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Frank L. Cassidy, Jr.
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Re: Joint Proposal from Investor-Owned and Preference Utilities on the
Future Role of BPA

Dear Mr. Wright and Mr. Cassidy:

On behalf of investor-owned and preference utilities, I submit the attached revised proposal regarding the future role of BPA in response to the request by the Council and BPA. The participating utilities intend to present this revised proposal at the public hearings that begin today.

Thank you for this opportunity.

Sincerely,

C. Clark Leone
Manager

Attachment

Executive Summary
Joint Proposal of the Northwest Utilities

The Future Role of BPA Regarding Power Supply

What is the proposal?

Essentially, the proposal would do two things. First, it would transfer from BPA to the region's utilities much of the responsibility for securing additional electricity for load growth in the region. It would do so through "slice" and requirements power sales contracts.

Under a slice contract, a utility receives power equal to a fixed percentage of the electricity produced by the federal system; in exchange, the utility agrees to pay a corresponding fixed percentage of federal system costs, whatever those costs may be. Beyond the fixed percentage of federal power, a utility entering into a slice contract would be responsible for finding the most cost-effective way to serve the additional load of its retail consumers.

Under the requirements contract, BPA would continue to provide full service to smaller preference customers, and would acquire resources needed to serve the load growth of these customers. Requirements customers would face the costs of these resources either indirectly through their BPA rate, or directly if they elect to acquire such resources themselves, just as the slice purchasers will.

Second, the proposal would provide long-term stability regarding the allocation of the federal system benefits, helping to align the interests of all consumers in the region. This would be accomplished through 20-year contracts between BPA and each of the region's utilities.

Contracts providing financial benefits would be the primary means of benefiting the residential and small farm customers of the investor-owned utilities. The financial benefits would approximate the benefits they would receive if they were to purchase slice power from BPA.

Who supports it?

This proposal is supported by an unprecedented coalition of the region's utilities. These utilities, including preference utilities, investor-owned utilities, and cooperatives, collectively serve virtually all of the region's retail electric consumers.

Why is it important?

It's important for at least two reasons. First, we all learned during the electricity crisis of 2000-2001 how expensive it is when BPA is forced to buy power on the wholesale market during an energy shortage. BPA paid hundreds of millions of dollar for that power, and then blended those costs in with the costs of the relatively low-cost federal hydroelectric system. As a result, BPA increased its power rates by 46 percent.

The supporters of this proposal believe it would be preferable to allocate a portion of the output of the federal system to many of the region's utilities, undiluted by the high costs of BPA's market purchases. With a portion of the federal output as a solid, affordable foundation, utilities could then decide how best to meet the remainder of their customers' load, now and into the future.

Second, this is an opportunity to set aside decades of strife between preference utilities and investor-owned utilities. None of the parties to this agreement received everything they wanted, but they are willing to accept it as a durable, 20-year deal that will allow the region's utilities to work together for the benefit of the region.

Are the Direct Service Industries (DSIs) eligible for a BPA power supply?

The proposal offers a 650 aMW pool of power to the DSIs priced at the same rate paid by utility customers of BPA. The costs of acquiring this power supply will be borne by all BPA customers. In addition, the proposal offers two options from which individual DSIs may choose that provide credit or financial assistance to DSIs that wish to develop incremental generating resources to serve the portion of their loads no longer served by BPA. This BPA service will be offered under 20-year take or pay contracts with credit assurance, load loss and termination provisions identical to the utility slice contract.

While this proposal will not guarantee that all smelters will be economically viable for the next 20 years, it does provide to the DSI customers a solid base of low cost power upon which to build a supply portfolio to replace BPA power.

Do we need to deal with this issue this year?

Yes. Although the 20-year contracts would not go into effect until 2006 (when some of BPA's current power supply contracts expire), the utilities need to know as soon as possible whether this agreement will be implemented. In particular, they need a reasonable opportunity to build generation facilities to supplement the slice power they would receive from BPA.

Would all of the region's utilities sign slice contracts with BPA?

No. Any preference utility or cooperative could ask BPA to continue providing for its current needs and future load growth. The only difference is that such a utility (sometimes referred to a “requirements” customer) would also have to agree to pay the electricity procurement costs incurred by BPA on its behalf.

Why are the contracts 20-years long?

There are several reasons. First, it’s in the interest of the U.S. Treasury to have long-term assurance that all of BPA’s costs will be paid. Second, it is important that the contracts be long enough to allow full amortization of the large capital investments some utilities expect to make in new generation facilities. Finally, BPA has commonly used 20-year contracts in the past. All of the contracts that BPA entered into with utilities following the enactment of the Northwest Power Act of 1980 were for 20 years.

Does the proposal change the way the Columbia and Snake Rivers dams are operated?

No. There would be no change in the way that the Corps of Engineers and the Bureau of Reclamation operate the federal dams on the Columbia and Snake River systems. The dams would continue to be operated in the same coordinated manner, subject to all of BPA’s statutory and treaty obligations.

How are conservation and renewables dealt with under this proposal?

All of the conservation and renewables programs that provide regional benefits, such as low-income weatherization and research and development, would continue to be operated by BPA, the costs of those programs would be treated as BPA system costs paid for by all of BPA’s customers. BPA’s current Conservation and Renewable Discount Program (which gives BPA customers a discount on the power they buy from BPA in return for investing in conservation and renewables) would continue, but would be enhanced and adapted to fit slice contracts. Both slice customers and requirements customers would have a greater incentive to invest in conservation and renewables because they are agreeing to more directly face the costs incurred to serve load growth.

Are the utilities seeking new federal legislation to implement this proposal?

No. We think that this proposal can be implemented by BPA under existing law.

Summary of Joint Proposal of the Northwest Utilities

The Future Role of BPA Regarding Power Supply

I. Introduction

The energy crisis of 2000-2001 brought home to the Northwest the urgent need to secure a stable, affordable energy supply for the region. Today's relatively low electricity prices give us an opportunity to act thoughtfully, but we also need to act promptly.

During the energy crisis, a drought in the region drastically cut hydroelectric production. In response, BPA was forced to spend hundreds of millions of dollars acquiring power in a superheated wholesale power market in order to meet the needs of its utility customers. This resulted in a BPA rate increase of 46 percent.

We can't prevent future droughts, but we can put local utilities in a better position to protect their consumers in the event of such a crisis. Currently, when BPA must pay high prices in the wholesale market, it blends those costs into the price of all the power it sells. This causes all of BPA's utility customers to pay a substantially higher price for all of the power that they buy from BPA. In turn, this forces most of BPA's utility customers to impose substantial rate increases on the region's consumers.

A better way to manage these power supply problems is to share among the utilities the relatively inexpensive Federal base system (Federal system),¹ undiluted by the high cost of BPA's market purchases. With a portion of the Federal system as a solid, affordable foundation, utilities can then decide how best to meet the remainder of their consumers' load, now and into the future.

For example, a fast-growing utility might choose to build a generation facility or enter into one or more long-term power contracts. A slow-growing utility, on the other hand, might choose to meet future load growth solely through a vigorous conservation program. In either case, both control and responsibility would be in the hands of the local utility to meet the needs of that community.

This approach would also enhance competition in the Western wholesale power market. Currently, BPA is such a large market participant that its purchases and sales cause substantial price movements. Wholesale prices climb on news that BPA is about to make a major purchase (as it did during the energy crisis), and drop on news that BPA is about to sell major amounts of power (as routinely happens during a wet Spring).

¹ The Federal system consists of the electricity produced by the federally-owned hydroelectric dams on the Columbia and Snake River systems, as well as the output of Energy Northwest's Columbia Generating Station (formerly known as WPPSS Plant No. 2).

These swings distort the market by sending volatile price signals to both sellers and buyers. When prices are very high, even the most inefficient generation facility in the region is economic to run, while in times of very low prices, even the most efficient generation facility is uneconomic to run. By reducing BPA's "footprint" in that market, in favor of diversified actions by smaller participants, the swings would be moderated and the price signals would more accurately reflect the costs of the most efficient generation facilities needed to meet regional needs.

This new approach first requires that we settle the pending litigation regarding BPA's recent Subscription process.² This litigation threatens to become the latest chapter in decades of conflict between preference utilities and investor-owned utilities, undermining our ability to stand together as a region. Our region's federal hydropower resources can only be put to the highest and best use if we are working together cooperatively.

We must also find an equitable and durable way to allocate the benefits of the Federal system among the utilities of the region. Spreading the benefits of the Federal system across the region's consumers is only a theory without a fair allocation. Reaching agreement on these issues is difficult. Everyone must give up something in order to achieve an allocation that is stable over time and over a variety of economic conditions.

A broad coalition of the region's utilities recently reached such an agreement. These utilities, including preference utilities, investor-owned utilities, and cooperatives, collectively serve virtually all of the region's retail electric consumers.

