

Tom Karier
Chair
Washington

Frank L. Cassidy Jr.
"Larry"
Washington

Jim Kempton
Idaho

Judi Danielson
Idaho



Joan M. Dukes
Vice-Chair
Oregon

Melinda S. Eden
Oregon

Bruce A. Measure
Montana

Rhonda Whiting
Montana

June 28, 2006

Mr. Steven G. Hickok
Deputy Administrator
Bonneville Power Administration
P.O. Box 3621
Portland, OR 97208-3621

Dear Steve:

Thank you for the opportunity to comment on Bonneville's proposed interpretation of section 4(c)(10)(B) of the Northwest Power Act, which pertains to the Northwest Power and Conservation Council's statutory funding limitation. The Council appreciates your effort to clarify that Bonneville should incorporate the residential exchange settlement agreements into Bonneville's forecast of firm power sales for the purpose of establishing the Council's annual operating budget. The proposed interpretation is consistent with the text and context of this provision, and consistent with our mutual long-held understanding of its meaning.

From the very beginning of the Council, both Bonneville and the Council have understood section 4(c)(10)(B), especially when read together with the residential exchange provision in section 5(c) and the rate provision in section 7(b)(1), to require Bonneville's total firm power forecast to include the residential exchange load. Bonneville and the Council signed an agreement to that effect in 1981. And Bonneville and the Council have continued to agree on an understanding of the Council funding limit that includes the residential exchange load in the firm power sales forecast, notwithstanding the fact that Bonneville now uses settlement agreements to implement the residential exchange program. Therefore, the Council agrees with Bonneville's proposed official interpretation that the settlement agreements are the equivalent of the prior residential exchange purchase-and-sale arrangements even though the actual implementation of both types of agreements may involve a combination of both power deliveries and monetary benefits or even purely monetary benefits.

The inclusion of the residential exchange in Bonneville's firm power sales forecast for the purpose of calculating the Council's budget has been a matter of public record since the Council's inception in 1981. On May 8, 1981, Bonneville and the Council signed an agreement pertaining to funding the Council's operations. The agreement includes the following paragraph:

2. Annually, and no later than March 1 of each year, Bonneville shall notify the Council of its latest forecast of firm power sales (including exchange/purchase sales under section 5(c) of the Act) for the next fiscal year, and preliminary, for each of the ensuing five fiscal years.

This provision clearly indicates that Bonneville intended the residential exchange to be included in the firm power sales forecast used to determine the Council's annual budget limitation. A copy of the 1981 agreement is attached.

Bonneville has reiterated this position in subsequent years. In an attached June 23, 1989, letter to Mr. John Carr, then-executive director of the Direct Services Industries, Bonneville stated:

Early in 1981, BPA considered the question of how to define the term "firm power forecast to be sold" in developing the process by which we would plan, develop, review, and implement the funding requirements of the Council. Whether the exchange in other contexts, such as financial reporting, would typically be considered a sale is irrelevant since Section 5(c) of the Northwest Power Act denominates the exchange transaction as a "residential purchase and exchange sale" and Section 7(b)(1) treats the exchange as a load for ratemaking purposes. BPA believes including the exchange as a sale of firm power is consistent with the terminology used in the Northwest Power Act.

The Council does not see any ambiguity in the Northwest Power Act's provisions pertaining to the calculation of the Council's budget limitation. Bonneville's proposed interpretation correctly explains that the shift in form from residential exchange sales agreements to residential exchange settlement agreements does not change their essential nature for the purposes of factoring the residential exchange into the firm power forecast and thus the Council's funding limitation. The Council has been consistent on this point. *See*, for example, the discussion of this issue in the Council's November 30, 2002, report to the House Appropriations Committee, which accompanies this letter. Moreover, Bonneville and the Council have consistently agreed to Council budgets over the last decade that reflect this understanding.

The Council also wants to emphasize that this opportunity for public review and comment potentially resolves only one of several problems associated with the Council's funding formula. The Council believes that the formula is in need of amendment, considering the many changes that have occurred in the utility industry and the Northwest's energy system over the last 26 years. For example, the formula provides no mechanism to ensure that the Council's budget keeps pace with inflation. This omission is likely attributable to Congress' expectation in 1980 that Bonneville would acquire all resources necessary to meet the region's electrical load growth. Had Bonneville acquired the resources to meet regional growth, this would have boosted the agency's firm power sales and automatically increased the Council's budget cap. In reality, the Council's budget has not kept up with inflation. In fact, the Council's 2006 budget is about \$4 million lower than it would be had an inflation factor been applied since 1981.

