

ISSUES, CONCERNS AND PROPOSALS FOR THE PROPOSED SLICE PRODUCT

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January 20, 1999

PROCESS AND GOALS

The goals of the process to develop the Slice product have been stated as:

1. Avoid shifting costs among customers,
2. Avoid shifting risks among customers, and
3. Comply with applicable statutes.

These are appropriate goals. In addition, we suggest that whether a specific Slice implementation fully meets these goals is a matter of judgement and interpretation. Predictably, most of the customer participation in the process to develop the Slice proposal is by persons actively desirous of an attractive Slice product – or at least eligible for the product. It is not reasonable to conclude that the interests of all customer groups have been fully represented in the process. Accordingly, the participants in the process should expect that BPA would present the Slice proposal broadly, and with explanations of how it is consistent with the above goals, to the full spectrum of potential BPA customers for additional comments.

Unlike many BPA products, the Slice product is not self-leveling. For many products, a customer that feels a product is too good can buy the product, or, conversely, if the customer feels the product is too disadvantageous it can purchase an alternative. However, BPA has defined that only a subset of present customers is eligible to purchase the Slice product. When only a subset of customers may purchase a product, the result of the product being too favorable is to shift costs from the eligible customers to other customers. Having limited the eligible customers, BPA has a greater duty to ensure that the product meets the above goals.

In the process, it has been suggested that comments should propose a solution to any issues or concerns articulated. The duty is on the parties seeking the product to evaluate comments and propose a product that meets the above goals. In an attempt to be constructive, we also propose solutions to the concerns set forth below.

SLICE PERCENTAGE

The current Slice product contemplates a one-time computation of the “Net Requirements” of an eligible utility using a single base year. Once the maximum percentage Slice is determined for a utility, the proposal contemplates no further review of the utilities “Net Requirements.”

This concept is flawed. BPA only is required to serve the Net Requirements of a utility. BPA is authorized to serve utility loads in excess of Net Requirements under prescribed conditions that, in this case, BPA may or may not meet. The determination of

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Net Requirements for these statutory purposes is not a static determination and, as currently contemplated, BPA would not comply with its obligations to other regional loads.

There are two reasons that a utility's Net Requirements might decline. A utility that has sold a regional resource may have an increase in its resource capability when sales contracts expire and the utility can use more of the regional resource to meet its loads. A utility may experience declining loads either due to loads that cease to exist or due to loads that shift between utilities.

Possible solutions:

1. BPA could recalculate the Slice percentage annually.
2. BPA could limit the Slice percentage to the minimum that corresponds to the minimum Net Requirement of the utility.
3. BPA could offer to sell other products to meet Net Requirements in excess of the minimum Slice for which a utility may be eligible. Such other products should be limited to block sales or other product terms that do not disadvantage other customers.
4. See the possible solution to 2 in the next section.

USE OF CRITICAL WATER CAPABILITY

In the most recent incarnation, but not yet written, BPA has stated that once a utility has contracted for a Slice percentage, BPA will not review the utility's sales of other resources dedicated to serve load. The agreement to use critical water capability (average FELCC) is inconsistent with BPA's approach on this issue. BPA is offering to sell to each Slice participant a percentage of the total system sufficient to assure that the Slice participant has approximately a 98% probability of surplus energy on an annual basis and virtually 100% probability of surplus in some periods.

It would be more consistent with industry trends and BPA's proposed *laissez faire* approach to the Slice participants' sales of their surpluses for the maximum Slice percentage to be based on average water capability of the Slice System. Within the year, BPA and the participants already propose to use average annual firm capability without regard to monthly relationships between requirements and the Slice capability. The active wholesale market could be used to fill any deficits and sell surpluses based on the average capability of the System. This would justify the BPA position that they have no obligation to look at the disposition of the participants' regional resource output.

