

Council Recommendations for the Future Role of the Bonneville Power Administration in Power Supply

Document 2004-02

April 9, 2004

Executive summary

Over the past several years the Bonneville Power Administration has faced periods of instability that have threatened its financial well being and that of its customers; hampered its ability to meet its obligations, including those to the U.S. Treasury; impeded the development of needed resources; and damaged the economy of the Northwest. The conclusion reached in several processes in recent years is that these problems have their roots in the ways in which Bonneville's role has been traditionally carried out and the uncertainties that creates with respect to resource development and load-serving obligations.¹ This led to proposals for changes in Bonneville's role in power supply. The region's governors have asked the Council to work with Bonneville and interests in the region to resolve this issue. The Council has consulted with a number of interests in the region and has convened a broadly representative steering committee to help address the key questions.

Bonneville has announced its intent to carry out a policy process this summer that would define Bonneville's future role as well as address a number of issues for the period remaining on its current power sales contracts.² These recommendations are intended to provide input to Bonneville as it prepares its initial proposal for that policy process and to the deliberations of Bonneville's customers and other interests as they consider Bonneville's long-term future role. The focus of these recommendations is primarily on the long-term as opposed to resolution of the questions Bonneville has raised for the last five years under the current contracts. However, there is a high degree of overlap between the long-term issues and many of those raised under the existing contracts. There needs to be consistency between the resolution of these issues for the remainder of the current contracts and how they are dealt with in new long-term contracts. The Council believes the issues must be dealt with as a package rather than as separate sets of issues. The Council's recommendations are summarized below.

A fundamental change in how Bonneville's carries out its role in power supply

Addressing the problems that have afflicted Bonneville and the region requires a fundamental change in how Bonneville executes its role in power supply consistent with the Power Act.

¹ See, for example, *Comprehensive Review of the Northwest Energy System -- Final Report: Toward a Competitive Electric Power Industry for the 21st Century*, Comprehensive Review Document CR 96-26, December, 1996. <http://www.nwcouncil.org/library/1996/cr96-26.htm>; *Cost Review of the Federal Columbia River Power System -- Management Committee Recommendations*, Document CR 98-2, March 10, 1998. <http://www.nwcouncil.org/library/1998/cr98-2.htm>; *Investor-Owned Utility/Preference Utility Proposal For The Future Role Of The Bonneville Power Administration*, October 29, 2002 Draft; *What Led to the Current BPA Financial Crisis? A BPA Report to the Region*, AKA "The Lessons Learned" report, Bonneville Power Administration, April 2003; *Northwest Power Planning Council Recommendations on the Future Role of Bonneville in Power Supply*, Council Document 2002-19, December 17, 2002. <http://www.nwcouncil.org/library/2002/2002-19.htm>; *The Future Role of Bonneville in Power Supply*, Council Document 2003-18, October 2003, <http://www.nwcouncil.org/library/2003/2003-18.htm>

² See attachment A

DRAFT FOR PUBLIC COMMENT

Under the Council's recommendations, Bonneville would market the existing federal system to eligible customers at its embedded cost and serve load growth that exceeds the capability of the existing federal system in such a way that the customers requesting such service bear the costs and risks of providing that service.³ This change would clarify who will exercise responsibility for resource development; result in an equitable distribution of the costs of growth; and prevent the value of the existing federal system from being diluted by the higher costs of new resources. This change in role ultimately should be implemented through long-term (preferably 20-year) contracts.

It has been suggested by some that Bonneville's future role in power supply would have to be addressed, in part, through legislation. However, legislation is risky. More importantly, the changes in Bonneville's future role that the Council recommends do not alter Bonneville's fundamental responsibility to serve the loads of those qualifying customers who choose to place load on Bonneville. They do represent a change in the way in which Bonneville has traditionally carried out that responsibility. The power-marketing change recommended here may be accomplished without legislation through rulemaking and should serve the region's needs just as well. Legislation should be considered only as a last resort, if the changes recommended here are not effected or prove insufficient.

Define policy direction through rulemaking

The Council believes that debate in the region over the future role of Bonneville is less over the end-state, a limited role for Bonneville in power supply, than how to reach that end state. The Council acknowledges that both new long-term contracts and a revised pricing structure will be necessary to fully implement the vision. The Council believes, however, that a clearly articulated and durable policy must guide the necessary contract negotiations and rate cases. There is a spectrum of means by which such a policy might be established. The process Bonneville has proposed for establishing policy may not provide the necessary durability. The most durable alternative would be to establish the policy in legislation. However the Council believes that would entail unacceptable risks for the region.

The alternative the Council recommends is that Bonneville first establish the basic elements of Bonneville's "future role" policy through rulemaking in accordance with the federal Administrative Procedure Act. Such a rule could have the force of law, the same as a statute, and bind the agency and those affected by the agency in all future implementing actions (as long as the rule remained in effect), such as in the negotiation of power sales contracts and the setting of rates. While the rule can be changed, it is a more rigorous process than changing a statement of policy. This rule should include provisions that Bonneville will allocate and sell power from the existing system using one basic rate; that load-service obligations beyond the existing system such as would require Bonneville to acquire resources or otherwise augment the existing system will occur only through bilateral, incrementally priced contracts with customers that need the power; and that in any event any acquired or augmented resources beyond the existing system will be sold at a distinct rate or rates reflecting the cost of that resource or resources. In addition,

³ Implicit in this position is that the contracts through which Bonneville would serve load growth beyond the capability of the existing system not subject other Bonneville customers to increased rates or other financial risk associated with resource acquisition authorized under Section 6 of the 1980 Power Act.