The inability of the Council's budget to keep up with inflation threatens the Council's independent planning capability. Historically, the Council's staffing capability was augmented by engaging independent contractors with special analytical expertise. In recent years, failing to keep up with inflation has forced the Council to halt or scale back some important projects that would have enhanced the Council's technical capabilities. For example, because of budget

reductions in contracting and personnel, the Council stopped updating the data and economic forecasts in its Demand Forecasting System models and the models were abandoned. Falling behind inflation has also prevented the Council from providing others in the region with detailed economic and demand forecast data, which many in the region had relied on for years. While the Council is still the premier energy forecasting entity in the region, this slow erosion of capability someday will inhibit its ability to serve the region in the manner originally intended by Congress and the four Northwest states.

In 1985, the Council's staffing costs represented 31 percent of its budget, and contract costs were 24 percent. In 2007, the Council expects its staffing costs to be about 54 percent of its budget and contract costs only 4 percent. In addition, the Council has reduced the overall number of its full-time employees by approximately 10 percent since 1985.

There are other problems with the existing formula, as well. These problems, which also could not have been anticipated when the Act was passed, are discussed at length in the attached report to the House Appropriations Committee.

Again, we appreciate Bonneville's desire to clarify how it understands the role of the residential exchange in the calculation of the Council's budget. We agree that Bonneville's long-standing practice of including the residential exchange agreements in firm power sales forecasts is consistent with the provisions of the Northwest Power Act.

Thank you for the opportunity to comment on this proposal.

Sincerely,

A handwritten signature in black ink, appearing to read "Tom Karier". The signature is fluid and cursive, with a large initial "T" and "K".

Tom Karier
Chair

enclosures

AGREEMENT

Between

UNITED STATES OF AMERICA
DEPARTMENT OF ENERGYActing by and through the
BONNEVILLE POWER ADMINISTRATOR

And the

PACIFIC NORTHWEST ELECTRIC POWER AND CONSERVATION PLANNING COUNCIL

This Agreement is entered into this 8th day of May, 1981, between the United States of America, Department of Energy, acting by and through the Bonneville Power Administrator (referred to hereinafter as Bonneville), and the Pacific Northwest Electric Power and Conservation Planning Council (referred to hereinafter as the Council).

RECITALS:

A. The Council (for which congressional consent was provided pursuant to Pub. L. 96-501, Act of December 5, 1980, hereinafter referred to as the Act), is required to prepare, adopt, and from time to time review and amend a regional conservation and electric power plan and a program to protect, mitigate, and enhance fish and wildlife, and to carry out other responsibilities specified in the Act.

B. The Council is intended to be a regional planning agency and shall not be considered an agency or instrumentality of the United States.

C. The Act provides that Bonneville shall pay from funds available to Bonneville the compensation and other expenses of the Council as are authorized by the Act and as the Council determines are necessary or appropriate for the performance of the Council's functions and responsibilities pursuant to the Act.

D. The Act mandates that Bonneville expedite payment for Council activities in order to assist the Council's initial organization.

E. Bonneville is required to pay Council expenses in an annual amount that shall not exceed 0.02 mill per kilowatthour (kWh) of forecasted firm power sales for the year to be funded.

F. Bonneville may raise that ceiling and pay Council expenses up to any annual amount not in excess of 0.10 mill per kWh of forecasted firm power sales in the year to be funded upon a showing by the Council that funds in excess of the ceiling of 0.02 mill per kWh will be required to enable the Council to carry out its functions and responsibilities under the Act.

G. The Act requires that, to the extent appropriate, Federal laws applicable to Bonneville in matters such as making of contracts and financial disclosure shall apply also to the Council.

H. The Act provides that the Council's records, reports, and other documents shall be available to the Comptroller General and that the Comptroller General shall carry out such audits, reviews, or other examinations as are authorized or required by section 11(d) of Pub. L. 93-454 (the Federal Columbia River Transmission System Act) or other laws applicable to the Comptroller General.

I. The Council's bylaws provide for an annual independent audit of its finances by a certified public accountant.

J. Pub. L. 93-454 requires that before Bonneville may make expenditures from funds available to Bonneville, including payments to carry out the provisions of the Act, such expenditures must be included in Bonneville's annual budgets submitted to Congress and are subject to such specific directives or limitations as may be included in appropriations acts.