II. Major Elements of the Proposal

A. Three Types of Contracts

Under the proposal, BPA would sign 20-year contracts with each of the region's utilities, beginning in 2006.³ Three types of contracts would be used: (a) a "slice" contract; (b) a "requirements" contract; and (c) a contract that provides financial benefits to the residential and small farm customers of investor-owned utilities.

A slice contract provides that the utility pays a fixed percentage of BPA's generation costs in exchange for a power supply equal to a fixed percentage of the electrical output of the Federal system. For

² Subscription was the regional public process that BPA conducted in 1999-2000 to formulate, negotiate, and execute power sales contracts with its utility customers, to replace the BPA power sales contracts that expired on September 30, 2001. Upon the conclusion of the Subscription process, lawsuits were filed in the Ninth Circuit Court of Appeals challenging the legality of BPA's investor-owned utility and slice power sales contracts. These lawsuits are still pending.

³ In 2006, some of the Subscription power sales contracts between BPA and the region's utilities expire; others expire in 2011. Utilities with contracts expiring in 2011 will be able to stay under those contracts until expiration.

example, a utility that contracts for three percent of the electrical output of the Federal system would also pay for three percent of all of the Federal system costs. The utility would procure any additional power on its own.

BPA began using slice contracts last year. By expanding their use, the responsibility for serving load growth in the region would be further shifted from BPA to the region's utilities. At the same time, the risks and benefits of the Federal system would become more broadly shared by the region's consumers. Through the rates charged by their local utility, all consumers would be similarly affected by changes in generation output of the Federal system, and would bear their share of the costs of the Federal system. This shared interest would create powerful incentives for cooperation, rather than conflict, within the region.

A requirements contract serves a different purpose. It is intended for those preference utilities that want BPA to continue to be responsible for providing the resources needed to meet their loads. BPA has traditionally provided this service to many of the smaller preference utilities in the region, and would continue to do so under this proposal, but on one important condition: that the utility agree to pay a rate that reflects all of the costs BPA incurs to provide such service.

In other words, those preference utilities choosing to have BPA as their supplier would be responsible for the costs of that choice. This also protects utilities that choose a slice contract from having to bear any of the load growth costs incurred by BPA on behalf of those utilities choosing a requirements contract.

In at least one important respect, however, those utilities choosing a slice contract and those choosing a requirements contract would have similar interests and incentives. Both groups of utilities would effectively become responsible for the costs of serving their load growth, either because they are procuring additional electricity on their own, or because they are paying BPA the full cost of procuring additional electricity on their behalf. This means that both groups of utilities would have a strong incentive to invest in conservation and renewable resources.

Finally, a contract providing financial benefits would be available only to investor-owned utilities, solely for the benefit of their residential and small farm customers. This type of contract takes the place of the Residential Exchange agreement, and essentially compensates for the fact that slice contracts will not be available to investor-owned utilities. The financial type of contract is designed to provide benefits similar to the value of a slice contract to the residential and small farm customers of the investor-owned utility.

PGE has indicated a desire to take about 140 aMW of power for the first five years of the new contracts in the form of a block purchase in the shape of its residential and small farm loads. This would reduce the financial benefits to PGE during the five-year purchase. Upon the expiration of this power purchase, PGE would be entitled to full financial benefits and the power would be made available to the slice and requirements purchasers.

Over the term of the contracts, the financial benefits available to the investor-owned utilities would be adjusted to reflect the difference between BPA's slice rate and the cost of power from a hypothetical combined cycle combustion turbine. This difference is then multiplied by 3300 aMW, which is approximately three-quarters of the residential and small farm customer load served by investor-owned utilities. During the first five years of the new contracts, the financial benefits are subject to caps and floors that moderate the changes to the level of benefits. This formula provides approximate alignment between the benefits received by residential and small farm customers of the investor-owned utilities and the benefits received by the customers of the utilities that actually purchase slice power from BPA.

Over the course of the 20 years, the financial benefits would be adjusted each year to reflect changes in the difference between BPA's slice rate and the cost of power from the hypothetical new generation facility, as well as changes in BPA's costs, the capability of the FBS, and the availability and value of secondary energy. In other words, if the gap between BPA's slice rate and the new facility cost grows, the financial benefits to the residential and small farm customers of investor-owned utilities would be increased; similarly, if the gap narrows, the benefits would be reduced. In this way the financial benefits will reflect the value of actual power purchased from BPA by preference customers. This will align the interests of the investor-owned and preference customers.

B. Effect on the Treasury

In at least two respects, the proposal would benefit taxpayers by strengthening BPA's ability to meet its obligations to repay borrowing from the U.S. Treasury. First, the proposed 20-year contracts would provide a reliable long-term payment stream in a turbulent marketplace. Second, the central feature of the contracts is that the buyer is obligated to pay its portion of the costs of the Federal system, whatever those costs may be. Thus, the risk of any cost increases is on the utilities that purchase slice power, and not on the Treasury or, ultimately, the taxpayer.

As we have seen from the impacts to the region of recent BPA rate increases, the benefits of the federal system can not only be threatened by events outside the region, but also by cost and program spending levels that make BPA power unaffordable. As a consequence, it is imperative that in return for this long-term commitment to BPA's financial integrity, the new power and financial benefits contracts provide those BPA customers with meaningful and enforceable participation in establishing the costs and rates they will pay over the terms of such contracts.

C. Service To New Preference Utilities

If a new preference utility is formed after the 20-year contracts are signed, it would be able to receive service from BPA. However, only the cost of the first 75 aMW of service would be treated as a system cost, borne by all of BPA customers. Any additional power above the 75 aMW needed by new preference utilities would be priced at the full cost incurred by BPA to procure such power.

Any annexations by preference utilities of investor-owned utility load during the 20-year period would be treated similarly. Prior to exhausting the same 75 aMW, the cost of serving the annexed load would

be treated as a system cost. After that, the preference utility would pay the full cost incurred by BPA in serving the annexed load. However, the financial benefits that flowed to the residential and small farm customers of the investor-owned utility would continue to flow to them as customers of the preference utility.

D. Service to the Direct Service Industries (DSIs)

The utilities propose that a pool of 650 aMW be offered to the DSIs, of which 50 aMW would be available to non-smelting DSIs. This power supply would be acquired by BPA from the least cost source, and the costs of acquisition would be treated as a system cost borne by all purchasers. This power would be offered for 20 years under contracts containing the same credit assurance, take or pay, load loss and termination provisions as contained in the slice contracts. The base allocation would be 100 MW per smelter, and BPA would allocate this power among the DSIs, taking into account their credit worthiness, bankruptcy status, fulfillment of obligations under current contracts and whether they have substituted market for BPA power during the current rate period.

The utilities also propose that BPA offer the DSIs two additional options they can choose between. The first is a limited, five-year credit support arrangement for incremental generation that will be used to serve smelter load no longer served by BPA. This would be structured to impose minimal financial risk on BPA. The second option would permit a DSI to obtain a power allocation from BPA greater than 100 aMW per smelter to the extent that it offers to BPA output from an incremental generating resource at cost, and BPA actually acquires such output. Such allocation would still be subject to the overall 650 aMW limit.

This proposal offers DSIs a reasonable base power supply, and help in transitioning off of BPA service now that their statutory entitlement to BPA power has expired.

E. Treatment of Conservation and Renewables

The utilities intend that overall funding for conservation and renewables be increased and stabilized over the 20-year period. The conservation and renewables programs that provide regional benefits, such as low-income weatherization, market transformation and research and development, would continue to be operated by BPA and their costs would continue to be treated as BPA system costs, paid for by all of BPA's customers. BPA's current Conservation and Renewable Discount Program (which gives BPA customers a discount on the power they buy from BPA in return for investing in conservation and renewables) would continue, but would be enhanced and adapted to fit slice contracts. Both slice customers and requirements customers would have a greater incentive to invest in conservation and renewables because they will face more costs incurred to serve load growth.

F. What is NOT Changed by this Proposal

It is important to note what would **not** be changed by the proposal. First, the proposal carries forward from the current subscription process the principle of broadly spreading the benefits of the Federal system within the region.

Second, there would be no transfer of ownership or operational control over the federal dams on the Columbia and Snake River systems; the respective roles of the Corps of Engineers and the Bureau of Reclamation in the ownership and operation of the dams would remain unchanged.

Third, the laws governing the operations of those federal dams would remain unchanged. For example, the application of the Endangered Species Act to the operation of the dams would be unaffected. Similarly, BPA's obligations relating to fish and wildlife, whether based in statute or treaty, would remain unchanged.

Finally, all of the benefits provided to the investor-owned utilities would continue to flow through to their residential and small farm customers. As with the residential exchange program, the allocation to investor-owned utilities (whether it be money or power) would benefit only their residential and small farm consumers, and not their shareholders.

