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BPA's Power Supply Role Post 2011
Comments of PNGC Power
June 13, 2004

General

PNGC Power appreciates this chance to offer comments on the second phase of BPA's Regional Dialogue which focuses on BPA's post-2011 power supply role. PNGC Power agrees with the basic policy BPA has adopted of limiting its sales of embedded cost power to output of the existing Federal Base System (FBS) and charging incremental cost for service beyond that level. This is a critical issue to the region in order to stabilize the benefits of the federal system into the future. The various elements of the proposal such as allocation, cost control, cost separation and contract enforceability, must work together to ensure success. Our comments below follow the order of topics set forth in Paul Norman's letter dated May 11, 2005 which invited comments from interested parties.

Policy Schedule

PNGC Power participated in BPA's June 8th workshop on the long-term Regional Dialogue. There it was suggested that BPA modify its process and put out a discussion paper in July rather than issue an officially-noticed proposal with hard comment deadlines so that additional time would be available to seek consensus among interested parties. We do not oppose this change but suggest that BPA set forth clearly the specific approaches or alternatives that it currently favors. This will help focus the efforts to reach consensus. In any event, in order to preserve adequate planning horizons for BPA's utility customers, we do not support delaying the timeline as it affects the release of a final Record of Decision.

Service to Public Utilities

Power Sales and Allocations

BPA should make a long-term allocation of the entire FBS capability among public utilities. We're pleased that BPA appears determined to take this approach after years of urging by regional study groups, utilities, the Regional Council and others. Each customer should be allocated a percentage of the FBS capability for the term of new long-term contracts irrespective of the type of contract a customer chooses to sign. The percentages should stay fixed for the term of the contract except for situations of significant and permanent load loss.

Since last summer the region's consumer-owned utilities have worked to fashion an allocation proposal that could be recommended to BPA. PNGC has participated actively in that effort to flesh out the concepts in a form that could be adopted by BPA. There has been much progress to date to the point where we know the concept of allocation will work. The proposal that has

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served as the basis for discussion with BPA staff was approved by the PPC Executive Committee last summer. That proposal calls for the use of 2002 contracted net requirements values as the basis for allocating the FBS. These values were known (at least for many utilities) and considered immune to manipulation. Specific adjustments – additional MWs - were proposed for several utilities judged to have unique circumstances needing special attention.

However, PNGC has grown increasingly concerned that some of the premises supporting the original approach may no longer be valid and need to be reconsidered. For example, when the current approach was developed, it was assumed that we would be allocating a balanced or short system. BPA appeared to be deficit in 2007, the first year of the new rate period. PNGC believed that implementing new contracts early (2007 or 2008) would be important before BPA had to confront decisions on resource acquisition.

It is now believed that BPA may be surplus (ignoring DSI loads) past 2011. In addition, it is now clear that most preference customers will retain their existing contracts through 2011 irrespective of what BPA may offer in 2007. Moreover, we have concluded that having multiple contract forms operating in parallel before 2012 does create difficult complications as it would require separate 7(i) processes and major new contract management challenges for BPA that would create the potential for more divisiveness between customer groups and with BPA. Given these circumstances we believe the focus for allocation and new contracts should be 2012. However, we still believe that BPA should offer contracts as soon as is practical in order to provide its utility customers with some certainty with regard to their future load responsibilities. In order to facilitate this BPA should define an allocation procedure and negotiate and offer new contracts as quickly as practical. As part of this process it is important for BPA to provide its customers with the most current information available on its customers' loads and resources. .

If BPA is roughly in balance through 2011 and 2012 is the operational date for all new contracts, some of the elements of allocation method under discussion should be reconsidered. For example, we believe that use of 2002 net requirements loads for allocating the FBS among preference customers should be revisited. Using load numbers that are 10 years old for allocating FBS capability in 2012 could add substantially to the complexity of implementing allocations and rates under new contracts due to the likelihood of large mismatches between utilities' entitlements and their actual net requirements. This could go on for many years even after any surplus is gone. The potential for major inequities and divisiveness resulting from efforts to manage this situation is considerable. Because allocation is a zero-sum game, it is best to avoid a situation where some utilities are immediately deficit and must purchase power at new resource or market costs while others are substantially surplus with their allocation of embedded-cost FBS power.

