

CLARIFYING BPA OBLIGATIONS STRATEGIC INTENT PAPER

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Background

This document is an expression of BPA's strategic intent developed in fiscal year 2014 through a series of conversations with BPA executives and subject matter experts. Initially the conversations were labeled "BPA long-term business strategy" with the goal of adjusting the current business model to continue to deliver value to the region. As the sessions continued, the group focused on critical areas where there were perceived tensions or conflicts between BPA's obligations to its regional preference customers and its obligations under its open access transmission tariff that required greater clarity, resolution, and direction. The dialogue centered on BPA's ability to fulfill its mission and meet its multiple statutory obligations as the industry evolves and external forces continue to affect BPA's traditional business model.

Industry Evolution

In 1937, the Bonneville Project Act created BPA and directed it to market federally produced hydroelectric power to customers, giving preference and priority in power sales to public bodies and cooperatives. The Act authorized BPA to construct, own and operate transmission facilities to deliver federal power at cost. BPA's marketing and delivery of federal power was bundled, with cost-based rates recovering both the costs of the federal power and the federal transmission system used to deliver the power to customers. For three decades, BPA and its customers benefited from hydro and transmission systems that had surplus energy and capacity.

In 1964 the Pacific Northwest Regional Preference Act was passed which established a regional preference to BPA's surplus hydro power (energy and capacity). This addressed concerns that once the Pacific Northwest and the California and Southwest regions became interconnected via the construction of the AC-DC transmission line, that the preference clause would extend to entities out of region and threaten the use of federal power for Pacific Northwest needs. Under the operation of this law and policy, the needs of the administrator's power customers in the Pacific Northwest must be met first before surplus power can be sold extra-regionally.

By the late 1960s, BPA anticipated limits to the hydro system and issued Notices of Insufficiency to investor-owned utilities in 1967, then to preference customers in 1977. To respond to the need for additional power (energy and capacity), the region's utilities began to plan to add new generation, mainly nuclear plants.

In 1974, Congress passed the Transmission System Act that required BPA to be self financing and vested the administrator with broad authority to construct and integrate and transmit both federal and non-federal power. The impetus for the Act was to support the



development of the Hydro Thermal Power Program whereby regional utilities would invest in the development and construction of non-federal thermal generation and BPA would construct the transmission system to interconnect such resources. By being free of the congressional appropriation process, BPA would be able to construct transmission on a more efficient and expedient basis. The Transmission System Act also required BPA to make surplus transmission capacity, capacity not needed to transmit federal power, available to all utilities on a non-discriminatory basis.

After the 1980 Pacific Northwest Electric Power Planning and Conservation Act passed, BPA was authorized to acquire resources on a long-term basis to meet the net load requirements of regional utilities (if requested), mitigate impacts to fish and wildlife, implement the Residential Exchange Program, and acquire energy conservation as a resource to meet load. BPA was directed to offer long-term power sales contracts to its regional customers. Congress also reaffirmed the preference and priority to public bodies and cooperatives at all times in the marketing or disposition of federal power.

In the 1990s, the energy regulatory landscape in the region began to change dramatically. In 1992, Congress passed the Energy Policy Act to create open access transmission and prevent undue discrimination. This act gave the Federal Energy Regulatory Commission (FERC) the authority to order BPA to provide transmission under certain circumstances while assuring that BPA followed applicable statutes. In 1996, FERC restructured the electric industry when it issued Orders 888 and 889. Under Order 888, the following key Open Access Transmission Tariff, or OATT, policies were implemented:

1. Transmission capacity was to be awarded on a first-come, first-served basis.
2. Two types of transmission service were to be offered: Point-to-point, or PTP, which is transmission sold from Point A to Point B, and Network, or NT, service, which is a load following service intended to integrate various types of generating resources).
3. Transmission providers were required to offer to build transmission if they had insufficient capacity to satisfy a request for service.

BPA is not subject to FERC jurisdiction under sections 205 and 206 of the Federal Power Act. Those sections provide the legal basis for FERC's Order 888 and 889 mandating that utilities adopt the *pro forma* open access transmission tariff. Although not required by FERC, BPA decided to adopt the FERC Open Access orders with certain modifications and "deregulate" with the rest of the industry. This decision was based on several directives or assumptions, including:

- BPA would separate its transmission function from its power function and become the Regional Transmission Organization or Independent System Operator in the Pacific Northwest;
- A 1995 Department of Energy memo supporting FERC's effort for national open access that directed power marketing administrations, including BPA, to support it;

- BPA could meet its statutory obligations under the open access transmission provisions; and
- Additional assumptions stated in BPA’s 1995 business plan.