III. Next Steps

Following those efforts, the utilities intend to seek prompt implementation of the resulting agreement. Much of the implementation can be done through contractual arrangements and settlement of the pending litigation. But a public process will be required in conjunction with the legal steps that BPA must take in order to implement an agreement. The parties will ask that this public process be completed expeditiously, so that there will be as much clarity as possible, as soon as possible, regarding the future role of BPA.

Future Role
of the
Bonneville Power Administration

Details of the Proposal
by the
Joint Utility Customers

September 2002

INVESTOR-OWNED UTILITY/PREFERENCE UTILITY PROPOSAL
FOR THE
FUTURE ROLE OF THE BONNEVILLE POWER ADMINISTRATION

I. Introduction

This draft proposal is a revision of the original 4/12/02 discussion draft proposal presented to BPA by its investor owned and preference utility customers. The changes reflected in this revised draft proposal respond to the concerns raised by BPA. The investor owned and preference utilities appreciate the complete review BPA gave to the 4/12/02 draft proposal, and believe that this revised draft proposal addresses the concerns raised by BPA. In particular, substantial efforts have been made to ensure the implementation of the proposal enhances BPA's ability to maintain system reliability and operate the system efficiently, and to address the legal concerns raised by BPA.

II. Settlement Objectives

1. To create a common interest between BPA's regional preference utility and investor owned utility customers by allocating to such customers equitable, secure and long-term benefits of the Federal base system (FBS).
2. To expose all BPA's customers to the same risks and benefits of changes to the costs and output of the FBS.
3. To reduce BPA's presence in the wholesale power market as a buyer and seller of power.
4. To enhance the ability of BPA to make its Treasury payments in full and on time across a broad range of possible futures.
5. To allocate the costs of procuring power for future load growth to the serving utility.
6. To reduce BPA's need to augment the FBS and its reliance on market revenues from the sale of secondary energy by shifting to utilities through expanded use of the Slice product the obligation to procure resources to serve their load growth and the marketing of secondary energy.
7. To settle outstanding litigation in a manner that is fair to all parties, and that avoids future litigation over the allocation of FBS benefits.
8. To implement the foregoing consistent with existing statutes, without federal legislation.

III. General Description of Settlement

A. Benefit Allocations

1. BPA will offer new power supply and financial benefits contracts to its regional utility customers defining BPA's power supply and financial benefits obligations for 20 years.⁴ These new contracts will allocate the output, costs and benefits of the Defined FBS⁵ and also will provide for the allocation of certain other resource costs and benefits as discussed below. The offer period for execution of the new contracts for power supply and financial benefits, and for the selection of the Block Product for the first contract year, will commence 150 days after BPA issues the final Record of Decision, and close six months later. The new contracts will take effect on October 1, 2006, and expire 20 years from the date of execution. These new contracts will be the sole contract to which the customer is entitled under sections 5(b) and (c) of the Regional Act during the contract term.⁶ Upon the expiration or termination of its new contract for power or financial benefits, each utility customer of BPA will have the right to request and receive from BPA, without penalty or surcharge, any and all statutory rights and services to which it is entitled.
2. The allocations of the output of the Defined FBS to preference agencies, net of now-existing contractual, system and treaty obligations (until their expiration), will be based on preference customers' forecast FY 2007 net requirements ("Baseline Net Requirements")⁷ and will be done in two steps. First, the amount of load placed on BPA by preference customers selecting Slice service (up to their Baseline Net Requirement) will be summed and that amount of Defined FBS capability (expressed as a percentage) will be allocated to the Slice purchasers. Second, the amount of Defined FBS capability remaining after the allocation to Slice purchasers will be allocated to the Requirements purchasers. The Defined FBS capability so allocated to Requirements purchasers that exceeds the sum of their net requirements placed on BPA will be managed by BPA, and the Requirements purchasers will bear the costs and/or receive the benefits from the sale of such surplus power. When the sum of the net requirements

⁴ The term of the new power supply contracts will extend for 20 years from the date of execution. Due to a difference between the execution and the effective date of the new contracts, the period of service under these agreements is likely to be less than a full 20 years.

⁵ "Defined FBS" shall consist of the generating resources set forth on Exhibit H of the Block/Slice contract. Fish and wildlife obligations will continue to be treated as system obligations to be met first.

⁶ The sole contract concept does not prohibit the type of contractual arrangements between BPA and PNGC Power and its member cooperatives entered into to address tax-exempt financing issues.

⁷ Upon execution of the new contract, preference customers that have purchased the Stepped-up Multi Year Block Product (SUMY Product) will receive a rebate of the amounts paid to date for the SUMY Product and the SUMY Product portion of the customer's Requirements contract shall be terminated.

of the Requirements purchasers placed on BPA exceeds the Defined FBS capability allocated to the Requirements purchasers, all costs of augmenting the FBS to serve net requirements of the Requirements purchasers will be borne by those purchasers.

3. The allocation to investor-owned utility customers will be for the benefit of their residential and small farm consumers and in settlement (for the term of the contracts) of their statutory rights to residential exchange benefits and their statutory rights to purchase their net requirements from BPA. The contract providing these benefits will be the sole contract to which the customer is entitled under sections 5(b) and (c) of the Regional Act during the contract term.

B. Service Selection

1. Each preference utility customer will make a one-time selection of either Slice or Requirements service for the contract term.
2. The Slice customers will be entitled to a power supply reflecting a percentage of the actual variable Defined FBS output, in return for paying the same percentage of the actual costs of the Defined FBS. This is not a transfer of ownership or operational control of the Defined FBS, both of which remain with BPA. Rather, this product provides to the purchaser a power supply reflecting its percentage of all Defined FBS capabilities. The costs of the Defined FBS will be accounted for separately from the costs of resource augmentation, shaping and other costs incurred by BPA to provide service to Requirements purchasers. Preference agencies electing Slice service will be responsible for procuring power to cover load growth and shaping services. See Section IV below for a detailed description of the Slice service.
3. Requirements customers will be provided power to meet the actual load of the utility, including load growth. Preference agencies electing Requirements service will pay their percentage share of Defined FBS costs and all costs incurred by BPA to provide Requirements service, including load shaping and load growth service. Under Requirements service, the preference utility will be able to use non-federal resources to meet its load growth in lieu of relying on BPA. See Section IV below for a detailed description of Requirements service.

C. Investor-owned Utility Financial Benefits

1. The investor-owned utilities will be offered financial benefits. The financial benefits will be calculated using a formula that compares the price of BPA power to the cost of power from a hypothetical combined cycle combustion turbine, and uses the difference to compute the financial benefits using an assumed small farm and residential load of 3300 aMW. During the first five years of the new power contract, the financial benefits calculated by the formula will be subject to floors and caps to moderate the range of the financial benefits across a range of possible BPA rates, and will also be adjusted to reflect the sale of power to PGE discussed in subsection III(C)(4) below. Starting in

FY2012, both the floors and caps and the adjustment for the PGE power sale will be eliminated, and the formula will be the sole determinant of the financial benefits available to the residential and small farm customers of the investor owned utilities. See Section VI below for a detailed description of the financial benefit calculation.

2. To ensure that the investor-owned utilities face the same Defined FBS costs and supply risks and benefits as the preference utility Slice customers, the financial benefits calculation will be adjusted annually to reflect the actual Defined FBS costs, changes in the Defined FBS firm capability and the amount and value of the Defined FBS secondary energy.
3. Preference agencies selecting the Slice service will have a one-time option prior to the signing of the new power contract to provide to BPA an amount power equal to their percentage responsibility for DSI load and/or the first 75 aMW of new public agency load served by BPA, and thereby be shielded from the costs of serving these loads. This power will be provided by the Slice customer delivering to BPA at the Federal system bus a block of power shaped to the DSI or new preference customer load equal to its percentage share of such load(s).⁸
4. During the first five years of service under the new power supply contracts, PGE will purchase from BPA about 140 aMW shaped to a profile of the historical load pattern of its residential and small farm load. The hourly shape of the PGE Purchaser will be fixed in the contract for the five-year term. This power will be priced at a rate equivalent to the lowest PF rate charged preference customers for Requirements service (“PGE Purchase”). In the event that the section 7(b)(2) rate test triggers and a surcharge is imposed on this sale, PGE will have the contractual right to terminate the sale and take full financial benefits in lieu of the power sale. The benefits of the PGE Purchase will be flowed through to PGE’s small farm and residential customers. The details of the PGE Purchase are set forth in a term sheet attached hereto as Attachment A.
5. The financial benefits available to PGE during the five-year PGE Purchase will be reduced to reflect this power sale. At the end of the five-year purchase, PGE will receive full financial benefits under the settlement.
6. Upon the expiration of the PGE Purchase, the returned power (about 140 aMW) will be treated as an increase to the firm capability of the Defined FBS. Slice purchasers will receive a portion of such returning power based on their Selected Slice Percentage. The remainder of such returning power will be available for service to the loads of

⁸ Upon the expiration or termination of BPA’s contractual service obligation to a DSI, any Slice purchaser that has elected the supply BPA power in lieu of paying its pro-rata share of DSI augmentation costs will be entitled to make a reduction its power deliveries to BPA in proportion to such reduction in BPA’s contractual service obligation to the DSI.