REGIONAL PREFERENCE AND SECTION 9(c) OF THE REGIONAL ACT

As noted above, during the meetings last week BPA stated that once a utility has contracted for a Slice percentage, BPA will not review the utility's sales of other resources dedicated to serve load. This concept has multiple flaws:

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1. Taken in conjunction with the present proposal for determining Slice percentage, above, this would allow a utility whose available resources grow in the future (e.g. a mid-Columbia PUD) to sell hydroelectric power outside the Region that could have been conserved within the Region.

Solution: See above.

2. For any utility, BPA is allowing or encouraging increased power sales outside the region. This is an undisguised method for BPA to allow its power to be arbitrated outside the region without any attempt to meet the requirement that it be surplus, not be conservable for service in the Region, or be offered in the Region at the rates established for such sales.

Solution: a. As noted above, BPA could base the determination of the Slice percentage to which a utility can subscribe on the ratio of the utility's Net Requirement to the average capability of the Federal resources rather than the firm capability. In this manner BPA should be able to make a reasonable determination that surplus will exist when utilities sell power outside the region.

b. BPA must establish policies on the use of Intertie capability that insure that all statutory restrictions have been met before any federal power is arbitrated outside the region. The Slice proposal could acknowledge that such policies will be developed and that purchasers will comply.

c. If BPA is successful in meeting all subscription requests (preference utilities, IOUs and DSIs) then the issues of regional preference and section 9(c) may be moot.

INVENTORY SOLUTION

The Slice product properly acknowledges that the costs to be paid by Slice purchasers include their percentage of the cost of augmenting the system to meet additional loads. However, there have been proposals that such costs that might occur after the first five years of the contract could be limited to less than all the costs BPA might then incur to augment the system. At best, this concept is based on the notion that BPA could make a policy decision that utilities that contract for more than five years have a grandfathered right to the embedded cost of the federal inventory. This policy, if adopted by BPA, would require that BPA now agree to future rate tiers based on the term of contracts.

BPA has not articulated such a policy decision. If such a decision is required for the Slice product, it must be subjected to full disclosure and discussion with all customers.

In the absence of a policy decision to tier future rates, the Slice product must acknowledge the same risks as faced by other customers, that future costs may include future augmentation of the system. Perhaps the most that can be said is that the costs attributable to the Slice product will be consistent with the costs that are recovered

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through power rates for those customers that sign contracts with a term exceeding five years for other products.

The foregoing is not meant to disagree with section VI. E. of version 5.1 that contemplates a distinction between the replacement of lost capability and the inventory solution.

ELIGIBILITY

BPA has asserted that the Slice product only is available to public bodies and cooperatives as a "requirements" product. As discussed above, limiting eligibility to a subset of customers requires much greater care in defining the product. Another solution would be not to limit the eligible class of customers. BPA can allow broader purchase of the product if it agrees to augment the system to meet all requests.

"BUY BACK" OR "SYSTEM USE"

The participants in the Slice process spent much time defining a "buy back" provision with complex provisions and storage accounts that did not work. This now has been replaced by a correct recognition that BPA can use its system. The Slice product cannot be a sale of Federal resource capability. BPA carefully has maintained that the Slice product is the sale of power indexed to the operation of the Federal resources. The most recent restatement of the "System Use" provisions acknowledges that BPA can use the capacity and energy in the Federal system so long as it meets the contractual obligation that it incurs to each Slice participant (and all other customers).

Moreover, any further restriction on the ability of BPA to use the capacity and energy in the Federal system is a cost shift that would be inconsistent with the articulated goals. For all other products, BPA receives and distributes through its rates to all customers the benefits of diversity among customers. If the Slice product were to prohibit or restrict BPA's use of its system to the non-coincident excess of its contract commitments, that would be a material reduction in BPA's benefit from diversity among customers. The inability to use such diversity likely would increase costs to non-Slice products.