In 1996, BPA functionally separated into distinct power and transmission business lines. However, this split was based on assumptions about the industry’s future that did not come to fruition. The region did not establish a Regional Transmission Organization or Independent System Operator.

In response to sentiments aimed at anti-manipulation of gas prices, heightened fears about grid reliability, and a desire for compliance with FERC regulations, Congress passed the Energy Policy Act of 2005. The Act created section 211A of the Federal Power Act, giving FERC the authority to exercise jurisdiction over BPA and other non-jurisdictional utilities by requiring them to provide transmission service at rates comparable to those the utility charges itself, and on terms and conditions that are comparable to those it offers itself and that are not unduly discriminatory or preferential. FERC rarely uses this authority, but has used it at least once against BPA. The provision is similar to the provision in the Energy Policy Act of 1992, but does not specifically account for BPA’s unique statutory obligations.

Starting in the mid-2000s, the BPA Balancing Authority, or BA, experienced rapid increases in wind generation to over 4,500 megawatts. As a result, today the BPA BA experiences significant generation production volatility requiring additional reserve requirements in order to provide balancing services to the variable generation resources. Since the hydro system is only capable of providing a finite amount of balancing capacity for wind integration, BPA is continuing to explore collaborative and creative approaches to adapt to the changing industry landscape that will provide certainty to preference customers while meeting BPA’s other obligations as an open access transmission provider.

This document is intended to explain or summarize at a high level what customers and stakeholders should expect from BPA in key areas as we evolve to adapt to the changing industry landscape.

A. Clarifying obligations to BPA’s regional customers

BPA’s regional customers, established in BPA’s authorizing statutes, include several entities including: public bodies, cooperatives, federal agencies, and investor-owned utilities. Since 1937 BPA has always met its power marketing obligations to supply federal power to serve the firm power needs of its regional power customers. In doing so, BPA must give preference and priority to public body and cooperative utilities before offering to serve non-preference entities. With the advent of open access transmission, BPA started to offer new power and transmission products to a broader set of users, such as marketers and independent power producers – including companies marketing wind power. As demand grew for these services, BPA began to realize that the available energy and capacity from the federal hydro system would not be sufficient to meet all competing demands, causing customers and stakeholders to be increasingly concerned about getting their “fair share” from BPA. As a direct consequence, ambiguity about “who BPA is here to serve” and uncertainty increased over time.

In FY 2014, BPA reviewed its statutory, regulatory and contractual obligations and affirmed that its preference customers are its core constituency.

B. Clarifying BPA's obligation to preference customers

BPA is obligated to meet its statutory and contractual obligations to preference customers so they can meet their total retail loads and load growth, minus their own non-federal power supply (*i.e.*, the power they purchase and/or produce from their own non-federal generators). BPA believes that the NT planning and capacity reservation provisions of the FERC *pro forma* open access tariff are consistent with BPA's statutory obligations to its preference customers. Fully enabling these provisions will require a renewed partnership between BPA and its customers to jointly plan for their future power and firm transmission needs regardless of whether the customers' power supply comes from BPA and the federal power system or from nonfederal generation. To accomplish this, BPA will work with these customers and institute clear, transparent load service business practices to define the roles and responsibilities for BPA and its customers. Internally, BPA will create an integrated planning function to anticipate incremental power and transmission load service needs.

C. Clarifying BPA's approach to generation capacity

As an open access transmission service provider, BPA has an obligation to provide Ancillary and Control Area Services, or ACS, to support basic transmission services, including providing balancing reserves for interconnected renewable generation. To date, BPA has primarily met its obligation to provide ACS using the inherent flexibilities of the federal hydro projects. The demands on the federal hydro system have increased dramatically since restructuring in the mid-1990s and the renewable resource boom in the Pacific Northwest that started in the mid-2000s. The competing demands for generation energy and capacity have prompted BPA to clarify that it will ensure preference customer priority and preference to the federal hydro system generation energy and capacity prior to making it available for other ACS services for non-preference customers.

BPA will provide ACS to non-preference customers through surplus hydro energy and capacity, and BPA will be explicit in demonstrating the statutory and physical limits on the FCRPS. If the hydro system cannot provide enough capacity to meet all obligations, it is BPA's intent to acquire and dispatch nonfederal resources as necessary for non-preference customers.

BPA will maximize the value of the system for preference customers by exploring new opportunities, including development of innovative and competitive product offerings derived from the unique capabilities and flexibilities of the hydro system. Offerings could include regulation response services for other regional utilities.