Requirements purchasers. The costs and benefits of the portion of the returning power available to the Requirements purchasers will remain solely in the Requirements rate.

D. Service To New Public Agencies⁹

1. After the execution of the new power contracts, any newly formed preference utility that meets BPA's standards for service may request and receive service from BPA. Service will be provided at a Targeted Adjustment Clause (TAC) rate until the costs of serving the newly formed utility can be included in BPA rates, as discussed below. Service to loads annexed from an investor-owned utility will be treated in the same fashion as load of a newly formed preference utility.
2. The service provided to loads of new preference agencies and to investor-owned utility loads annexed by any preference agencies will be limited to Requirements service, and the first 75 aMW of such service in the aggregate for all new and annexed preference utility load will be provided at a melded rate, with the costs of any necessary increase in the firm capability in the Defined FBS to serve such 75 aMW being treated as a system cost. After the 75 aMW is exhausted, all of the costs incurred by BPA in procuring the power and shaping necessary to provide requested service in excess of the 75 aMW will be directly assigned to the preference utility requesting such service.
3. If there is any transfer of residential consumer service obligations between utilities during the term of the new power contracts, all benefits flowing to such consumers by virtue of this settlement will either be extinguished or follow those consumers. If there is such a transfer of residential consumer service obligations from an investor-owned utility to a preference utility while the 75 aMW supply referred to in paragraph 2 above is still available, service to such load will be provided out of the 75 aMW to the extent available, and a proportionate share of the financial benefits shall be transferred for such residential load not served from the 75 aMW.¹⁰ The financial benefits attributable to such transferred residential load served out of the 75 aMW will be extinguished. When the 75 aMW has been used up, the preference utility to which the residential load is transferred will be eligible to receive only the financial benefits associated with such transferred load, and will be eligible to purchase requirements service from BPA for its entire load at the full cost incurred by BPA to provide such service. The purchase by a preference utility out of such 75 aMW at the melded rate and the receipt of any financial

⁹ The provisions of this section do not apply in the cases of a merger of two preference agencies or the annexation by one preference utility of another preference utility's load. BPA will cooperate with preference agencies that want to enter into such transactions and will not apply the "sole contract" policy to prohibit or impede them. Such mergers or annexations will not result in any increase or decrease of rights to Defined FBS benefits or obligations for Defined FBS costs. Such transactions will not result in preference utility load being served under a Requirements contracts obtaining service under a Slice contract, or vice versa.

¹⁰ Such proportionate share received by such preference customer will be determined without inclusion of an amount of its residential load equal to the product of any amount of such 75 aMW received by such preference utility multiplied by the percentage of its load that is residential.

benefits shall be in lieu of any right of such preference agencies to receive residential exchange benefits.

E. BPA And Other Resource Costs

1. The region has recently seen the economic hardship that double digit BPA rate increases can inflict. Under this proposal, BPA's customers will be making a long-term commitment to BPA's financial integrity by assuming much of the market and resource risks currently borne by BPA. In order to make such a long-term commitment, it is imperative that these customers obtain meaningful and enforceable participation in the process for setting BPA's expenditures, and the rates these customers will pay under the new contracts. This participation may take the form of an advisory group and contractual rate provisions. The purpose of these mechanisms is to ensure that the commitment made by the customers to BPA's financial security under the new, long-term contracts is matched by an enforceable ability to ensure that rates they will pay are based only on necessary and legitimate costs.
2. The BPA's existing long-term transactions (both within and outside the Region) will be treated as system obligations until their expiration, with the costs and benefits of such transactions being spread to all BPA firm power rates.¹¹
3. BPA will not include the costs of any additional resources or transactions in the Defined FBS or the Slice or Requirements pools except as provided in this settlement proposal.
4. The costs that BPA incurs to procure the resources necessary to serve BPA's firm power sales to DSI customers (if any), and to serve the first 75 aMW of new preference customers will be included in the costs used to calculate to the rates charged to Requirements and Slice purchasers (other than those who elect the supply reduction option described in section III(C)(3)), and in the calculation of financial benefits to the investor owned utilities. If a DSI purchaser ceases to purchase power from BPA, upon the expiration of any power purchase made to supply such customer, the costs of such power purchase will be removed from the Requirements and Slice rates, and from the calculation of investor owned utility financial benefits.
5. Funding for conservation and renewable discounts (C&RD) and market transformation will be increased and stabilized, with specific funding provided for renewable resources. Funding at current levels will be maintained through FY 2006 for all existing conservation and renewable resource programs. Conservation and renewable program treatment is described in more detail in Section VII below.

¹¹ This provision is not intended to require such costs and benefits be included in the prices charged for (i) surplus power sold at market rates, (ii) power sold under existing contracts that prohibit such treatment, or (iii) power priced at the cost of new resources that are not included in the Defined FBS.

F. Settlement Implementation

1. Within 150 days of the issuance of the Record of Decision by BPA, each utility customer will provide to BPA and all BPA utility customers a written, non-binding indication of whether it intends to recommend to its governing body in the case of preference customers or regulatory authority in the case of investor owned utilities the execution of the new power contract be approved, and if it intends to recommend execution the type of BPA service it intends to elect. In the event that a customer determines that its recommendation regarding the execution of the new contract will differ from that indicated in the written notice, the customer will notify those who received the initial notice of the changed recommendation.
2. This settlement will be implemented in three steps. The first will be a filing with the Court declaring that a settlement in principal has been agreed to by the parties, and setting forth a schedule for the drafting of necessary contracts, conducting a public process, and obtaining regulatory approval. The second will be negotiating acceptable contracts implementing the settlement, conducting the necessary public process and obtaining regulatory approval. The third will be the filing of a stipulation dismissing any then pending litigation challenging the preference utility and investor-owned utility Subscription contracts and Subscription settlement agreements. The stipulation will contain a covenant not to challenge and to cooperate in opposing any challenge of the current PF, Slice and RL rates, this settlement, or the treatment of the 7(b)(2) rate test in this settlement and in the current and future BPA rates for the contract term, and will have the contracts implementing this settlement attached.¹²

IV. Slice and Requirements Service Options

A. Slice Service Option

1. Slice service will be provided under contracts essentially the same as the existing Slice agreement. The purchaser will receive a fixed percentage (Selected Slice Percentage) of the variable output (energy, capacity, storage and pondage) of the Defined FBS, and will pay the same fixed percentage of the Defined FBS costs. The Selected Slice Percentage established when the Slice contract is signed will be based on the forecast of the purchaser's net requirement for FY 2007. As under the current Slice agreement, the purchaser's Selected Slice Percentage will be fixed by contract.
2. The net requirement of each Slice purchaser will be subject to periodic determination, as it is under the current Slice agreement, which periodic determination will establish on a planning basis the division between Requirements and Surplus Slice. As under the current Slice agreement, BPA will have the ability to recall power under contractually

¹² The settlement described in this section does not include any claims or judicial or administrative litigation relating to DSI service or to DSI rates.

specified conditions when the Slice purchaser has retail load loss, which contractual provisions will be similar to those in the current Slice agreement. These provisions will include withdrawal of non-federal resources, determination of BPA deficits, and reasonable compensation to the Slice purchaser if BPA recalls power.

3. Slice purchasers will pay their Selected Slice Percentage of the Defined FBS costs, including the costs of any DSI settlement, the augmentation costs associated with the first 75 aMW of new public utility load (except as provided in section V below), and the costs of the investor-owned utility financial settlement. Except for the limited inclusion of augmentation costs for new preference utility load described in Section III(D), all of the costs of providing Requirements service, such as resources procured by BPA to serve Requirements customers, planned net revenues for risk associated with Requirements service, costs of shaping purchases, and any credit for secondary energy sales will be excluded from the Defined FBS costs paid by Slice purchasers.
4. Under the new long-term contracts, BPA will not collect financial reserves under the Slice product, nor will Slice purchasers receive any benefit from financial reserves held by BPA. However, at the end of FY 2006 (and at the start of FY 2007), BPA's financial reserves will include amounts that were contributed during the 2002-06 rate period through purchases of Block and Requirements power products other than Slice by customers that have selected the Slice product under the new power contract.

In order to align the costs and benefits for customers selecting Requirements or Slice service, respectively, at the end of FY2006 there will be an allocation of BPA's accumulated reserves, in excess of a calculated threshold amount to be retained by BPA, to Slice customers that have contributed them according to method set forth on Attachment B. Both the threshold amount and any balance remaining after the allocation to the Slice purchasers will be retained by BPA as financial reserves. Conversely, if BPA's financial reserves at the end of FY 2006 do not exceed the threshold amount, there will be no allocation of financial reserves to Slice purchasers.