TRANSMISSION SURCHARGE

Some participants have suggested that BPA credit the Slice purchaser for any surcharge that may be applied to transmission rates to meet obligations of the power system. This proposal should not be adopted. This is a proposal that makes a bad idea worse.

The proposal for the PBL to credit some customers to offset a surcharge further compromises the separation between the PBL and the TBL. Application of transmission rates should be blind to the contractual relationship between the transmission user and the Power Business Line. Moreover, if Slice participants were to receive such a credit, they then would need to carry a liability to repay the credit when the power rates

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subsequently are increased to repay the TBL. The liability would not expire with the Slice contract.

This credit proposal effectively is a proposal that the PBL loan to a Slice participant an amount to offset the Slice participant's share of a loan from the TBL to the PBL. First, if the TBL to PBL loan is allowed, this proposal would be either a reduction in the net proceeds to the PBL or an increase in the amount that must be collected from other TBL customers. Second, the PBL should not be loaning money to its customers.

RESOURCE REPLACEMENTS AND ACQUISITIONS

The recent draft language is flawed. Section 6(m) of the Region Act (i) deals only with major resources and (ii) allows BPA in the alternative to offer a reasonable share of the particular resource or a reasonable equivalent. The language drafted for the proposal would require BPA to offer a reasonable share of any resource. This appears to be an attempt to contract away the limitation of major resources and the alternative of a reasonable equivalent. It is not clear that an offer by BPA to the Slice participant to include the new resource into the group to which the Slice percentage applies is not a reasonable equivalent.

Solution: replace the language circulated on 1/14 with:

(3) Resource Acquisitions by BPA

BPA will not be obligated to acquire resources for any reason, including the replacement of resources that are part of the Slice System. Nothing in the Slice product shall relieve BPA of any obligation that it may have to a Slice participant under section 6(m) of the RPA.

(4) Federal Base System Replacement Resources

Should BPA acquire a resource that it designates as a FBS replacement resource, and BPA and the Slice participant agree that the Slice participant may elect to participate in such resource, the Slice participation contract shall set forth the conditions under which the Slice participant's share of such resource may be included in its Slice share.

Further comment: The concepts above could create the result that each Slice participant has a different set of resources in its Slice system than any other participant. Moreover, further complexity may be created by resources that are in Slice systems for some Slice participants and not in the Slice system of other Slice participants that have a share of the same resource. It should be clear that Slice participants pay all the costs of administering and accounting for such uniqueness.

DETAILS OF EXPENSE AND REVENUE "TRUE UP"

The true-up should be open and transparent to all customers. All customers have an interest in this issue because the true-up affects the costs and risks to other customers. The general principles for the true-up should be vetted in the rate

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proceeding. In accordance with the principles established in the rate proceeding, at least annually, BPA should publish and circulate among all customers the proposed true-up and hold an information/comment forum for all customers before making a final decision to close out a year.

Other customers have a similar interest in the determination of administrative costs to be charged to Slice participants.

CAPITAL EXPENDITURES

The handout for this topic on 1/13 is complex and has several rate implications for other customers – especially during the second rate period. The arrangements for true-up of capital expenditures are a rate matter. This matter should not be decided in this forum; it should be part of a 7(i) rate proceeding. Perhaps the work of this group could become the initial proposal on this topic in the rate proceeding. The rate proceeding could establish principles that would apply to the entire term of the Slice contract.

PAYMENT FOR IMPLEMENTATION COSTS

The proposed language appears to lack flexibility to accommodate future new costs of administration of the Slice contracts. See, for example, the note above in the discussion of resource replacements. See also the discussion of “Stay Flexible” in Version 5.1. The development of implementation costs must be able to recover new costs not anticipated in advance. The details of these costs should be distributed to other customers in the same manner as discussed above under true-up.

ECONOMIC DISPLACEMENT OF WNP2

The provisions of the proposal distributed on 1/13 and discussed on 1/14 seem unduly complex and require administrative burden. Partial shutdown -- It is not clear that BPA would track the costs of partial operation of WNP2 to the Slice participants that elected to continue to receive energy during a partial shutdown. This cost tracking should be specified.