We also find troubling the concept of pooling of allocation amounts that are surplus to system needs. We believe this would be difficult to administer and would result in the creation of unfair and unsustainable access priority for some preference utility customers at the expense of others.

<u>Contract Terms and Product Types</u>

BPA should offer contracts and power products for post-2011 in forms that will best support long-term allocations of the embedded-cost FBS and the ability of utilities to assume the primary responsibility for meeting load growth. Of the products currently in place, Slice is inherently well-suited for operating under an allocated system since it provides the greatest flexibility for developing and integrating new non-federal resources whether these are conservation measures, renewable resources projects, or more conventional power sources. The Slice product should be strengthened, and other products should be adjusted as necessary to make them work well under an allocated system.

New contracts should have terms for at least 20 years. Longer terms should be considered in order to facilitate long-term resource investments and to preserve FBS power for the region. This would require Congressional action. BPA should consider letting customers switch products during the term of new contracts, but this should be permitted very infrequently and only under carefully defined circumstances and only to the extent that BPA and other customers are held harmless. In general, the new contracts should be as straightforward as possible. BPA should avoid including provisions (such as some of those currently being suggested) that add unduly to the complexity, costs and uncertainty of implementation and which have the potential to complicate BPA's operations and planning and create unintended cost shifts and rate-making challenges. In addition, BPA should carefully evaluate the circumstances under which utilities may be able to "un-declare" resources dedicated to firm load service. This technique should not be available to lock-in allocations that would otherwise go unused for extended periods.

Another issue of concern to PNGC Power is the residential exchange as it applies to preference customers. Use of the residential exchange by preference customers is incompatible with the purposes of an allocated system where new resource costs are not melded. BPA should require as consideration for offering each preference utility a new contract with a long-term FBS allocation, that each such customer forgo any use of the residential exchange mechanism for the term of the contract.

Benefits to Newly-Formed Public Utilities

PNGC Power supports BPA setting a deadline for new preference customer formation in order to obtain a long-term allocation under new contracts. If a new preference utility is not formed before the deadline, eligibility for an allocation should await the termination of the new contracts with two possible exceptions. First, BPA could make available any surplus firm power it has to such customers at cost on a first-come first-serve basis. Second, BPA should consider maintaining a relatively small "set-aside" which could be used on a first-come first-serve basis to support long-term allocations to new preference customers formed during the term of the new contracts. To the extent such set-aside goes unused, BPA could re-market it or use it to serve load growth requests from other customers with the revenue received shared with all of its firm power customers.

Long-term Rate Methodology

The rate methodology applicable to the allocations of embedded-cost FBS power should be established under long-term contracts approved by FERC and/or Congress. Such methodology should clearly define the cost categories comprising the rate charged for such embedded-cost power. This would essentially define the costs that would be collected from each preference customer by applying the load-based percentage allocations defined under contract. Rates applicable to other services such as load growth, would be set in separate bilateral contracts and in BPA's more traditional 7(i) rate cases covering terms of 2-5 years.

Benefits to Residential and Small-Farm Consumers of Investor-owned Utilities

PNGC recognizes the statutory responsibility to share the benefits of the federal base system with the small farm and residential customers of the region's investor-owned utilities. We believe those should be provided in the form of financial benefits rather than direct power sales. We believe that the level of those benefits has recently risen to levels that are out of the historical norm and are unsustainable due to the burden they place on consumer-owned utility customers. As a general matter, we favor returning the levels to closer to the historical average, and adjusting them over time in ways that closely correlate to the cost of power experienced by traditional preference utility customers.

Service to Direct Service Industries (DSIs)

Our basic position is that BPA is not obligated to provide power to a DSI and lacks legal authority to subsidize rates for DSI service. In addition, BPA should not subsidize or provide credit support for development of generation by current or former DSIs or affiliates. As we have stated before, PNGC Power would support BPA, after serving all preference customer loads without augmenting the FBS, selling a limited amount of FBS firm surplus power, if available, to a DSI at an unsubsidized IP Rate if the DSI has met all of its financial, bad debt and other obligations under its subscription contracts and provides robust credit support. Any surplus firm power should be offered for one rate period at a time. BPA should not augment its system to serve a DSI unless the DSI pays the full cost of the additional resource. If continued DSI operation in the region is considered good public policy, any necessary governmental subsidies should be borne by U.S. taxpayers, not Northwest ratepayers.