K. The Council's budget for each fiscal year, to be developed in consultation with Bonneville, will be treated separately in Bonneville's budget submittal to Congress.

L. Advance notification and documentation from the Council on the Council's budget requirements are required for Bonneville to include that item in Bonneville's annual budget submittals to Congress.

M. An estimate of initial Council budgets for fiscal year 1981 and fiscal year 1982 was prepared before the Council was established and was included in Bonneville's budget submittals to Congress.

N. It is necessary for Bonneville and the Council to establish mutually satisfactory procedures for Bonneville to pay necessary or appropriate compensation and other expenses of the Council.

NOW, THEREFORE, in view of the foregoing circumstances, it is mutually agreed by and between the parties hereto as follows:

1. For the fiscal year beginning October 1, 1982, and thereafter, the Council shall annually prepare, adopt, and submit to Bonneville an advance budget using the same fiscal year basis as used by Bonneville (October 1 through September 30).

2. Annually, and no later than March 1 of each year, Bonneville shall notify the Council of its latest forecast of firm power sales (including exchange/purchase sales under section 5(c) of the Act) for the next fiscal year and, preliminarily, for each of the ensuing 5 fiscal years.

3. No later than July 1 of each year beginning in 1981, the Council will inform and consult with Bonneville on the Council's advance budget for the fiscal year commencing 15 months later, and submit a certification that the budgeted expenditures are necessary or appropriate for performance of its functions and responsibilities under the Act, together with such supporting

documentation and detail as is necessary to include the item in Bonneville's annual budget submittal to Congress. If the amount of any annual budget submitted by the Council exceeds the product obtained by multiplying 0.02 mill by the forecasted number of kWh of firm power sales by Bonneville during the year to be funded, the Council will provide such information as, in the Council's judgment is appropriate to show that the amount above the 0.02 mill per kWh level is necessary to permit the Council to carry out its functions and responsibilities under the Act. The Council reserves the right to testify on its own behalf before the congressional Appropriations Committees.

4. Pursuant to the Act and Section 8 of this Agreement, Bonneville shall pay necessary or appropriate Council expenses authorized by the Act and included in the Council's advance budget, as reflected in Bonneville's budget submittal to Congress, that do not exceed an annual amount equal to 0.02 mill per kWh of forecasted firm power sales for the year to be funded, subject to such directives or limitations as may be given by Congress in appropriations acts pursuant to Pub. L. 93-454 and other relevant legislation.

5. Upon an annual showing by the Council that amounts included in the Council's annual budget in excess of the 0.02 mill per kWh ceiling (but not in excess of an annual amount of 0.10 mill per kWh) are necessary to carry out the Council's functions and responsibilities under the Act, and if either agreed to by Bonneville as reflected in Bonneville's budget submittal to Congress, subject to congressional directives or limitations, or if specified by such congressional directives or limitations, Bonneville shall pay such additional amounts pursuant to Section 8 of this Agreement. Any incremental payment of Council expenses by Bonneville above 0.02 mill per kWh in any year shall not automatically apply to subsequent annual budgets submitted by the Council.

6. The Council's advance annual budget for the fiscal year beginning October 1, 1982, and for fiscal years thereafter, to be submitted to Bonneville shall include the following information:

- a. The total amount budgeted and requested from Bonneville for the forthcoming fiscal year and the projected budgets for each of the following 5 years.
- b. The amounts to be expended for compensation of the Council members and Council employees, including labor overhead expenses.
- c. The amounts to be expended for contract studies and other contracted services.
- d. The amounts to be expended for all other operating expenses of the Council broken down by general category.
- e. The amounts, if any, actually spent by major category in each of the two preceding completed fiscal years and the amounts budgeted for the current uncompleted fiscal year in which the Council's advance budget is prepared.
- f. The amount of any budgeted expenditures by major category or advances of funds by Bonneville unexpended at the end of each of the two preceding completed fiscal years.
- g. The amounts and sources of all other Council funds including interest earned.
- h. Such other detail as the Council may wish to provide or as is necessary to include the item in Bonneville's budget submittals to Congress.

7. Subject to congressional directives and limitations pertaining to the Council's budget as included in Bonneville's budget submittals, Bonneville will make the budgeted amount for Council activities available for disbursement from the Bonneville fund.