5. Slice purchasers may elect to buy from BPA, for a payment in addition to their Selected Slice Percentage of the Defined FBS costs, a Block Product to convert all or any portion of the purchaser's Slice power into a block delivery. The shape of the block delivery will be contractually fixed for the term of the Block Product purchase. This option may be elected for any portion of the purchaser's Slice power, and for any duration up to a full rate period. The aggregate amount of Block Product service shall not at any time exceed the aggregate amount of Block Product service elected for the first Contract Year. The cost of the Block Product will be determined by BPA based on the purchaser's requested block shape and in no case shall the cost of the Block Product be less than zero. All costs and risks of this product will be borne solely by the requesting purchaser, and it will include an after-the-fact annual true up to reflect the actual costs of BPA incurred to provide the Block Product.

6. Slice service will not include additional power for load growth over the term of the contract, nor does it guarantee a power supply at a particular level. Rather, it provides a power supply that varies based on the actual output of the Defined FBS, which output can decrease for such reasons as fish obligations and hydro conditions, and can increase for such reasons as the return of power from the expiration of BPA power sales obligations. Purchasers selecting Slice service will be solely responsible for shaping the Slice power to meet their actual loads, including balancing purchases and sales, and power needed to meet their load growth. Other than providing the Block Product, BPA will be contractually released from any responsibility to provide shaping and load growth service to Slice purchasers. All preference customers retain their statutory rights to request a power supply from BPA to serve their net requirements upon expiration of the new power contracts, without discrimination or penalty based upon customers' choice of Slice or Requirements service products.
7. During the term of the contract, BPA will include in the Defined FBS upgrades to resources listed Exhibit H of the Block/Slice contract and certain renewable resources, but will not include in the Defined FBS any costs from the acquisition of FBS replacement resources. BPA will have no obligation to provide service to Slice customer loads served by non-federal resources if those resources are lost during the contract term.

B. Operations Under The Slice Product

1. Under the new Slice agreements, BPA will continue to operate the federal system, and will continue to have the unilateral right to establish operating constraints to fulfill its statutory, treaty and multi-use obligations. Fish and wildlife requirements will continue to be treated as system obligations that will be met first, and the system capability available to Slice purchasers will be what is left after fulfilling all of these obligations.
2. As is the case under the current Slice agreement, BPA operations will retain the rights it currently enjoys to take unilateral actions it deems necessary to respond to emergencies in a manner that maintains system reliability, including use of the portion of the system allocated to the use of Slice and Requirements purchasers. The fact that such actions will impact the Slice resource that would otherwise be available to purchasers will require BPA and the purchasers to work cooperatively to address such impacts. One means of doing so would be for BPA to share with affected Slice purchasers proceeds from the sale of power used to alleviate the emergency based on the amount of power the Slice purchasers contributed to alleviating the emergency.
3. BPA will continue to establish the operational limits within which all parties entitled to a Slice of the system (including PBL) must abide, absent an emergency situation discussed above. Since the result of any party exceeding an operational limit is to take energy to which other Slice purchasers are entitled, once BPA establishes

operational limits, such as maximum and minimum generation, all parties must face penalties for exceeding the operational limits that fully compensate other Slice purchasers for the harm suffered by such exceedence.

4. To ensure that the FBS is operated in an efficient fashion with an expanded use of the Slice product, the Slice purchasers will provide to BPA information regarding their expected operations, including loads and resources, necessary for BPA to operate the system in the manner it currently does. This will include Slice purchasers providing BPA operational personnel with their load and resource planning information in a format and timeframe that will replace BPA's current reliance on forecast data. The information provided to BPA by the Slice purchasers will be about prospective operations, and as a consequence will be business sensitive. BPA will be obligated to treat this information in a confidential manner, and not reveal it to potential competitors (including the BPA trading floor).
5. More widespread reliance on the Slice product may warrant the installation of Generation Management System (GMS) at some point, but at the outset BPA and its customers should explore cost effective alternatives to full scale implementation of GMS, including Slice customers covering the cost of the within hour risk currently borne by BPA.
6. Communications between BPA's operations personnel and its trading floor appear to be necessary in order to help ensure that BPA meets its obligations in an efficient and cost-effective manner. Such communications should be continued under the new power contracts. This will be done in a manner that ensures that the BPA trading floor and all Slice purchasers receive the same information about system operations, requests by the trading floor for changes to operations and/or operating limits, and actual or possible changes to system operations, from BPA at the same time.
7. Generation inputs needed by TBL for ancillary services will continue to be provided by PBL to TBL at cost, and such obligation will be treated as a system obligation, until such time as a competitive market in generation inputs for ancillary services has developed in the Northwest. At such time, TBL will acquire its generation inputs from such competitive market, into which PBL and Slice purchasers will be free to offer generation inputs for sale in such market.
8. New Slice purchasers may not have the appropriate transmission arrangements to enable them to move the surplus Slice power to market. This may be rectified by converting existing NT agreements to PTP service, by PBL assigning to such customers PTP capacity it no longer needs, by use of transmission from secondary markets, or by other innovative approaches to resolve this matter that do not shift costs to other transmission customers. The customers anticipate working closely with TBL to identify solutions to these issues.

C. Financial Considerations Under the Slice Product

1. The current Slice contract contains extensive credit assurance provisions that allow BPA to take actions to secure payment of the purchaser's obligations. The new Slice agreement should contain similar provisions for credit support to help ensure that the risk assumed by Slice purchasers is not shifted to other BPA customers.¹³
2. The more widespread use of the Slice product will shift to numerous utilities the risk of managing fluctuating power supply, market prices and surplus power availability. There is concern that this may result in an increased risk of default by such utilities, exposing BPA to risks for which it has no financial reserves. To address this concern, the Slice contract will contain a provision under which the Slice rate will be subject to a temporary surcharge to cover the cash flow impact of a default in payment by a Slice purchaser. This provision will ensure that BPA will not fail to make its Treasury payment due to such a default in payment by a Slice purchaser.¹⁴
3. Increased reliance on the Slice product will likely change the timing of BPA's cash flow. Since timely payment to the Treasury is of primary importance to the region, the investor owned and preference utilities are committed to working with BPA regarding cash flow and timing issues under the Slice agreements to ensure they do not conflict with BPA's financial obligations, including its payment to the Treasury.
4. The more widespread use of the Slice product by BPA may be viewed as a change by the bond rating agencies. Since the Slice product will provide BPA with an assured cash flow and reduced revenue volatility due to less reliance on surplus revenues, the bond rating of BPA should be positively impacted. BPA's utility customers are ready to work with BPA to explain to the appropriate rating agencies the revised draft proposal.

D. Requirements Service

1. Requirements service will provide firm power for the entire variable load of the purchaser in excess of any declared non-federal resources, and includes load following and additional power to serve load growth occurring during the term of the new power contract.

¹³ This will not preclude BPA and individual Slice purchasers from working bilaterally to implement credit assurance provisions that are tailored to better suit unique situations.

¹⁴ This payment assurance provision will limit the payment by the Slice purchasers, will ensure that the payment is allocated to the Slice purchasers in proportion to their Selected Slice Percentage, will require BPA to make use of all credit assurance provisions available to it before seeking payment from other Slice purchasers, will require BPA to take all reasonable actions to mitigate the loss due to the default, and will entitle the Slice purchasers making payment under such provision the right to repayment from the defaulting utility or its successor.

2. Customers with non-federal generation will be able to elect Requirements service. Such customer will declare the amount of load to be served by its non-federal generation, and the customer will be responsible for serving that portion of its load regardless of the performance of its non-federal resources. BPA will provide service to the remainder of the customer's load, including load following and load growth.
3. The Requirements service rate will include all of the costs of additional resources needed to serve Requirements load growth, planned net revenues for risk associated with such service, shaping purchases for Requirements loads, and a proportionate share of the investor-owned utility financial settlement, the costs of serving the first 75 aMW of new preference load and any DSI settlement costs. This rate will also include the costs of the portion of the Defined FBS allocated to serve requirements loads, and a credit for revenues from the sale of secondary power associated with the portion of the Defined FBS allocated to serving Requirements loads.
4. During the new power contract, Requirements purchasers can develop non-federal resources for use in serving load growth or for sale into the market, with contractually stipulated notice to BPA of when the resource will begin serving the customer's retail load. Once a non-federal resource has been dedicated to serving the Requirements purchaser's retail load under the new power contract, it must continue to be so used until removal from load service is authorized under BPA's 5(b) policy. The Requirements rate will also include the costs of additional resources needed to serve additional Requirements load due to such removal.
5. Surplus Defined FBS output resulting from retail load loss by Requirements purchasers will be marketed by BPA, and the proceeds or losses from such sales will be equitably shared by Requirements purchasers.