PNGC Power is on record in disagreement with BPA's initial direction under its Short-term Regional Dialogue ROD to offer federal power benefits to the DSIs. PNGC Power appreciates the challenge the BPA staff faces in trying to create consensus solutions on this issue. However, at this point DSI service as suggested by BPA for the 2007-2011 period represents risk to the agency unless lawsuits are settled. We believe it is unrealistic to broach proposals relating to DSI service for the post-2011 period until issues surrounding DSI service during the 2007-2011 period have been completely resolved. Thus, we believe BPA should shelve the issue as far as the post-2011 period is concerned.

Resource Adequacy Standards

With respect to the question of resource adequacy standards, PNGC Power agrees that it is appropriate to revisit current regional criteria for energy and peak reliability. We have committed staff to participate in this effort. However, we do not believe new contract enforcement mechanisms will be needed to make any revisions to current standards effective. The current BPA power sales contracts treat this question adequately. If resource responsibilities are defined clearly through an allocation process, consumer-owned utilities, at the direction of their local governing bodies, will certainly do their part to provide sufficient resources. This does not rule out the appropriateness of control area utilities and other utilities with load serving responsibilities agreeing to memorialize adherence to various reliability standards in other agreements where such standards may be addressed.

Cost Controls and Dispute Resolution

Cost control, cost separation, and dispute resolution are all critical to long-term success under new contracts. Especially in the instance of contracts that may be 20 years or more in duration, it will be necessary to create tools that create confidence among utility customers that they will have a higher level of knowledge and input into the costs that they are expected to pay.

Recently, BPA staff has indicated an inclination to focus on non-contractual means to promote financial transparency. While PNGC Power appreciates recent efforts by BPA to involve customers in some review of the agency's costs and business practices, this will not be sufficient as the agency moves toward long-term contracts. We remain very concerned that long term contracts will be unworkable unless significant new methods are put in place to address these areas.

PNGC Power and a large group of other BPA customers exchanged several ideas with BPA staff regarding concepts that might add some additional level of customer involvement in BPA's budgeting process. We urge BPA to continue to work with the customers to come to agreement around cost control and cost separation tools creating more direct customer input into the process run by BPA to determine cost levels and cost assignments. In light of feedback from BPA staff, we understand that achieving significant cost control, cost separation, contract enforceability, and dispute resolution methods may require either Congressional ratification of the new agreements or possibly focused legislation. If this is not the case, then we would ask the agency in its draft proposal on the Regional Dialogue to outline in some specificity the tools that it believes can create adequate customer confidence while not requiring any change to current law. We stand ready to assist in further work on these topics.

Conservation and Renewable Resources

PNGC has made its views known on these subjects including our reservations regarding BPA's proposals to modify the Conservation and Renewable Discount program and to re-centralize its approach to conservation. We also believe that BPA needs to show much more flexibility in how it defines qualifying cost-effective measures so that rural utilities, in particular, will be able to capture more conservation under regional criteria.

In general, we can support BPA's involvement with conservation and renewable resources when requested by its customers in order to meet future load requirements. However, consistent with an allocated future, the main responsibility should fall on utilities and their customers to develop conservation and renewable resources to manage growing loads. As such, it will be each system's responsibility to judge for itself the rate and community benefits of conservation resources, as its governing board fashions a power portfolio to meet its resource needs.

Transfer Service

BPA's role in delivering power through transfer service has a long historical precedent. The importance of this role will continue. BPA should ensure that public power entities served by transfer service can get federal and non-federal supplies of power to their loads. When BPA makes an allocation of its power system, the ability to move non-federal power to load on a basis equivalent to federal power deliveries will be essential. To this end, BPA should address the remaining "GTA" issues as promised.

PNGC Power looks forward to a continuing dialogue with BPA and other parties as we work to define BPA's load service role and arrangements in the post-2011 period.