DRAFT FOR PUBLIC COMMENT

the policy should be consistent with Bonneville's statutory responsibilities for conservation, renewables and fish and wildlife.

Offer long term contracts as soon as possible

The best means by which a change in how Bonneville carries out its role in power supply can be reliably altered is through the combination of rulemaking described above, fully implemented through long-term (preferably 20-year) contracts. Only long-term contracts will provide the certainty, continuity, and durability that customers need to make long-term resource commitments; the stability that Bonneville needs to be able to assure Treasury repayment; and the protection the region needs for one of its most significant assets. Bonneville should offer such contracts as soon as possible

The biggest impediment to long-term contracts is the customers' concern that they will have given up the major means by which they can exercise discipline on Bonneville's costs and business practices – their ability to take load off Bonneville. The Council believes that the benefits of long-term contracts are sufficient that all parties need to be open to examining ways in which this impediment can be overcome.

Allocation of the existing system

Fundamental to implementing the changes in Bonneville's role in power supply is allocating the power from the existing federal system among eligible customers. The system should be defined as the currently existing system. To preclude opportunities for gaming the process, any allocation should be based on customers' historic net requirements placed on Bonneville, rather than forecasts. A multi-year historical period should be used and the allocation should be done on a monthly basis for both heavy and light load hour periods to reflect the time-dependent demands placed on the federal power supply system.

Tiered Rates under existing contracts

If Bonneville's role is defined in rulemaking as described above and new contracts can be negotiated and offered well before the end of the current contracts, the Council would not press for near-term implementation of tiered rates under the current contracts. However, if there is no significant progress toward establishing Bonneville's role in rulemaking and developing new contracts consistent with effecting that role, the Council would reconsider implementation options such as tiered rates. Tiered rates would be the clearest practical indication of how Bonneville will be carrying out its role in the future.

Range and choice of products

Customers should have access to the full range of products that are currently available, such as requirements, block, and slice products. What is important is that the costs of each product be confined to the purchasers of that product. There should not be any significant cross-subsidies among products. In the process of negotiating new contracts, customers should have the opportunity to choose the products that best meet their needs.

Direct Service industries (DSIs)

If a DSI has been a responsible customer of Bonneville, the Council supports providing a limited amount of power for a limited duration under terms and conditions that would permit the DSI to

DRAFT FOR PUBLIC COMMENT

operate. Every effort should be made to minimize the cost impact on other customers. For example, consideration should be given to allowing DSIs priority access to non-firm hydropower, and DSI service should be conditioned on the ability to interrupt service for short-term system stability purposes, for provision of operating reserves, and for market and/or reliability purposes. Bonneville potentially could provide credit support for development of a resource by the DSIs to firm up the non-firm power available to them. However, some level of augmentation may be necessary. The net cost of that augmentation including revenues from the DSIs and the value of DSI interruption, should be recovered through the rates charged for the existing system resources. Alternatively, an equivalent financial package should be evaluated. Such a package could entail less risk for Bonneville and its customers. Contracts offered to DSIs should be relatively short term -- the period covered by the rate case, for example. The DSIs may be unable to commit for longer periods and, as conditions change, the service package should be re-evaluated.

Benefits for the residential and small farm customers of investor-owned utilities

The Council strongly supports resolution of the issue of benefits for the residential and small-farm customers of investor-owned utilities (IOUs) for a significant period. The Power Act established a mechanism for sharing of benefits of access to low cost federal power. That mechanism has operated in such a way that it satisfies no one. However, "fixing" these features of the Act could have broad ramifications that make legislation risky. The Council favors a long-term settlement that provides benefits in the form of dollars. The Council cannot judge what is an equitable settlement. However the necessary characteristics of a settlement can be defined. A settlement must provide certainty, it must be transparent, and it must not be subject to manipulation. The proposed settlement that collapsed in early 2004 contained these elements and was supported by nearly all of Bonneville's Northwest customers. The Council believes this could be the template for a long-term settlement.

Fulfilling responsibilities for conservation and renewables

Bonneville should continue to support a rate discount mechanism for some conservation. However, a rate discount should not necessarily be the only mechanism available. The Conservation and Renewables Discount (C&RD) has been instrumental in motivating some utilities to pursue conservation and renewables activities. And it clearly expanded the portfolio of activities and measures deployed across the region. But the rate discount needs to be refined as outlined in the Council's December 2002 recommendations. The focus needs to be on determining how to reliably acquire all the cost-effective conservation at the lowest cost to the utility system. Bonneville and the Council should facilitate a collaborative process to refine the details of a rate discount and produce recommendations by early 2005.

The Council continues to believe that levels of renewables development should be guided by the Council's Northwest Power Plan that evaluates resources on the basis of cost and risk mitigation. The Conservation and Renewables Discount could be used to support customer acquisition of renewable resources provided that this acquisition was in addition to acquisition of cost-effective conservation.