V. Slice Supply Reduction Option

1. Slice purchasers may elect to provide their pro-rata share of augmentation for first 75 aMW of new public agency load and/or DSI loads that are treated as system obligations in lieu of paying their share of the costs incurred by BPA to serve such loads. To implement this option, the Slice purchaser will make a one-time election for the term of the contract prior to executing the new power contract to deliver to BPA at the Federal bus an amount of power shaped to the load of the new public agency load and/or the DSI loads. The amount of power so delivered will be equal to its pro-rata share of the DSI and/or new public utility load served by BPA that is treated as a

system obligation.¹⁵ Slice purchasers making such an election would be shielded from the augmentation costs incurred by BPA to serve such loads.¹⁶

VI. Investor Owned Utility Financial Benefits

1. The annual aggregate investor-owned utility financial benefits will be calculated using the following formula:

$$3300aMW \times ((A + B) - C) = \text{financial benefits}$$

Where:

A is the CCCT costs in mills/kWh other than commodity fuel

B is the commodity fuel cost using a 10-year rolling average gas price and a heat rate of 7100 btu/kWh

C is the Net Slice Costs in mills/kWh

2. The Net Slice Costs in each year will be determined with the following formula:

$$\frac{\text{Defined FBS Costs} - \text{Secondary Revenue Credit}}{\text{Historic Defined FBS Firm Output}}$$

Where:

Defined FBS Costs mean the costs (in each case as applied during the applicable year for Slice purchasers) of the Defined FBS, including the costs of the investor-owned utility financial benefits, a share of the up to 75 aMW for new preference utilities, and any DSI settlement.

Secondary Revenue Credit means for a Contract Year the value of the Historic Defined FBS Secondary Energy (based upon the applicable Mid-Columbia hub indices for the corresponding periods of the preceding Contract Year) less a transmission cost for transmission of such energy. Such transmission cost per kWh for a month shall reflect the transmission costs actually paid by preference utility Slice and Slice/Block customers for delivery in the region on the high voltage transmission grid of Slice or Slice/Block power to other than their retail

¹⁵ Pro-rata share means a percentage of the DSI and/or new public load equal to the percentage that the Slice purchaser's net requirement is of BPA's total preference agency, investor owned utility, DSI and federal agency loads.

¹⁶ Upon the expiration or termination of BPA's contractual service obligation to a DSI, any Slice purchaser that has elected the supply BPA power in lieu of paying its pro-rata share of DSI augmentation costs will be entitled to make a reduction its power deliveries to BPA in proportion to such reduction in BPA's contractual service obligation to the DSI.

loads during such month. The Secondary Revenue Credit (before reduction by the transmission costs described above) for such month will equal the sum of the products of the Historic Defined FBS Secondary Energy for each hour of the month multiplied by the Mid-Columbia firm index applicable to power in such hour.

Historic Defined FBS Firm Output means for each Contract Year the monthly firm energy allocated by hour during the previous Contract Year of the Defined FBS using critical water conditions, as adjusted for System Obligations. For purposes of determining the Historic Defined FBS Firm Output, the monthly firm output shall be allocated among the hours of such month in a manner that reflects the actual availability of firm output to preference utility Slice and Slice/Block customers.

Historic Defined FBS Secondary Energy means for each Contract Year the (i) total energy produced by hour by the Defined FBS during the previous Contract Year as adjusted for System Obligations, less (ii) the Historic Defined FBS Firm Output.

3. The value of A will be set once for the term of the new power contract using the following initializing formula :

$$A=39.90 - B_{2006}$$

Where:

B_{2006} is the commodity fuel cost using the 10-year (1996-2005) rolling average gas price for the first year and using a heat rate of 7100 btu/kWh.

4. The annual financial benefits paid to PGE in each of the first 5 years of the new power contract will be reduced by a dollar amount calculated using the following formula:

$$[140 \text{ aMW} \times (A + B)] - D = \text{amount deducted from PGE financial benefits}^{17}$$

Where:

A is the CCCT costs in mills/kWh other than commodity fuel

B is the commodity fuel cost using a 10-year rolling average gas price and a heat rate of 7100 btu/kWh

D is the total amount paid by PGE to PBL for such power in each year.

¹⁷ The 140 aMW used in this formula is an estimate based on a preliminary examination of the PGE historic residential and small farm load data, and may be subject to change based on a more thorough analysis of the PGE residential and small farm load data.

This adjustment is made to reflect the reduction in financial benefits due to the PGE Purchase.

5. The annual aggregate investor-owned utility financial benefits will be calculated in year one (and in subsequent years) using the formula from paragraph 1 above with the initialized value for A, the then-current 10-year rolling average gas price for B and the Net Slice Costs for C.
6. To reflect changes in the actual costs of the Defined FBS, the financial benefit payments made to the investor-owned utilities will be subject to an annual true up based on the actual Defined FBS costs incurred by BPA. This adjustment will use the same costs and payment procedures that are used to adjust the Slice rate for preference utility Slice purchasers.
7. The specific CCCT assumptions regarding the value of A and the heat rate set forth in paragraphs 1 and 3 above will not be subject to change. The CCCT assumptions will not be revised for technological change.
8. The gas price used to calculate the CCCT costs for the calculation of the financial benefits will be based on a ten-year rolling average of the gas prices for a gas supply derived 1/3 each for Rockies, Sumas and AECO. In other words, the first year gas price for the calculation of the financial benefits will be calculated using the volume-weighted price of gas from each of the three sources for the preceding ten years (1996-2005). Moving forward, a new year of gas prices will be added to the average, and the oldest year will be dropped from the average. The year to year change in the ten-year rolling average gas price will be capped at one standard deviation above and below of the previous year's ten-year rolling average price. The standard deviation will be calculated using the 10-year monthly average prices from the immediately prior year. A sample calculation of the standard deviation is provided in Attachment C.
9. In the event the Net Slice Costs exceed the cost of power from the CCCT as determined by the above calculations ("C" is greater than "A" + "B"), the financial benefits to the investor owned utilities will be zero until such time as the CCCT costs exceed the Net Slice Costs. In other words, there will be no accrual or payment of any negative benefits.
10. During the first five years of the new power contract, the total benefits available to the investor owned utilities will be subject to certain caps and floors that will be applicable based on the level of the Net Slice Costs (from Section VI(1) above), used to calculate the benefits for the residential and small farm customers of the investor owned utilities that is established for the rate period FY 2007 through FY 2011. The caps and floors applicable to the investor owned utility financial benefits are set forth on Attachment D. The caps and floors will apply to the investor owned utility financial

benefits (and to the annual true-up of such financial benefits calculated pursuant to section VI(6)) based on the final, iterated Net Slice Costs that includes all costs, such as DSI service, the financial benefits for investor-owned utility residential customers and the augmentation costs incurred to serve the first 75 aMW of new public utility load. In the sixth and subsequent years, the financial benefits for investor-owned utility residential customers will be calculated as set forth in this section VI and shall not be subject to any cap or floor.

11. Any dispute arising with regard to the implementation of the investor-owned utility financial benefits will be subject to dispute resolution conducted pursuant to an arbitration process to be developed.

VII. Conservation and Renewable Programs

(This section is under discussion with representatives of the conservation and renewable constituencies, and may be revised to reflect agreements reached in those discussions.)

With respect to conservation and renewable resources, the customers' goal is to acquire the lowest cost resources through continued reliance on the least-cost planning concepts embedded in the Northwest Power Act as implemented by the NW Power Planning Council in its Regional Power Plan on a region wide basis. This will encourage the acquisition of all cost-effective conservation and renewable resources are acquired along with more conventional generation resources to ensure an adequate, efficient, economic and reliable power system for the region.

The customer conservation and renewable resource proposal relies on existing institutions and proven program delivery mechanisms, but adapted to a customer – BPA business relationship that shifts the primary responsibility for load growth to the customer, and places less reliance on BPA as the regional power supplier of choice. This proposal was designed to conform to the principles articulated by the NW Power Planning Council and public interest representatives. The roles of the various parties under the customer conservation and renewable proposal are described below.

1. Northwest Power Planning Council Role

The Northwest Power Planning Council (NWPPC) will continue to prepare the five-year regional power plan. In each plan the NWPPC will set the cost-effectiveness standard for conservation and renewable resources, identify the amount of such cost-effective conservation and renewable resources that is expected be available in the region in the planning period, and the portion of such cost-effective resources that BPA is expected to acquire.

