" the customers are proposing could pose a risk to our interests, Kitchen replied.

We also are concerned about our ability to secure revenues from the publics over a 20-year period, Kitchen said, particularly regarding possible retail access legislation that applies to public utilities, bankruptcy and financial off-ramps that might be built into the contract. Our concern is that the expected stable market conditions would not remain stable, and we would be forced to honor contracts without the revenue to support them, Kitchen said.

You either want to protect yourself from price spikes, or you don't, Brattebo said. Kitchen replied that BPA's concern is that while the JCP formula would protect BPA from market price spikes, it does not protect BPA at times when market prices are low. There could be a scenario where we went to extended low market prices, said Litchfield (Litchfield Consulting Group), but the goal is to move toward long-term stability in BPA's rates. The fundamental problem is the disconnect between retail rates and wholesale rates, Kitchen said -- FERC's goal is wholesale markets that are tied to variable cost and most expensive resource running.

Part of the problem here is a threshhold question, said Marcus Wood (PAC) -- that is, that the impact of SMD on market prices tends to be a self-fulfilling prophecy. If you have SMD, you may have low market prices, but there won't be much available at that price -- it isn't something that can be used to meet a 4,000 MW load. One issue I'm having trouble with is, what will the market price represent in the future? Wood said. Also, what really represents the opportunity costs of your customers? Is it really the market, or is it something else?

Kitchen replied that he doesn't necessarily agree with that statement. We're also concerned that regulatory change is going to impose a resource adequacy standard some time in the next 20 years that could result in lower wholesale market prices than anyone has forecast. All of the Aurora runs the Council, the customers and BPA have done assume a return to the California price spike, and that, under the regulatory standard, $200 prices over a couple of months during peak periods are more economical than requiring retail utilities to invest in combustion turbines.

In my opinion, that is the circumstance under which Bonneville is at the least risk, Wood replied – what Bonneville is concerned about is customers exercising options to go elsewhere. If a customer does not have a Bonneville power supply, and this regimen is really in place, the customer has to meet both Bonneville's and their own resource adequacy requirements. That means the customers will have to buy resources and pay the capital costs for that output. The reason the market will be cheap is because the market is thin, Wood said -- the concerns you have are far bigger concerns in a situation that includes no resource adequacy. Also, added another participant, if the resource adequacy requirement drives down the wholesale market, then that is picked up, presumably in the customer formula's credit for secondary revenues.

Kitchen continued on through some of Bonneville's other concerns with the financial formula of the JCP, noting that, in BPA's opinion, it does not adequately discount the value of the benefits provided to the IOUs or the risks removed from the IOUs. The level of benefits were set based on projected low BPA costs, when our actual costs are closer to the IOU ASCs, and would result in fewer average megawatts exchanged. On that last point, we may need to do a little math with you, because I think that may be less of a concern than BPA believes, said Wood. Bear in mind, too, that many of these provisions were put in as tradeoffs, another participant observed – none of us really got everything we wanted, either.

Moving on, Kitchen said another BPA concern has to do with the fact that it is unclear whether or not the net Slice rate will adequately address the timing of federal system runoff. Federal secondary revenues vary significantly depending on the shape of the runoff - he said runoff can happen over a month, or it can come off over one weekend – to capture that Slice accurately means getting actual hourly runoff vs hourly prices, and that will be tricky, with respect to accurately calculating secondary revenue – you would need to develop a sophisticated model, staff it and run it.

We had very significant discussions on that point, and that's why we went to a historic one-year lag number, one participant replied. All I'm saying is, don't forget the implementation piece of this, Kitchen said; it isn't free to get the real numbers that will make the theoretical model work.