D. Clarifying BPA's commitment to the FERC open access transmission policies

BPA remains committed to providing non-discriminatory open access transmission through the BPA OATT, so long as it can continue to meet its statutory responsibilities to preference customers and others. BPA will aspire to meet the spirit and letter of the FERC *pro forma* tariff by implementing a comprehensive BPA OATT compliance program.

Ultimately, if BPA determines that it cannot honor its statutory and contractual responsibilities through *pro forma* language adopted in its existing OATT, BPA will consider revising its OATT and moving away from *pro forma* in those areas, as needed. In that event, BPA may not continue to pursue reciprocity and will not file its tariff at FERC for approval. Regardless of BPA's reciprocity status, BPA will continue to engage in regional and national energy policies related to issues important to the agency and its stakeholders.

E. Clarifying BPA's approach to optimize operation of the Balancing Authority

The Northwest has a longstanding tradition of addressing operational challenges through coordinated system operations, including the Pacific Northwest Hydro Coordination Agreement, Contingency Reserves Sharing and regional collaboration on wind integration. As needs evolve, BPA will continue with its tradition of collaboration to help the region and the western interconnection move forward in this time of industry evolution. BPA will collaborate with the region to make the current bilateral energy and capacity markets more efficient and may become part of a centralized regional Security Constrained Economic Dispatch mechanism if the business case and governance framework prove amenable to regional parties and demonstrate value to BPA's customers.

As a consequence of functionally separating BPA's power marketing function from its transmission function in the mid-1990s, BPA's power and transmission operations evolved separately. This created significant communication barriers between Power and Transmission, many of which can now be eliminated through greater clarity and understanding of FERC Standards of Conduct requirements. Internally, BPA will take practical steps to further integrate communication and coordination between power and transmission operations to maintain and enhance reliability. BPA will work to increase coordination between power and transmission assets through, for example, improved redispatch during periods of system congestion.

BPA will modernize its Balancing Authority through prioritized technological investments to maximize the value of the assets through efficient operations. These tools will increase situational awareness and visibility, and will be shared across the agency's power and transmission functions in order to operate the BA most efficiently and effectively. Adoption of a one-BPA commercial operations strategy will provide BPA with the core functionality required to meet modern standards for situational awareness, integrate non-federal balancing resources into dispatch, and better communicate with adjacent balancing authorities through evolving operational mechanisms and market designs. This will include efforts to increase dynamic transfer capacity and automate Remedial Action Schemes.

F. Clarifying BPA's role in regional transmission expansion

Since 2008, BPA has played a central role in expanding the transmission system in the region through its network open season, or NOS, transmission policies in the BPA OATT. During a five-year period beginning roughly with the first NOS process in 2008, a significant amount of wind generation was connected in the Pacific Northwest.

BPA acknowledges that in the future there may be dynamic shifts away from the traditional transmission expansion paradigm. The recession that began in 2008 caused electricity demands to decline and to grow at a slower rate, and substantial changes in market conditions and state policies led to continuing shifts in the business environment. As a result, some customers, particularly wind developers, determined they no longer needed transmission service they had requested from BPA. In addition, due to increases in distributed generation development and increasingly cost-effective new technologies, there are new dynamics affecting the roles and interdependencies between distribution and transmission.

As BPA takes a central role in regional planning it will look for new arrangements and partnerships where system expansion is needed. The fast-changing landscape of the electricity sector and changing demands of the transmission grid will increase the risk of stranded costs to BPA's end-use customer base. BPA will critically evaluate how it is deploying its limited capital and will pursue alternative ownership and financing models to minimize its costs and debt burden. BPA will employ robust modeling scenarios to better understand what may happen to future transmission use as it determines how to evaluate and plan for the need for new transmission.

BPA will ensure that the transmission system is planned in a manner that extracts the maximum value out of the existing system consistent with its load service obligations. BPA will be an active leader and participant in regional transmission planning.

G. Clarify BPA's approach to regional collaboration

BPA will collaborate with the region to advance a reliable, efficient and environmentally sustainable power system. BPA will continue to be engaged with the region to advance issues that are consistent with BPA's mission and where BPA's participation will be most advantageous to customers and the region. BPA will speak externally with one, unified and consistent voice. "One BPA" external messaging will be developed through a disciplined internal policy development process, effective cross-agency decision making and clear accountability. To the extent possible, BPA will consolidate and increase the efficiency of its BPA-led public processes to reduce the burden on its customer and stakeholders and to address constraints on BPA's internal resources.