8. Upon execution of this Agreement and application by the Council, and subject to approval by the U.S. Treasury Department, Bonneville will initiate payment to the Council for initial working capital of an amount estimated by the Council to meet Council expenses for 30 days. Thereafter, to replenish the Council's revolving working capital account, reimbursement for actual Council expenses incurred will be made at least once each month, but no more frequently than biweekly, upon receipt of a Financial Summary Statement certified by the Council's certifying officer that its expenditures have been documented and made in accordance with applicable Federal laws. Payments to the Council will be deposited by the Council in the Council's own account or accounts separate from Bonneville. Payments to the Council shall not exceed amounts determined pursuant to sections 4 and 5 of this Agreement. The Council shall provide to Bonneville the name and title of its certifying officer or others authorized by resolution of the Council pursuant to its bylaws to make such certifications.

9. To the extent that Council budgets exceed the 0.02 mill per kWh annual ceiling, Bonneville will not disburse any such overceiling funds until the Council has made a showing that the excess over such ceiling is required to enable the Council to carry out its functions and responsibilities under the Act subject to the terms of Section 5 of this Agreement.

10. Bonneville shall not make an initial disbursement of funds to or on behalf of the Council until the Council certifies in a letter signed by its chairman or the Council's designee that the Council has made provision for an adequate accounting system to facilitate audit of its finances. A copy of each annual independent audit report of the Council performed by a certified public accountant shall be made available to Bonneville. Bonneville shall exercise fiscal oversight as appropriate under this Act.

11. No funds disbursed from the Bonneville fund shall be used for payment

of any Council expenses incurred prior to establishment of the Council or for any other purpose not permitted by law.

12. Bonneville shall not be liable for any obligation or expenses incurred by the Council. The Council shall be solely responsible for, and Bonneville shall be held harmless from, any risks or obligations incurred by the Council.

13. The Council and Bonneville may amend the terms of this Agreement, from time to time, to ensure that the Agreement adequately provides the administrative procedures necessary for funding of the Council's operations in accordance with the provisions of the Act.

IN WITNESS WHEREOF, the Parties hereto have executed this Agreement the day and year first hereinabove written.

UNITED STATES OF AMERICA
DEPARTMENT OF ENERGY

By *F. P. E. Gjelke*
ACTING Bonneville Power Administrator

PACIFIC NORTHWEST ELECTRIC POWER AND
CONSERVATION PLANNING COUNCIL

By *Sam Jones*
Chairman



Department of Energy

Bonneville Power Administration

P.O. Box 3621

Portland, Oregon 97208

JUN 23 1989

In reply refer to: DR3

Mr. John D. Carr, Executive Director
Direct Service Industries, Inc.
925 Lloyd Center Tower
825 NE. Multnomah Street
Portland, OR 97232-2150

Dear Mr. Carr:

The Administrator asked me to respond to your June 6, 1989, letter in which you discuss the Northwest Power Planning Council's (Council) FY 1991 draft budget. We appreciate your comments on the Council's draft budget. We, too, are troubled over the growth in the budget and have indicated our concern in our comments to the Council. Enclosed is a copy of our letter to the Council's Executive Director dated June 12, 1989.

Another point you raise concerns Bonneville Power Administration's (BPA) inclusion of the residential exchange in the annual forecast of firm power sales which is the basis for computing the lower and upper limits of the Council's budget. This results, you say, in the forecast of power sales being nearly 50 percent higher than it would be if the residential exchange were excluded from the forecast. You note also that BPA treats the residential exchange as an operating expense in our Quarterly Report.

Early in 1981, BPA considered the question of how to define the term "firm power forecast to be sold" in developing the process by which we would plan, develop, review, and implement the funding requirements of the Council. Whether the exchange in other contexts, such as financial reporting, would typically be considered a sale is irrelevant since Section 5(c) of the Northwest Power Act denominates the exchange transaction as a "residential purchase and exchange sale" and Section 7(b)(1) treats the exchange as a load for ratemaking purposes. BPA believes including the exchange as a sale of firm power is consistent with the terminology used in the Northwest Power Act.

I can assure you BPA is equally concerned over the rising costs forecasted in the Council's budget and, as our June 12 letter indicates, has recommended several areas where the Council may look as part of a budget reexamination. If you have further questions on these matters, please contact me.

