


CON - 037



BENTON RURAL ELECTRIC ASSOCIATION

402 7TH Street • P.O. BOX 1150 • PROSSER, WASHINGTON 99350 • 509/786-2913 • Fax: 509/786-0291

A Touchstone Energy® Cooperative 

June 17, 2008

Paul Norman, Vice President – Power Services

Bonneville Power Administration

905 NE 11th Ave

Portland OR 97232

Re: Concerns about Tiered Rates

Dear Paul:

As I indicated in our recent call, I think that putting the Benton REA Board's concerns regarding tiered rates in writing is the best way to communicate them to you. So here is my effort to do so.

The Benton REA Board, and many others in public power, started down this road in order to achieve some very specific objectives thought to protect BPA and public power utility's preference rights:

- ◆ Improve over current circumstances, and for the long-term, the right of preference utilities to the output of the Federal Base System (firm and non-firm), and protect that right from alteration or diminution from legislative (Congress) and administration (OMB, DOE, BPA) actions.
- ◆ Secure in a manner better than is currently the case, and for the long-term, the right of preference utilities to purchase the output of the Federal Base System (both firm and non-firm) at the lowest possible cost based rate, and protect such cost based pricing from alteration or diminution from legislative (Congress) and administration (OMB, DOE, BPA) actions.
- ◆ Do both of the foregoing in a manner that reduces the frequency of the political attacks that are launched to diminish preference rights and take away from preference customers the value of the Federal Base System (difference between cost and market) to use this Federal Base System (FBS) value including secondary sales for other purposes, such as deficit reduction.

Paul Norman

June 17, 2008

Page 2

These were the objectives we sought. Because of the value we placed on achieving these objectives, we were willing to give up melded cost rates, and the way we have successfully conducted business with BPA for over 60 years.

Preference customers chose to achieve these goals through implementation of a power allocation and rate design memorialized in contract. Preference customers believed that an allocation of FBS power and a rate design memorialized in contract would be immune from legislative and administrative change, and would be enforceable through binding arbitration against BPA. Unfortunately, the objectives set out above fell by the wayside when we shifted to a rate design construct during the TRM discussions. We believe that the current Tiered Rated Methodology ("TRM"), which represents neither a power allocation nor a contract right, falls far short of what is necessary to accomplish public power's objectives described above. We base this conclusion on the following facts:

- ◆ Since Tiered Rates is a rate construct memorialized in a policy, and not in a contract, TRM does *not* memorialize nor make the claim of preference customers to the output of the FBS any more secure from legislative or Administration initiatives than is currently the case.
- ◆ The TRM memorializes a rate design for the contract term, but that rate design does not provide service to preference customers at the lowest possible cost based rate. While the energy supply is provided at a rate that is below cost, the load shaping charge is based on market (not cost) and the demand rate is charged at a rate that has nothing to do with cost and is based upon the hypothetical cost of capacity from a combustion turbine priced on the margin. In short, more elements are based on market prices than the actual cost of production. The current TRM does *not* ensure the lowest PF rates, and, in fact, secures a rate design which includes many market based elements.
- ◆ The TRM highlights two facts that may not be in the region's best interest: First, that our Tier 1 power supply is very inexpensive and well below regional and national market rates; and second, that Pacific Northwest preference utilities are willing to pay BPA market prices for our power supply at the margin. Therefore TRM does *not* reduce the political exposure of preference customers. In fact, TRM *increases* the political exposure over current circumstances by highlighting these two aspects of the system that have historically motivated political attacks on preference power in an effort to take away the benefits of the Federal system.

Paul Norman

June 17, 2008

Page 3

- ◆ Tiered Rates connects preference to a resource base that is capped, and that its relative value will likely diminish over time. For this reason, TRM does *not* protect preference, but could actually be the first step to its demise over time. As the size of the FBS shrinks over time, so do the rights of preference customers. With Tiered Rates, we are agreeing to the ultimate extinction of preference.

The move away from melded rates was theoretically justified by the objectives described above that we thought we would achieve. Now that it is clear that Tiered Rates will not deliver on those objectives, the costs and negative impacts on preference of moving from melded to Tiered Rates are more troubling. They include:

- ◆ The cost of shifting from a known and proven business model to an undeveloped, unproven model that is extremely complicated will require more administrative and operating costs just to do what we do now, and will undoubtedly lead to adverse unintended consequences.
- ◆ Melded rates shield customers from the direct consequences of market price fluctuations and resource acquisition risks. In contrast, the Tiered Rates construct shifts directly to individual customers these risk elements, increasing both the risk and cost volatility faced by these customers.
- ◆ The loss of diversity in utility loads and load growth by moving Tier 2 loads off of BPA and on to individually owned non-federal resources will increase system costs by diminishing operational efficiency, increasing resource costs through the loss of BPA financing and scheduling benefits and causing more fragmented (compared to one utility concept) operations.
- ◆ Melded rates ensured that the benefits of the federal system (difference between FBS costs and market) are utilized to the benefit of preference customers. Melded rates accomplishes this by committing the financial difference between BPA rates and market prices to the purchase of new resources used to serve preference customer loads, making these funds unavailable to the Congress and Administration.
- ◆ TRM provides each Preference utility a High Water Mark (HWM) which reflects a percentage share of the critical water output of the FBS. However TRM does not address in an enforceable manner the application of benefits from secondary sales (all FBS output above critical water) either directly, or indirectly through financial applications, in a manner that guarantees the benefits to preference customers. Absent a contractual guarantee, these benefits are subject to Congressional and Administrative mischief.

Paul Norman

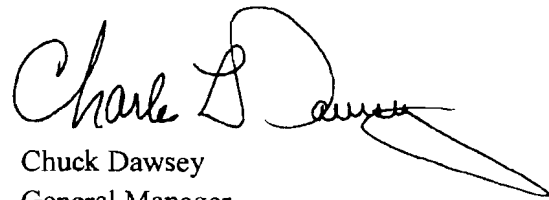
June 17, 2008

Page 4

- ◆ By adding new resources to the FBS, melded rates ensure that BPA's preference rates increase with market prices, reducing outside political exposure and pressure to add programmatic costs to the FBS, and ensuring that the FBS to which preference applies continues to grow over time, increasing the value of preference over time.

I hope this letter expresses to you the thoughts that motivate the concerns of the Benton REA Board regarding Tiered Rates, and why we believe it is not in the best interests of BPA, public power, or Benton REA, to implement the TRM. I would like to set up a meeting with you at your convenience to address these issues in more detail. Please call me with possible dates that are convenient for you in the first half of July.

Yours truly,

A handwritten signature in black ink, appearing to read "Chuck Dawsey". The signature is written in a cursive style with a long, sweeping tail on the last letter.

Chuck Dawsey
General Manager