DRAFT FOR PUBLIC COMMENT

Bonneville is uniquely suited to pursue some activities that would facilitate renewable resources development and that would not happen without Bonneville participation. These activities benefit all of Bonneville's customers and their costs should be recovered from the existing system. These include activities such as: 1) removing barriers to cost-effective renewable resource development that would not be resolved soon if not addressed; 2) activities such as developing storage and shaping services, developing transmission re-dispatch products and making transmission acquisition for renewables easier; and 3) limited, region-specific research and development. The costs of actually providing services like storage and shaping should be borne by the purchaser.

With regard to acquiring the output of new renewable resources, the Council believes Bonneville's activities should be consistent with the power plan. Bonneville should acquire new renewable output to meet new or replacement resource needs placed on the agency provided resources are cost-effective after accounting for any risk reduction or other benefits the resources provide. Customers choosing to place load growth or replacement resource requirements on Bonneville should bear the full cost of acquiring, operating and maintaining those resources.

Resource adequacy

Even absent changes in the way Bonneville carries out its role in power supply, the issue of resource adequacy and the possible need for an adequacy standard that ensures adequate power supplies are maintained has been a major concern of the Council and others in the region. A change that results in more of the risk and responsibility of meeting future load obligations being borne by individual utilities instead of Bonneville does not reduce overall risk. The Council is aware that new policies may be necessary to ensure that adequate information and safeguards exist to ensure adequate and reliable electric power for the Northwest. In particular we are concerned about the possibility that a severe deficit by any one utility could have detrimental effects on other utilities in the region. This risk can only be removed if all utilities ensure an adequate level of resources for their own load-serving responsibilities.

The Council is committed to working with all regional players including Bonneville, utilities, the states and their regulators, and other regional and West-wide organizations to ensure that appropriate adequacy policies are in place and the data and other tools to implement them are available. The Council believes these policies need to be in place prior to the implementation of long-term contracts.

Fulfilling responsibilities for fish and wildlife

The Council believes these policies will not affect Bonneville's fish and wildlife obligations. Their obligations will be determined in a manner consistent with the requirements of the Power Act and the Council's fish and wildlife program. Costs should be allocated to the existing system.

DRAFT FOR PUBLIC COMMENT

The goals we're trying to achieve

To solve the identified problems, the Council proposes the following goals:

- Preserve and enhance the benefits of the Federal Columbia River Power System for the Northwest;
- Not increase and, preferably, reduce the risk to the U.S. Treasury and taxpayers;
- Achieve an equitable sharing of the benefits of the federal power system;
- Develop and maintain widespread support for the federal system and reduce conflicts within the region;
- Align the costs and benefits of access to federal power;
- Maintain and improve the adequacy and reliability of the Northwest power system;
- Make it clear who will be responsible for meeting load growth and on what terms;
- Provide clear signals regarding the value of new energy resources;
- Lessen Bonneville's exposure to market risk;
- Lessen Bonneville's impact on the market;
- Satisfy Bonneville's responsibilities for conservation and renewable resource development;
- Satisfy Bonneville's responsibilities with respect to fish and wildlife; and
- Accomplish these goals at the lowest possible cost to the region's consumers.

The scope of these recommendations

The Council's recommendations primarily are focused on achieving long-term resolution of the question of how Bonneville carries out its role in power supply in the future. The recommendations are intended to guide Bonneville as it develops its "future role" proposal in June, 2004, and to serve as a reference during "future role" deliberations among Bonneville, its customers and interested parties over the next several months. The Council believes that decisions that result from this deliberative process should be implemented as quickly as possible and in a way that will provide the certainty, continuity, and durability required for the resource decisions that Bonneville and its customers will need to make after 2006. It is important for Bonneville and its customers to resolve near-term contract issues, and the Council recognizes the right of customers to stay with their current contracts. However, there is a great deal of overlap between many of these near-term issues and the long-term issues addressed here. Using the Council's recommendations as a guide, Bonneville and the customers should resolve near-term contract issues in a manner consistent with a transition to long-term contracts. The Council intends to be an active participant in Bonneville's "future role" process as it evolves.

DRAFT FOR PUBLIC COMMENT

Recommendations

A fundamental change in how Bonneville carries out its role in power supply

The governors, the Council, most customers and interested parties who have been engaged in recommending a new role for Bonneville believe a fundamental change is required in traditional power supply business practices. Those with a stake in the benefits of the Federal Columbia River Power System (FCRPS) believe Bonneville should transition toward a new role in marketing the FCRPS, providing power to eligible customers at its embedded cost and serving load growth that exceeds the capability of the existing federal system in such a way that customers requesting such service bear its costs and risks. This would result in an equitable distribution of the costs of growth. Customers that choose to take responsibility for their own load growth would not be exposed to the costs of new resources that are undertaken to serve the needs of other customers. Those that choose to have Bonneville serve their load growth would pay only the costs of serving their growth. Such a change would prevent the value of the existing federal system from being diluted by the higher costs of new resources.

Conceptually, this revised role for Bonneville developed as an outgrowth of the 1996 Comprehensive Review and was carried forward in the 2002 Joint Customer “future role of Bonneville” proposal. Subsequent Council recommendations to Bonneville largely supported the concept.

If this change in role is to have the desired effect, it must be in place with sufficient certainty in time to allow Bonneville and customers to make resource decisions in the latter part of the decade. Customers are concerned about making future power supply decisions only to find that changes in Bonneville’s role have not been effected as expected. The Council recommends a combination of rulemaking, rate design and, ultimately, long-term contracts to effect this change. Until this is accomplished, parties should be careful not to take actions that would preclude or impede implementation of this recommendation.