2. BPA Role

- a. BPA will establish a budget for the rate period to acquire all or some portion of the cost-effective conservation and renewable resources that BPA is expected to acquire during the rate period under the NWPPC power plan. The overall budget level will be subject to both a floor and ceiling that will limit the amount that the budget can change from year to year, and would not be set below current overall budget levels. The funding of individual program elements within the budget may change from rate period to rate period to reflect changes in technology, availability of conservation and renewable resources, and the cost-effectiveness of resource alternatives. For the first five years of the new contract, the funding level for renewable resource program element would be set at or above current funding levels. The final budget level will be determined by BPA after consideration of relevant factors set forth in the contract, including without limitation BPA's need for additional resources.
- b. Once the budget is established, through the rate process BPA will establish the conservation and renewable discount (C&RD) available to customers, including investor owned utilities based on the amount of load used to calculate the financial benefits, who implement conservation and renewable resources that qualify for the C&RD. A fixed percentage of the C&RD expenditures will be dedicated to acquisition or support (such as contribution to the Bonneville Foundation) of renewable resources, and this percentage will be reviewed after 10 years to determine if it is adequate.
- c. BPA will be responsible for program administration, including receiving reports from utilities, verifying measure installation, and conducting periodic audits.
- d. BPA will also collect charges from customers that fail to implement sufficient conservation and renewable projects to qualify for their full C&RD. The money so collected by BPA will be invested in conservation and renewable projects to make up for the shortfall, and may be used to fund conservation augmentation programs. There will be no requirement that such money be spent in the service area of the utility from which it was collected.
- e. BPA will continue to operate as centrally funded programs low income weatherization, research and development for emerging technology that has special application in the region, market transformation and legacy programs such as multi-year conservation augmentation contracts currently in place. The budgets for these programs will be set in the same manner that BPA currently uses.

3. Regional Technical Forum Role

- a. The Regional Technical Forum (RTF) will be made more permanent and more

professional by the inclusion of hired experts who would work with utility personnel and interested parties. Using the NWPPC cost-effective standard, the RTF will evaluate proposed measures and establish the list of qualified measures, their cost credit and expected savings to be recommended to BPA. Utilities and other interested parties will have an active role in the measure evaluation, cost credit and expected savings analysis, but the final decision on what to recommend to BPA will rest with the hired experts. Since the conservation and renewable programs are BPA programs, BPA will have the final word on all of these matters.

- b. The RTF will conduct periodic verification audits to determine if the measures being installed are producing the expected energy savings, and if not, the reason for the shortfall.

4. BPA Customers' Role

- a. The primary role of the BPA customers is to implement conservation measures from the RTF recommended list, and to acquire or support the appropriate amount of renewable resources. Utilities will be free to participate in conservation augmentation contracts with BPA in addition to the activities conducted under the C&RD program. Implementation of conservation and renewable resources that are done pursuant to local, state or federal mandates will qualify under the C&RD program.
- b. Utilities will report at least annually on the number and type of measures installed, and will be required to pay the power surcharge if they have failed to implement sufficient conservation and acquire or support the required amount of renewable resources within the rate period. Utility reports must show reasonable progress toward qualifying for the full C&RD through the rate period to avoid loss of the discount prior to the end of the rate period.
- c. Utilities can group their conservation and renewable activities, and both credits and measures can be traded in order to achieve the target level of conservation and renewable resources.

VIII. Service to DSIs

(This section is under discussion with representatives of the DSIs, and may be revised to reflect agreements reached in those discussions.)

1. This proposal includes provisions under which BPA would take the discretionary action of offering to DSI customers a long-term power supply from BPA that would serve to preserve jobs in the region. As a necessary element of this offer, BPA will include in each new DSI power contract, and in the new contracts of utilities that so

request, a meaningful and enforceable contract provision which prohibits BPA, both during and after the term of the new power contract, from executing with any DSI a power supply contract, other than the new power contract described in this section VIII, that supplies power at a rate that does not fully recover all of the costs of providing such service.

2. BPA will offer to the qualifying smelter loads of DSIs an amount of federal power not to exceed 600 aMW. An additional 50 aMW will be offered to qualifying non-smelting DSI loads, with such amount being prorated among the qualifying non-smelting loads.
3. The base allocation will be 100 aMW per qualifying smelter, and BPA will decide which smelters qualify for an allocation. BPA should consider as qualified smelters that have a current BPA power contract, have not been declared unsuitable for operation by the company and are not in default of their payment obligation under their current BPA contract at the time of allocation. To the extent there are competing qualified requests that cannot all be met out of the 600 aMW pool, BPA will give priority to smelters that have not imposed stranded costs on BPA during this rate period by electing to substitute market power for BPA power under their current contract with BPA.
4. Companies owning more than one operating smelter may from time to time shift their federal power supply, in whole or in part, between such smelters for operational reasons. However, such shifts must be temporary because each allocation of federal power is intended to support continued operation of a specific smelter.
5. The power supply contract offered to the companies will include credit assurance, load loss and contract termination provisions to the benefit of BPA that are the same as those contained in the Slice power supply contract offered to preference customers.
6. On a case-by-case basis, BPA should give consideration to providing credit support to DSIs who develop incremental generating resources that they are willing to contractually dedicate to serving their in-region smelter load not served by BPA, and who are unable to otherwise procure financing for such resources. Any DSI requesting such credit support from BPA will be limited to an allocation of federal power of 100 aMW per smelter.
7. If offered, credit support should generally contain the following:
 - a. The DSI must demonstrate that financing of the resource is unavailable without BPA credit support, and that with such credit support the generating resource can be reasonably expected to be developed and placed into commercial operation.
 - b. The term of the credit support would be limited to 5 years from the date

of the commercial operation so that BPA bears no risk of resource non-completion.

- c. The credit support would be limited to fixed resource costs, including debt service, but excluding equity costs and returns. Credit support would not include any variable costs of the supported resource, other than fuel purchases approved by BPA and having a duration no longer than one year.
 - d. Any default in payment by the DSI would terminate the DSI's BPA power supply agreement.
 - e. If the DSI is in default of its payment obligation under the credit support agreement and BPA has suffered a loss due to the resale of power available under the credit support agreement, BPA would be entitled to priority repayment of such losses from the power sales revenues of the supported resource ahead of the payment of an investment return to, or a buy-out of, the equity participants. Such repayment obligation would continue until satisfied.
 - f. When the DSI has failed to fulfill its payment obligation under the BPA power sales agreement, BPA would be entitled to make dispatch decisions regarding the supported resource.
 - g. BPA would agree not to waive any material breaches of, or fail to exercise any of its material remedies, under the BPA power contract with the DSI or the credit support agreement with the supported resource.
 - h. BPA should be entitled to additional consideration for providing such support, such as access to excess energy produced above warranted amounts at the variable cost of producing such energy.
8. DSIs seeking an allocation for a smelter in excess of the 100 aMW limit may do so by offering to BPA at cost the output of an incremental generating resource. On a case by case basis, BPA will evaluate the incremental resource output offered by any DSI. To the extent that BPA acquires the output so offered, the DSI making such offer may obtain an allocation equal to the amount of the incremental resource output so acquired by BPA. Such allocation may exceed the 100 aMW per smelter limit, but all such additional allocations must be accommodated within the 650 aMW available to the DSI customer class.
9. To facilitate service to DSI loads not supplied by BPA, all new 20-year power sales contracts would include a provision that would preclude the imposition of a charge on transmission service to collect power costs (other than FERC recognized ancillary services) not charged to BPA power customers. This provision would not preclude BPA from exercising any authority it may be determined to have to impose a charge on transmission

service to pay existing obligations to Energy Northwest, nor from collecting power costs specifically assumed by a particular customer.

10. The rate charged for the federal power supply for DSI service would be the BPA rate equal to the Net Slice Cost calculated pursuant to the formula contained in Section IV of the proposal with the addition of a pro-rata share of costs of planned net revenues for risk as determined in the most recent BPA rate case.
11. The federal power would be provided under a 20-year power sales contract containing a take or pay provision that requires monthly payment for power whether taken or not, with a credit at the end of each operating year for revenues generated by the resale of power not taken by a DSI. In the event that such credit exceeds the take or pay obligation, such excess revenues would be retained by BPA for credit against future take or pay obligations. Any accrued credit remaining at the end of the rate period in which it was accrued would be reduced to zero. The customer would not have rights to directly remarket federal power.

Attachment A

PGE Power Purchase Term Sheet

PGE would purchase a power product from BPA for five years on the following basis:

The power would be shaped such that the peak 280 MW would coincide with PGE's historical annual peak for its residential load. The power amount for the other 8759 hours (8783 in leap years) would effectively be a percentage of the peak based on the historical shape of PGE's residential load.

PGE would submit a five-year schedule for power deliveries to BPA that would be based on the residential load shape. PGE's preliminary calculations indicate that this would amount to approximately 140 average annual megawatts (aMW) of energy.

The power would be priced at a rate equal to BPA's lowest priority firm power rate (PF rate).

During the term of the power purchase the value of the power would be subtracted from PGE's share of the IOUs' monetary benefits. Therefore, if the PGE rate is higher than the PF rate, the value of the power subtracted from PGE's monetary benefits would be less than if the power were priced at the PF rate.