Another concern is that the JCP formula does not address the IOUs' share of the cost of lost resources, such as WNP-2, Kitchen said -- the publics would bear the cost of losing those resources, but the IOUs would not. Wood disagreed, noting that, under the customer formula, the PF rate would go high, but because of built-in linkages, that would automatically clamp down on customer benefits. I don't think that's the case, said Kitchen – if I remember correctly, if there is no FBS replacement; the amount of Slice would go down, and a public utility would buy replacement power at some other price while paying a higher PF rate. In other words, the output of the Slice customers would go down, but aMW amount of IOU benefits would not, eventhough they receive benefits based on the higher PF rate. That's not true, said another participant – the IOU benefits are the difference between the firm Slice, plus whatever secondary credit there is. If you had less surplus energy because, say, Columbia Generating Station was down, there would be less of a secondary credit, and less of a delta between that and the virtual turbine.

Kitchen explained that BPA's concern here is that a Slice customer might have 100 megawatts of FPS at the net Slice rate; an IOU might have 50 megawatts of FPS. If you lost 20% of the system, the Slice customer would have 80 megawatts at the net Slice rate, but the IOU would still have the 50 megawatts. Various customers disagreed with BPA's interpretation of this point. We'll work through it and see, said Wood – again, it may be less of a concern than you think.

Another concern is that the customer formula does not adequately address the potential magnitude of exchange costs under subscription contracts for public customers who do not sign Regional Dialogue contracts, Kitchen said. For 20 year contracts, they would have to sign and give up their exchange rights, but if they decide to keep their subscription contracts at essentially the same rates, they would be eligible to sign an exchange contract under the subscription proposal. Is that a 2012 issue? one participant asked. It's more a 2007 question, Kitchen replied – there is some question about what the PF exchange rate will be in 2006.

So, that's my list of concerns, Kitchen said. Is there a hard floor on IOU benefits in the JCP, after the first five years? one participant asked. Zero is the floor, Litchfield replied. Zero could also be the floor in the first five years, but it's a linear curve tied to Bonneville's rates, another participant observed.

The group devoted a few minutes of discussion to the math underlying the formula, creating a series of hypothetical examples to illustrate how the formula would work under various cost and market assumptions.

Again, said Kitchen, Bonneville is trying to develop a financial formula that addresses both the customers' concerns and Bonneville's; however, our executives are focused on our financial health right now, not on this.

One concern is that, if this is to be a settlement that is acceptable to our executives and our commissions, there has to be proportionality, said Wood. We're not interested in getting more than our customers' fair share over time, because that wouldn't be stable, but whatever we ultimately agree to, it needs to be even-handed on both the upside and the downside, with respect to where benefits truncate. I understand what you're saying with respect to truncation, said Kitchen -- there is an issue between wholesale rate parity and retail rate parity, and there is the other issue of truncation. One thing subscription did was provide a financial formula, with Bonneville able to hedge its risk through power sales and purchases. The IOUs also have an obligation to serve their loads, and need to hedge the risk of serving that load. In other words, both of us are trying to use the same load for hedging purposes, and that's where we see the potential for conflict, Kitchen said.

The existence of the rate case does approximate that truncated approach, in that the IOUs are trying to assure a certain level of benefits, said another participant. That gets down to the base level of disputes regarding how the exchange program is supposed to function, Kitchen agreed.

We're looking at a different paradigm, said Wood -- if the exchange rate is high, you could simultaneously be above-market and paying out large sums of money. The joint customers have chosen a different approach, he said -- our intention was to use a market surrogate. It's quite clear that even if our own costs are above this surrogate, this is still all we get. In other words, we recognize that issue, but there are two ways we can approach it -- we can approach it as subscription did, and attempt to share the benefits as fairly as possible in all situations: a long-term stable approach. We could also choose a less-productive route, with both sides making hypothetical arguments about what subscription does and does not do, said Wood.   I absolutely agree, said

Kitchen – it needs to work across a range of scenarios. One benefit from the 2001 price spike is that it gives us a set of data to stress-test any formula, he added.