It has been suggested by some that Bonneville’s future role in power supply would have to be addressed, in part, through legislation. However, legislation can be risky. More importantly, the changes in Bonneville’s future role that the Council recommends do not alter Bonneville’s fundamental responsibility to serve the loads of those qualifying customers who choose to place load on Bonneville. They do represent a change in the way in which Bonneville has traditionally carried out that responsibility. The change recommended here may be accomplished without legislation through rulemaking, and should serve the region’s needs just as well. Legislation should be considered only as a last resort if the changes recommended here are not effected or prove insufficient.

Define fundamental policy direction through rulemaking

The Council believes that debate in the region over the future role of Bonneville is less over the end-state, a limited role for Bonneville, than over how to reach that end-state. The Council acknowledges that both new long-term contracts and a tiered-rate structure will be necessary to fully implement the vision.

DRAFT FOR PUBLIC COMMENT

Beginning with the 1996 Comprehensive Review, the Council, many customers and other interested parties have recommended that Bonneville limit and condition its role in the region's power supply in ways compatible with what is recommended here. Bonneville has responded with a series of business management decisions using tools such as policy statements, strategies, contracts and rates. These tools have not proven adequate to the task.

The Council believes that a clearly articulated and durable policy must guide the necessary contract negotiations and rate cases. There is a spectrum of means by which such policy might be established. The process Bonneville has proposed for establishing policy may not provide the necessary durability. The most durable alternative would be to establish the policy in legislation. However the Council believes that would entail unacceptable risks for the region. A third alternative is for Bonneville to take a decisive step to establish its new role in binding agency policy through rulemaking before beginning long-term contract negotiations and an associated rate cases. Bonneville would then implement this established policy through the subsequent contract and rate case forums. This approach avoids the risk of legislation while providing a more binding and durable solution than a simple Bonneville policy.

Thus, the Council recommends that Bonneville first establish the basic elements of the future role envisioned here through rulemaking that will bind the agency and those affected by it as the agency enters into subsequent contract negotiations and ratemaking. Such a rule could have the force of law, similar to a statute, and bind the agency and those affected by the agency in all future implementing actions unless and until the formally established rule is amended or rescinded through the same administrative procedures process which establishes it.

More specifically, Bonneville should initiate the rulemaking procedure in the federal Administrative Procedures Act in 2004 and adopt a final rule as soon as possible thereafter defining how the agency will act in the future with regard to load growth, resource acquisition, augmentation, and associated power sales contracts and rates. The Council recommends that the elements of this rule include provisions stipulating: 1) that the agency will allocate and sell power from the existing system, using one basic rate; 2) that load-service obligations beyond the existing system that would require Bonneville to acquire resources or otherwise augment the existing system will occur only through bilateral, incrementally priced contracts with those individual customers or groups of customers necessitating the action; and 3) that in any event, any acquired or augmented resources beyond the existing system will be sold at a distinct rate or rates reflecting the cost of that resource or resources. In addition, the policy should be consistent with Bonneville's statutory responsibilities for conservation, renewables and fish and wildlife.

Bonneville would have to comply with National Environmental Policy Act in the process of proposing and adopting a legislative rule of this nature. It is likely that the significance of the step contemplated would require an environmental impact statement (EIS), although given the nature of the 1995 Business Plan EIS, Bonneville may be able to comply with NEPA through a supplement to that EIS. A rule of this nature would be establishing overarching, binding agency policy, even if specific in content. NEPA coverage would have to be at a similar overarching policy level. Once the rule itself is accompanied by the proper NEPA coverage, the NEPA analysis for subsequent, subordinate applications of the rule -- in rates and contracts -- could be tied to the policy-level EIS

DRAFT FOR PUBLIC COMMENT

Offer long-term contracts as soon as possible

The best means by which Bonneville's role in power supply can be reliably altered is through the combination of the rulemaking described above and long-term (preferably 20-year) contracts. Only long-term contracts will provide the necessary certainty that customers need to make long-term resource commitments; the stability that Bonneville needs to be able to ensure Treasury repayment; and the protection the region needs for one of its most significant assets.

New long-term contracts should be offered as soon as possible to provide as much certainty as possible for the development of new resources that will be needed. Resource decisions will almost certainly need to be made well before 2011. Although it would not be necessary for the new contracts to take effect before 2011, offering new contracts well before 2011 would provide the business certainty that the customers need regarding load serving responsibility after 2011.

To be consistent with the new policy role for Bonneville, the new contracts should be consistent with Bonneville's rulemaking and clearly describe how power from the existing federal system will be allocated to customers and the terms under which Bonneville will serve additional load with acquired or augmented resources. The contracts must also incorporate necessary checks and balances to both protect customers from unwarranted costs while ensuring that Bonneville is able to fulfill its responsibilities, including timely repayment of its debt.

Cost Control and Business Practices

The biggest impediment to long-term contracts is the customers' concern that by entering into long-term contract they will give up a major point of leverage to exercise discipline on Bonneville's costs and business practices – their ability to take load off Bonneville. Bonneville and the customers have taken steps to provide greater transparency to Bonneville's costs and decision processes through the Customer Collaborative and Sounding Board processes. These efforts should be continued. However, that is only part of the customers' concerns. In particular, many customers are concerned by what they see as Bonneville's practice of defining issues in such a way that disputes are adjudicated in the Ninth Circuit Court of Appeals, where the scope of judicial review is limited to the record established by Bonneville.