At the end of the power sale PGE's share of the IOU monetary benefits would return to its full share of the IOU monetary benefits for the remaining years of the new power contracts.

PGE would have rights to terminate the power sale and convert to monetary benefits in certain circumstances (e.g. "PGE rate" is higher than PF rate, 7(b)(2) is determined to be applicable to the sale etc.).

ATTACHMENT B

ALLOCATION OF FY 2006 ENDING PERIOD FINANCIAL RESERVES

The method for allocating end of year FY 2006 reserves for the benefit of post-2006 Slice purchasers and post-2006 Requirements purchasers is as follows:

First, an equilibrium reserve amount (ERA) is calculated as:

$$(0.5)(1-0.226)(\$525 \text{ MM}) = \$203.18 \text{ MM}$$

Second, a threshold reserve amount (TRA) is calculated as:

$$\text{TRA} = (\text{ERA}) (\text{RR})$$

Where:

RR is the % of BPA revenues contributed by non-Slice purchasers during FY 2002-2006 that choose Requirements service under contracts beginning in FY 2007.

Third, reserves allocated to post-2006 Slice purchasers (RAS) is calculated either as:

$$\begin{aligned} \text{RAS} &= (\text{RS}) (\text{YER}) \text{ when } \text{YER} = \text{ or } > \text{ ERA, or as} \\ \text{RAS} &= (\text{YER} - \text{TRA}) \text{ when } \text{YER} < \text{ ERA} \end{aligned}$$

Where:

YER is BPA's ending FY 2006 accumulated reserves.

RS is the % of BPA revenues contributed by post-2006 Slice purchasers during
FY 2002-2006 through their purchases of non-Slice products.

When $\text{YER} < \text{ERA}$, RAS is allocated among post-2006 Slice purchasers pro rata based on their respective percentages of the total revenues contributed by such Slice purchasers through their 2002-2006 purchase of non-Slice products. RAS may be less than the total revenues contributed by Slice purchasers through purchases of non-Slice products during 2002-2006, but in no event may RAS exceed such total revenues contributed by Slice purchasers.

BPA will distribute RAS to post-2006 Slice customers 30 days after FY 2006 numbers are final, but in any case no later than October 1, 2007.

ATTACHMENT C

Sample Calculation of the Standard Deviation

Example: Determine the allowable price range for the 10-year rolling average used to calculate financial benefits for FY2003 (*i.e.*, the 10-year rolling average ending in 2001 plus or minus one standard deviation of the ten yearly averages comprising the 10-year rolling average ending 2001).

Step 1: Calculate for each of the ten years included in the 10-year rolling average used to calculate financial benefits for the preceding year an average yearly price, derived by equally weighting the twelve volume-weighted monthly prices from Sumas, AECO and Rocky Mountain.

Volume -Weighted Monthly Prices (\$/MMBtu)¹⁸

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
1992	1.40	1.00	1.04	1.00	1.10	1.03	0.90	1.03	1.03	1.25	1.50	1.74
1993	2.25	1.74	1.80	1.80	2.25	1.58	1.55	1.65	1.92	1.75	1.80	2.40
1994	2.18	1.79	1.98	1.62	1.60	1.39	1.48	1.45	1.36	1.18	1.52	1.63
1995	1.40	1.03	1.00	0.97	0.99	0.97	0.85	0.75	0.85	0.96	1.26	1.29
1996	1.24	1.20	1.15	0.93	0.93	0.90	0.96	1.01	1.01	1.10	2.17	3.55
1997	4.15	2.37	1.05	1.11	1.33	1.38	1.22	1.08	1.19	1.48	2.70	1.40
1998	1.85	1.43	1.12	1.43	1.70	1.38	1.45	1.57	1.46	1.67	2.14	2.09
1999	2.88	1.77	1.50	1.51	1.95	1.91	1.94	2.21	2.50	2.39	2.92	2.28
2000	2.30	2.36	2.31	2.73	2.74	3.64	4.07	3.04	3.45	4.88	4.83	13.69
2001	14.20	6.95	5.21	5.37	5.17	3.96	2.67	2.42	2.18	1.38	2.78	2.68

For the 1992 yearly average, the calculation would be as follows:

1992 Yearly Avg. = Average of 1.40, 1.00, 1.04, 1.00, 1.10, 1.03, 0.90, 1.03, 1.03, 1.25, 1.50 and 1.74

1992 Yearly Avg. = **1.17**

Repeating this calculation for the remaining years yields the following results

Yearly Averages

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Avg.	1.17	1.87	1.60	1.03	1.35	1.71	1.61	2.15	4.17	4.58

Note: The 10-year rolling average of yearly averages ending in 2001, or the 10-year rolling average used to calculate financial benefits in FY2002, would be the average of the above yearly averages, or \$2.12/MMBtu; *i.e.*,

10-year rolling avg. of yearly averages ending 2001 = Average of 1.17, 1.87, 1.60, 1.03, 1.35, 1.71, 1.61, 2.15, 4.17 and 4.58

¹⁸ The monthly averages in this example are not the average of the volume-weighted average prices for Sumas, Aeco and Rockies, but rather are the volume weighted monthly average prices for Sumas only.

10-year rolling avg. of yearly averages ending 2001 = 2.12

Step 2: Calculate the standard deviation of the ten yearly averages.

For the standard deviation of the yearly averages that comprise the 10-year rolling average ending in 2001, the calculation would be as follows

St. Dev. of 10 yearly averages ending 2001 = Standard Deviation of 1.17, 1.87, 1.60, 1.03, 1.35, 1.71, 1.61, 2.15, 4.17, and 4.58.

St. Dev. of 10 yearly averages ending 2001 = 1.2338

This standard deviation is the limit (to be determined each year) on the amount of change, either positive or negative, in the 10-year rolling average used to calculate financial benefits in the subject year from the 10-year rolling average used to calculate financial benefits in the previous year.

For the 10-year rolling average used to calculate financial benefits for FY2003 (i.e., the 10 year rolling average of yearly averages for the 10 years ending 2002), the limit on its change from 2001 would be 1.2338. Therefore, the 10-year rolling average used to calculate financial benefits for FY2003 could not be \$1.23 greater than or less than the 10-year rolling average used to calculate financial benefits for FY2002, or rather could not be greater than \$3.35 (\$2.12 + \$1.23) or less than \$0.89 (\$2.12 - \$1.23).

If the 10-year rolling average exceeds or falls below the bound, the upper or lower bound would be the gas price upon which benefits will be calculated. For example, if the 10-year rolling average ending in 2002 is greater than \$3.35, the gas price used for calculating financial benefits in 2003 will be \$3.35.

In the year following a year where the bound is used as the price for purposes of calculating financial benefits, the calculation of the 10-year rolling average and standard deviation for use in that year will be calculated via the steps stated above using the actual data without reflecting the bound.

In summary:

Benefits for FY 2003 would be based on either:

- (a) The 10-year rolling average of yearly averages for the 10 years ending 2002, OR
- (b) The 10-year rolling average of yearly averages for the 10 years ending 2001 plus or minus one standard deviation of the yearly averages of the 10 years ending 2001.

If (a) is inside the bounds calculated in (b) (10-year rolling average of yearly averages for the 10 years ending 2001 plus or minus one standard deviation of the yearly averages of the 10 years ending 2001), the benefits are based on (a).

If (a) is outside the bounds calculated in (b), the benefits are based on the appropriate bound (b).

ATTACHMENT D

Limit of Financial Benefits FY 2007 – 2011

Final, iterated Net Slice Costs rate (in \$/MWh)	Limit of financial benefits (in millions of dollars)	
	<u>Ceiling</u>	<u>Floor</u>
25	396	376
26	367	347
27	338	318
28	318	298
29	298	278
30	278	258
31	258	238
32	238	218
33	218	198
34	198	178
35	178	158
36	158	138
37	138	118
38	110	90

The final, iterated Net Slice Costs rate includes the costs of the financial benefits for investor-owned utility residential customers, the C&RD program, augmentation costs for service to DSIs and the first 75 aMW of service to new public utilities.

The cap and floor are applied to IOU financial benefits prior to reduction for the PGE purchase.

In the event that the final, iterated Net Slice Costs rate falls between rows of the above table (e.g., \$26.5/MWh), interpolate linearly for corresponding values of the floor and the cap.

For values of Net Slice Costs rate greater than 38,

- (A) the floor equals the greater of (i) zero and (ii) an amount equal to \$90 million reduced by the product of \$28,908,000 multiplied by the amount by which the Net Slice Costs rate exceeds 38, and
- (B) the ceiling equals such floor plus \$20 million.

For values of Net Slice Costs rate less than 25,

- (A) the floor equals the greater of (i) zero and (ii) an amount equal to \$376 million plus the product of \$28,908,000 multiplied by the amount by which 25 exceeds the Net Slice Costs rate, and
- (B) the ceiling equals such floor plus \$20 million.