In general – the entire proposal requires administration. The accounting and tracking costs must be administrative costs allocated to Slice. Perhaps a simplification is to allow return of energy to BPA whenever agreed by BPA or whenever the market price of energy equals or exceeds the price at the time of delivery.

COMBINATION OF SLICE WITH OTHER PRODUCTS

BPA has evaluated the combination of Slice and other products and indicated no interest in such combination. This is appropriate and should be within BPA's discretion. Should BPA reverse this decision, it is incumbent on BPA to establish principles or restrictions on non-Slice products used in combination that avoid any opportunity to

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game BPA with its own power. For example, a product purchased in combination with Slice could be required to be either (a) flat for all hours of the year or (b) shaped to the utility load monthly and within the month. BPA would have a duty to explain to other customers how any flexibility in a Slice participant's purchase of other products could not be used to disadvantage BPA and, therefore, other customers.

ASSIGNMENT/POOLING/AGENTS

Currently BPA sells power to its customers' loads and receives the benefit of any diversity in load shapes. The fundamental concept behind pooling is to combine purchases to benefit the purchasers by capturing their own diversity. This would be a shift of cost or risk to other customers.

CONVERSION IF INVALID

The language proposed by BPA on 1/13 may create one or more "off-ramps" for Slice participants. This is contrary to the intent of the Slice concept.

Solutions:

1. At a minimum, the language should be clarified to limit such an off-ramp to exclude a court acting following a billing dispute or future dispute over implementation. That is, the off-ramp should be related to litigation commenced during the 90 day window.
2. Any such off-ramp that occurs after a full year under the contract should not allow the Slice participant a unilateral option to walk. The participant should be able to elect the proposed off-ramp if there is an initial adverse decision during the first year. If the litigation is not final prior to the end of the first year, the participant should be required to choose:
 - (i) To convert at that time to another product,
 - (ii) Take the off-ramp, or
 - (iii) Thereafter, only be able to elect to purchase other power products for the same Net Requirement and for the full term of the Slice contract unless it is mutually agreed between BPA and the participant that the participant may take an off-ramp.

FUTURE INTERPRETATIONS AND IMPLEMENTATION

The Slice proposal contemplates a "Contract Implementation Group" or "CIG" that would "be responsible for formulating and establishing implementation details not defined by the Slice Contracts." No other BPA power product would have such a delegation of responsibility. As contemplated in section XII.B.(2), BPA must have a veto right -- just as it may or may not agree with customers on issues under other contracts.

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Moving future decisions into a forum in which participants outnumber BPA inherently would shift risks.

TECHNICAL ASPECTS OF ENERGY AND POND ACCOUNTING

It is difficult or impossible for other customers to achieve sufficient confidence to accept for ten years the technical aspects of energy accounting, scheduling, pond accounting and similar matters. BPA should retain the authority to make adjustments in conformity with the goals stated above. The proposed CIG is not sufficient for this purpose as it allows the other Slice participants to jointly veto a change needed by BPA to protect other customers.

DISPUTE RESOLUTION

The unique dispute resolution mechanism is inherently flawed. All disputes contemplated in section XIII.C will involve BPA as a party to the dispute and many disputes may involve all "Participants". Thus, BPA cannot be on the review panel – it must be a panel of other customers (from the limited subset of customers eligible for Slice.) In some cases there will be no-one eligible for the panel; in all other cases the panel likely includes parties that would benefit in the future by deciding against BPA at present.

The case has not been made that there is a need for a special review panel beyond the "CIG" or any other special dispute mechanism unique to the Slice contract. Even if there is such a need, the mechanism must not be biased against the interests of BPA and non-Slice customers of BPA. The review panel mechanism is not reasonable and likely is not practical.