The Council believes that the benefits of long-term contracts are sufficient that all parties need to be open to examining ways in which this impediment can be overcome. We believe that at least the following options need to be considered:

- Addressing costs in Bonneville rate cases. Unlike rate cases for regulated utilities, Bonneville costs are not open to question in rate case proceedings. Allowing parties to address cost issues in rate cases would allow cost issues to be fully aired.
- Establishment, perhaps through administration action of the Department of Energy, of a dispute resolution process that could arbitrate disputes over costs and business practices.

Allocation of the existing system

Fundamental to implementing the changes in Bonneville's role in power supply is allocating the power from the existing federal system among eligible customers. In the long-term model, it is a utility's allocation of this power that would be purchased at the lowest embedded cost rate. A

DRAFT FOR PUBLIC COMMENT

utility's requirements above this level would either be met by the utility itself or by Bonneville, with the customer bearing the cost and risk of the additional resources required. Any implementation of tiered rates under the existing contracts should be as consistent as possible with the long-term model.

Any allocation should be done in such a way as to preclude opportunities for gaming the process. For that reason the Council believes that any allocation should be based on customers' historic net requirements placed on Bonneville, rather than forecasts. And because there are variations in loads year to year, the allocation should be based on a multi-year historical period. Further, the allocation should be done on a monthly basis for both heavy and light load hour periods to reflect the time-dependent demands placed on the federal power supply system.

New or Annexed Public Loads

Legally, Bonneville ultimately must serve all qualified public loads. The formation of new public utilities or the loads of areas annexed by public utilities need to be served and, in the long run, they need to be served on a basis comparable to other public utilities. The amount of the new or annexed load that would qualify for service from the existing system should be determined on the same basis as the system allocation described above. Any loads above that level would be served at the costs of the resources required to serve those loads or the utility could serve those loads themselves.

Serving new or annexed public loads from the existing system would require either a reallocation of the existing system, which would result in all customers getting a reduced share, or augmentation of the existing system with the costs of that augmentation included in the cost of the existing system. However, a waiting period of sufficient duration is needed to allow existing customers and Bonneville to make the necessary resource decisions. The Council suggests that the net requirements on which reallocation for a new public would be based should be for the same historic period as that used in the initial system allocation.

Until reallocation took place, new publics or annexed areas could be served by Bonneville at the cost of the resources required to serve them or by the new or annexing public itself. In cases where a new public was formed from IOU territory or IOU territory was annexed, a proportional part of the residential and small farm benefit would transfer to the new or annexing public utility until a reallocation of the federal system are carried out.

Existing customers whose allocation is reduced as a result of new or annexed public loads would have the option of having Bonneville serve the amount of load that can no longer be served by the existing federal system at the cost of the resources required or doing so themselves.

These recommendations would apply to both the existing contracts or new contracts.

Reduced Public Utility Loads

Similarly, there should be provisions for reallocation in the case of loss of loads not attributable to the conservation actions of the customer. This would be loss of load associated with plant closures or long-term decline in population and economic activity in a service territory. However, reallocations should be undertaken only where a loss of loads has persisted over a

DRAFT FOR PUBLIC COMMENT

period of several years or where there has been a loss of service area. Until such time as there is a reallocation, the revenues from the sale of the unused allocations should be used to reduce the rate charged for power from the existing federal system.

The Council does not want the threat of reduced allocation to discourage investments in cost-effective conservation. In most instances, utilities will be able to avoid the costs of new resources through conservation. However, there may be instances where utilities are not growing but they still have cost-effective conservation options available to them. In instances where verifiable conservation savings reduce a customer's load below its initial allocation, the utility should receive the value of the savings to Bonneville after subtracting what the utility would have paid Bonneville for the reduction in load attributable to conservation.

Loss of Existing Federal System Resources

There is always the potential for the loss of resources from the existing federal system. If such loss were to occur, customers should have the option of having Bonneville replace their proportionate share and charge them the cost of replacement or to replace the resource themselves.

Should Bonneville implement tiered rates under the current contracts?

If Bonneville's role is defined through rulemaking as described above and if new contracts can be negotiated and offered well before the end of the current contracts, the Council would not press for tiered rates under the current contracts. However, if there is not significant progress toward establishing Bonneville's role in rule and developing new contracts effecting that role, the Council would reconsider implementation options such as tiered rates. Tiered rates would be the clearest practical indication of how Bonneville will be carrying out its role in the future.

Products and terms of service

The Council believes that customers should have access to the full range of products that are currently available, e.g., requirements products, block products, and slice. What is important is that the costs of each product be confined to the purchasers of that product. Not only should the costs of serving load growth be confined to those purchasing that service but there should not be any other significant cross-subsidies among products. In the process of negotiating new contracts, customer should have the opportunity to choose the products that best meet their needs.