Bonneville staff believes that a financial formula is the most likely path to a negotiated solution, Kitchen said; we've been struggling to develop a formula better than the one the joint customer has proposed, in that it would address some of the asymmetrical statistical issues. The best way to do that is to serve us with real power, Brattebo replied – that was the starting-point for the JCP proposal. What we've heard from BPA is that if they serve us with real power, they would only give us 2,200 MW, which is only half our load, Brattebo said. The point is that there has been a lot of discounting and give-and-take that went into this portion of the proposal, he added – we didn't just ignore the concerns you've raised.

Where do we go from here? asked John Saven (NRU). In my mind, BPA can either give us a proposal, to which we can say yea or nay, or we can engage in problem-solving together and try to come to grips about the things that concern both the joint customers and BPA. I don't want to belittle anyone around this table, he said, and I think you've identified some legitimate issues, whether I agree with them or not. I don't disagree with what you're saying, said Rettenmund, but I don't necessarily want to rush to that point, either.

What I think we can constructively accomplish today probably isn't problem-solving on the financial formula BPA is developing, said Kitchen, and it hasn't yet been decided if we're going to go down the financial, or the power, path. We're certainly willing to go down the power path, said Wood; we recognize that any settlement must be equitable if it is to endure. We're all for problem-solving, and are not ruling out the changes it may take to get there.

Where we need to get, eventually, is to yes, Litchfield observed. That will require us to say, I see two or three problems with your proposal, and here are two or three ideas as to how we can fix that. To get there, also, we need to reach agreement on a common set of principles and objectives. That's a key point, agreed Jack Speer. And we have spent a lot of time arriving at a common set of principles and fundamental needs, said another participant. I think we need to work through those shared goals again, said Speer, because we're no longer on the same page. And they have to be politically sustainable goals, Wood agreed.

So if we're going to make progress, we need to get to another layer of depth, with respect to both goals and objectives and the detail of our discussion of the issues and tensions inherent in the two sides' positions, Litchfield said. The problems you've put on the table lead me to believe that we should move more toward volatility, and I don't know how we do that, he said.

There are still a lot of publics interested in long-term contracts, Saven observed; certainly there is an interest in working through this to achieve a long-term solution. If there are limits past which BPA cannot go, let's make sure everyone clearly understands what those are, he said. My concern is that people get their backs up, and there are things we need to do in the short term, with respect to modeling and other things.

Is it your view that you won't be able to get the management time and feedback so that you have something closer to a proposal package until after the June recess is over, or will you work on this in the interim? Saven asked. I think once we put this issue on the table, we're willing to continue to work on it between now and June, provided we can get enough of BPA management's time to make substantive progress, Rettenmund replied. We'll certainly be able to get more of management's attention during the latter part of that period, he added.

Is there anything we can do to further closure of the financial vs. power paths argument? Brattebo said. Sorry, I can't address that issue, Rettenmund replied.

Is there value in continuing with the subgroups working on ASC determinations and gas and market price modeling? Geoff Carr (NRU) asked. In the case of the ASC determination subgroup, I would say definitely yes, Kitchen replied. With respect to the modeling subgroup, none of the policymakers want to be dragged down into that level of minutiae – our view is that we want a solution people think is fair whether the market is 30, 40, 50 or 60, Kitchen said. The trouble is that the decision about whether to go with your proposal or ours depends almost entirely on the market, said Carr.

What's the interest in this group, in terms of getting back together, Rettenmund asked – do we need to have a Bonneville "proposal" to put on the table, or can we just get back together if we identify an issue on which we would like to have some discussion? After a few minutes of discussion, it was agreed that, to move on to problem-solving, BPA and the Joint Customers need to propose solutions. That doesn't mean BPA needs to put a proposal on the table, Litchfield said, but we need to have some constructive discussions based on a proposed solution

We'll go back to the office and talk about next steps on this issue, said Rettenmund. There is also significant interest on the part of the customers in BPA cost control, which includes both cost structure, in which there may be some flexibility, and cost control, where that flexibility might be applied. We could begin talking to you about that as soon as March 12, Rettenmund said. That makes sense to me, Litchfield said. It was agreed to hold this meeting beginning at 9 a.m. With that, today's workshop was adjourned.