Service to:

Direct Service Industries

While Bonneville may contract to supply power to Direct Service Industries (DSIs), it is not required to do so. However, the decision to not serve some DSI load cannot be taken lightly. Some are still important elements of local economies in the Northwest. If a DSI has been a responsible customer of Bonneville-- that is, if the DSI has not imposed stranded costs on Bonneville by substituting market purchase for federal power, has not rejected its Bonneville power contract in a bankruptcy proceeding, and has not defaulted on its payment obligation under an existing contract, there may be an opportunity to provide a limited amount of power for a limited duration under terms and conditions that would permit the DSI to operate.

DRAFT FOR PUBLIC COMMENT

The federal system is currently roughly in load/resource balance. Consequently, some level of augmentation may be necessary to provide reasonably continuous service. In developing a service package for the DSIs, every effort should be made to minimize the costs imposed on other customers. Options that should be considered include:

- Offer the DSIs access to non-firm hydro. There are many months in many water years in which there is sufficient non-firm power available to serve a few hundred megawatts of DSI load with a relatively high probability.
- DSI service could be interrupted for system stability purpose and for market and/or reliability purposes.
- Bonneville could potentially provide credit support for development of a resource by the DSIs to firm up the non-firm available to them.

The cost of that augmentation, net of revenues from the DSIs and the value of DSI interruption, should be recovered through the rates charged for the existing system resources. Alternatively, an equivalent financial package could be offered and might entail less risk for Bonneville and its customers. Contracts offered to DSIs should be relatively short term, that is, the length of the rate period. The DSIs may be unable to be able to commit for longer periods and, as conditions change, the service package should be re-evaluated.

New Large Single Loads

Moving to a system whereby power from the existing system is allocated and additional power requirements are met at the cost of the power to serve them essentially makes the question of new large single loads moot. Power for service to new large single loads would be served at the cost of the resource acquired to serve them. The choice of whether to meld those costs at the retail level would be the decision of the retail utility.

Until such time as an allocation is made, the existing new large single load policy should be adhered to and such loads should not be included in subsequent calculations of a customer's allocation of the existing federal system. DSI loads should not be allowed to migrate to local utilities and be included in the utilities allocation calculation.

Benefits for the residential and small farm customers of the region's investor-owned utilities

The Council supports a resolution of the issue of benefits for the residential and small farm customers of investor-owned utilities (IOUs) for a significant period. Accomplishing this would be an indication of having achieved an equitable sharing of the benefits of the federal system between the customers of publicly owned utilities and the residential and small farm customers of the investor-owned utilities; it would resolve significant public/private disputes and would result in a broad cross-section of the region seeing a direct, long-term interest in preserving the Federal Columbia River Power System for the region.

This was the objective of the exchange settlement under the existing contracts. Given the litigation surrounding that settlement, the question of the benefits for the residential and small farm customers of the IOUs under the existing contracts may be decided by the Courts.

DRAFT FOR PUBLIC COMMENT

Otherwise, Bonneville should fulfill its obligations under the existing contracts under its existing authorities.

For the longer term, there is general agreement that the mechanism for the sharing of benefits established in the Act has operated in such a way that it satisfies no one. However, “fixing” these features of the Act could have broad ramifications that make legislation risky. The Council is opposed to such legislation.

This would appear to leave settlement as the only option. The objective of the exchange provisions of the Act was, at heart, an equitable sharing of the benefits of low-cost federal power to the residential and small farm consumers of the region, no matter who served them, publicly owned utilities or investor-owned. Under a settlement, benefits could be provided in the form of power or dollars. The Council believes that providing the benefits in the form of power is both more risky for Bonneville and could make the question of allocation more difficult.

The Council cannot judge what is equitable in the eyes of the parties. It is clear, however, that there are some desirable characteristics of a settlement that can be defined. It must provide certainty, it must be transparent, and it must not be subject to manipulation. Certainty requires that the cost impact on publicly owned customers be capped on the upside and that there be a floor under the benefits for the residential and small farm customer of the IOUs. Transparency requires that the benefit be calculated in such a way that it is easily understood. And if it is not to be manipulated, the key parameters must be subject to independent verification.

The recent proposed settlement contained precisely these elements and was supported by most of the customers in the region. The Council believes this could be the template for a long-term settlement. One of the objections raised about the settlement was that it did not provide long-term certainty. Using this settlement as the starting point for the long-term solution would address that concern.

The Council encourages all parties to carefully consider the benefits to be derived from substantially reducing the uncertainty surrounding the benefits to be provided for the residential and small farm customers of the IOUs. The Council believes this value is the basis for successful compromise.

Fulfilling responsibilities for conservation and renewables

Conservation

The Council’s conservation recommendations are fundamentally the same as in its December 2002 recommendations.⁴ In summary those recommendations were:

- The system for conservation development should: 1) rely on the Council’s power plan to define the cost-effective resource; 2) rely on proven delivery mechanisms; 3) provide stabilized and adequate funding for conservation over the duration of the new contracts; 4) reinforce the role and capabilities of the Regional Technical Forum; 5)

⁴ Council Document 2002-19, op. cit. pages 20-27

DRAFT FOR PUBLIC COMMENT

provide a mechanism for ensuring that cost-effective conservation is implemented; and 6) capture conservation at as low a cost to the power system as possible.

- The Council believes it is imperative that any proposal to fundamentally change Bonneville's role in power supply include a realistic approach to ensuring that the region develops cost-effective conservation. The fact that Bonneville's customers can bring loads back to Bonneville at the end of the contract period makes the achievement of all cost-effective conservation a continuing priority. The fact that the model for Bonneville's future role is at least faced with the actual costs of load growth is a major step in the right direction. It is, however, not sufficient given the disincentives to utility investment in conservation, even though it is a lower-cost resource.
- Bonneville should establish conservation budgets based on Bonneville's share of regional conservation potential identified in the Council's Northwest Power Plan and estimated program costs to capture that conservation. However, conservation savings targets and mechanisms should be designed to *encourage* conservation on all loads of preference- customer utilities, not just the part served by Bonneville.
- Bonneville's obligations and authority with respect to investor-owned utility (IOU) conservation is limited to the residential and small farm loads of those utilities that are subject to the residential exchange. The Council, however, will continue to encourage and support the work of the states' utility regulatory commissions to use their authorities and least-cost planning regulations to ensure that the cost-effective conservation on all the IOU load is accomplished.
- Conceptually, the Council supports the use of a mechanism like the Conservation and Renewables Discount to support local implementation. However, the existing mechanism must be redesigned to ensure cost-effective acquisitions, encourage best practices and minimize the cost of acquisition consistent with achieving the savings. The mechanism also must limit expenditures on activities that do not clearly support the development of tangible savings and ensure accountability.
- Further, the Council believes the mechanism should be designed to reduce the need for any Bonneville backstop mechanism. A better alternative would be to work with utilities at the outset to identify good opportunities and approaches. Then, the discount could be provided incrementally, addressing the local utilities' immediate cash flow requirements. Subsequent payments would be made on demonstration of progress. Bonneville would step in only as a last resort.

Customers prefer a mechanism in which they are granted the full discount at the outset and only charged if a customer fails to take the actions necessary to achieve its target. The Council is willing to give consideration to such a model, but only if there are frequent (annual) progress checks and the ability for Bonneville to take action if necessary in response to the results of those progress checks.

- The Council believes a broader range of conservation activities should be carried out at the regional level than was described in the original customer proposal. This is because there are a number of activities that can be carried out more effectively if they are approached on a coordinated regional basis with local implementation.

DRAFT FOR PUBLIC COMMENT

However, since those recommendations were developed, a few things have become clear. Customers have expressed an interest in continuing the status quo through the next rate period. The status quo is a half mill rate discount with considerable built-in flexibility for “local conservation,” some funding of regional conservation approaches as well as qualifying renewable resource activities from system revenues paid by all. However, that solution alone is not likely to capture all cost-effective conservation that has been identified during the development of the Council’s Fifth Power Plan.

The last 20 years of conservation development have benefited the region tremendously, reducing loads about 2800 MWa at a cost less than half that of adding similar amounts of generation. The Council expects its future Power Plans will continue to identify significant cost-effective conservation potential that the region should pursue. This conservation is valuable to the region regardless of whether we are developing new generation or not. However, given recent large retail rate increases, we believe Bonneville and the utilities will find it difficult to raise rates to adequately fund conservation activities as they have been implemented in the past. ⁵

Therefore, the Council believes it is increasingly important that the region continues to enhance its conservation efforts to ensure that it is achieving conservation at the lowest cost to the utility system. Bonneville should use the full extent of its authority to ensure that all cost-effective conservation is captured in an efficient, low-cost and timely way and Bonneville should retain a strong and active role in the coordinated planning and implementation of conservation efforts across the region.

Bonneville should continue to support a rate discount mechanism for some conservation. However, a rate discount should not necessarily be the only mechanism. The C&RD has been instrumental in motivating some utilities to pursue conservation and renewables activities, and it clearly expanded the portfolio of activities and measures deployed across the region. Those attributes should not be lost. But the rate discount needs to be refined along the lines recommended in 2002⁶. Bonneville and the Council should facilitate a collaborative process to refine the details of a rate discount and produce recommendations by early 2005.

Furthermore, in addition to a rate discount Bonneville should establish budgets and other mechanisms, including bilateral contracts with its customers to ensure the development local implementation of conservation and the full portfolio of activities and approaches.

The Council believes there is a need for increased budgets for regional implementation activities including market transformation, cross service territory program design and marketing activities, and evaluation activities. Guided by the Council’s plan, the region should come to agreement on the level of funding for regional implementation of conservation through a process facilitated by the Council. The goal should be to capture conservation at as low a cost to the power system as possible.

⁵ Conservation and renewables work group discussions

⁶ Ibid.

DRAFT FOR PUBLIC COMMENT

Renewables

Recommendations with respect to renewable resources are not as well developed as those for conservation. The Conservation and Renewables Discount mechanism has been used to support development of renewable resources. The Council supports the continuation of this policy so long as the cost-effective conservation is also acquired.

Some people advocate a pattern of “sustained orderly development” for renewable resources such as wind. This would translate into a megawatts per year target for renewables development. The Council continues to believe that levels of renewables development should be guided by the Council’s regional plan that evaluates resources on the basis of cost and risk mitigation. It is also not clear that renewables, or at least wind generation, needs a particular boost in light of recent levels of development and the fact that the region, in aggregate, currently has sufficient resources.

There are some activities that would facilitate renewable resources development that Bonneville is uniquely suited to pursue and that would not happen absent Bonneville participation. These activities benefit all of Bonneville’s customers and their costs should be recovered from the existing system. These include activities such as: 1) removing barriers to cost-effective renewable development that would not be resolved soon if not addressed, 2) activities such as developing storage and shaping services, developing transmission re-dispatch products, making transmission acquisition for renewables easier; and 3) limited, region-specific research and development. The costs of actually providing services like storage and shaping should be borne by the purchaser.

The Council expects this portfolio of activities will change over time as new cost-effective resources emerge and new implementation barriers are discovered. The Council plan will identify some of these barriers. Bonneville and the Council should facilitate a process to periodically review and identify renewable resource activities and budgets suitable for funding by all Bonneville customers.

With regard to acquiring the output of new renewable resources, the Council believes Bonneville’s activities should be consistent with the power plan. Bonneville should acquire new renewable output to meet new or replacement resource needs, provided the resources are cost-effective including any risk reduction or other benefits the resources provide. The costs of that resource acquisition should be allocated to those customers that choose to have Bonneville meet their load growth or resource replacement requirements. Bonneville’s renewables acquisition activities could include aggregation of loads of customers that choose to place renewables-only requests on Bonneville. In all cases of renewable resource acquisition, costs of the acquisition should be born by the customers choosing to place it on Bonneville and priced at its full cost.

Resource adequacy

Even absent changes in the way in which Bonneville carries out its role in power supply, the issue of resource adequacy and the possible need for an adequacy standard to ensure that adequate power supplies are maintained has been a major concern of the Council and others in the region. A change that places more risk and responsibility of meeting future load obligations on individual utilities rather than on Bonneville does not reduce overall risk. The Council is

DRAFT FOR PUBLIC COMMENT

aware that new policies may be necessary to ensure that adequate information and safeguards exist to ensure adequate and reliable electric power for the Northwest. In particular we are concerned about the possibility that a severe deficit by any one utility could have detrimental effects on other utilities in the region. This risk can only be removed if all utilities ensure an adequate level of resources.

In its recent draft paper, “Bonneville’s Strategic Direction For the Future,” Bonneville emphasized the importance of workable adequacy standards to ensure the region has adequate resources and that all responsible parties are carrying their fair share. Bonneville also noted the role that the Council can play in helping the region focus on a strong regional approach.⁷

The Council accepts this responsibility and will continue work with all regional players including Bonneville, utilities, the states and their regulators, and other regional and west-wide organizations to ensure that appropriate adequacy policies are in place and the data and other tools to implement them are available. The Council believes that these policies need to be in place prior to the implementation of long-term contracts.

Fish and wildlife

The Council believes these policies will not affect Bonneville’s fish and wildlife obligations. Their obligations will be determined in a manner consistent with the requirements of the Power Act and the Council’s fish and wildlife program. Costs should be allocated to the existing system.

Comments

The Council will accept comments on these recommendations through the close of business Friday, April 23, 2004. Comments should be directed to Mark Walker, Director of Public Affairs, Northwest Power and Conservation Council, 851 S.W. Sixth Avenue Suite 1100, Portland, OR, 97204-1348. Comments also may be submitted by e-mail to comments@nwcouncil.org.

⁷ DOE/BP-3572, March 2004, p.6

DRAFT FOR PUBLIC COMMENT

Attachment A

Bonneville Issue List

1. **Long-Term Power Obligations:** Establish Bonneville's policy for its total load obligations at the lowest embedded cost rates. We expect to propose that these obligations be limited to close to the firm output of the existing Federal system. This part of the policy would extend past 2011.
2. **Tiered Rates:** Determine whether Bonneville should propose a tiered rates construct to implement the other Regional Dialogue policy decisions. Specific rate design decisions would be reserved for the rate case.
3. **New Publics and Annexed Loads:** Determine the conditions under which newly formed public utilities or IOU loads annexed by public utilities will be served at the lowest embedded cost rate.
4. **Conservation and Renewables:** Address Bonneville's general approach to carrying out its conservation and renewable resource responsibilities.
5. **New/Different Products:** Establish how Bonneville should respond to customer requests to modify, (a) the amounts they are obligated to purchase under existing contracts from 2007-2011, and/or (b) the type of product they purchase. This would include requests to increase or decrease Slice purchases from 2007-2011.
6. **Cost Controls:** Propose mechanisms to provide customers and others with greater assurance regarding cost management by Bonneville and its partners, and more input to cost decisions.
7. **Service for Expiring Five-Year Contracts:** Identify whether Bonneville will provide products to public utility customers with contracts expiring on September 30, 2006, that vary from their existing service, and whether 2007-2011 service will be offered at the lowest PF rate or at a different rate established in the next rate case.
8. **Post-2006 Service to Direct Service Industries (DSI)/New Large Single Loads:** Determine whether Bonneville will offer Federal power to DSI loads. If so, determine the amount of power Bonneville will offer to sell to DSIs from 2007-2011, and the terms and conditions of such service. The draft policy statement will also address treatment of new large single loads, including treatment of former DSI loads that may become loads of public utilities. A collaborative effort should be undertaken to hone the list of activities and develop associated budget levels.
9. **Residential Exchange:** Determine how Bonneville will implement terms of existing IOU contracts for 2007-2011, including whether Bonneville will provide IOUs power or financial benefits over the remaining term of the contracts.

DRAFT FOR PUBLIC COMMENT

p:\jah\power\bpa-future-role-april-9-2004.doc