Sincerely,

Assistant Administrator for
Financial Management

Enclosure

JUL 12 1989

DByrnes:ldt:4967:06-23-89 (WP-VS1-4398B) OFM 3378

**NORTHWEST POWER PLANNING COUNCIL
BUDGET FORMULATION REPORT**

**Submitted to
COMMITTEE ON APPROPRIATIONS
U.S. HOUSE OF REPRESENTATIVES**

**Pursuant to House Report 107-681
ENERGY and WATER DEVELOPMENT
APPROPRIATIONS BILL, 2003**

November 30, 2002

A. The Northwest Power Planning Council

The Council is an agency of the states of Idaho, Montana, Oregon and Washington created in 1980 as an interstate compact agency pursuant to the Pacific Northwest Electric Power Planning and Conservation Act (Act) (Public Law 96-501).

The Act gives the Council three distinct responsibilities: 1) to develop a 20-year plan to assure the region an adequate, efficient, economical and reliable electric power supply; 2) to prepare a program to protect, mitigate and enhance fish and wildlife of the Columbia River Basin that have been affected by the construction and operation of hydropower dams; and 3) to inform the Pacific Northwest public about energy and fish and wildlife issues and involve the public in decision-making.

In 1996, Congress amended the Act. The amendment strengthened the Council's role for ensuring that cost-effectiveness and science-based review are incorporated in the implementation of the Council's Columbia River Basin Fish and Wildlife Program.

The Act also establishes certain oversight requirements, both for the Council and for the Bonneville Power Administration (Bonneville), in matters pertaining to energy resource acquisitions, fish and wildlife program implementation, cost-effective conservation programs and Council budgets.

B. Council funding

The Act provides that the Bonneville Administrator shall pay the Council's expenses from funds available to Bonneville, collected through ratepayer revenues.

The Act provides for Council funding at 0.02 mills multiplied by the kilowatt hours of firm power forecast to be sold by the Administrator in the year to be funded. Upon an annual showing by the Council that such amount will not permit the Council to carry out its responsibilities, the Administrator may raise the multiplier to a maximum of 0.10 mills. Currently, 0.10 mills would result in approximately \$9.7 million.

From Fiscal Year 1985 through Fiscal Year 2002 (17 years), the Council's budget has grown 25 percent, from \$6,738,000 (0.070 mills) to \$8,425,000 (0.090 mills). Cumulative inflation during this same period has been in excess of 65 percent. The Council had 58 full time employees in 1985 and has 53 full time employees in 2002, a reduction of 10 percent. (See Attachment A)

Typically the Council spends 2 percent-4 percent less than it has budgeted and has, in fact, returned over \$3 million in unexpended funds to Bonneville over the last 17 years. The Council's Fiscal Year 2002 budget (approximately \$8.4 million) is equivalent to 0.2 percent of Bonneville's annual budget (approximately \$3.9 billion).

While the General Accounting Office is responsible for auditing the Council's fiscal and program operations, the Council also engages an independent audit firm to conduct annual financial audits.

C. Council/Bonneville agreement on funding requirements

In 1981, the Council entered into a written, administrative procedures agreement with Bonneville for funding the Council's operations. The agreement describes, in a

formal manner, the fiscal relationship between both agencies and, in particular, outlines the requirements for formulation of the Council's budget. A summary of some of the key provisions of the agreement follows:

- a) No later than March 1 of each year, Bonneville shall notify the Council of its latest forecast of firm power sales (including Bonneville's obligation for exchange/purchase sales under sec. 5 (c) of the Act), for the next fiscal year and, preliminarily, for each of the ensuing five fiscal years.
- b) No later than July 1 of each year, the Council will inform and consult with Bonneville on the Council's advance budget and submit a certification that the expenditures are necessary or appropriate for the performance of the Council's functions and responsibilities. The Council will provide additional information when the Council's budget exceeds the 0.02-mill limitation, showing that the additional funding is necessary for the Council to carry out its responsibilities.
- c) The Council reserves the right to testify on its own behalf before the Congressional Appropriations Committees regarding its budget submittal.
- d) Bonneville shall pay the necessary and appropriate Council expenses, authorized by the Act, included in the Council's advance budget and subject to such directives or limitations as may be given by Congress in appropriations acts and other relevant legislation.
- e) Bonneville shall pay additional amounts (above the 0.02-mill limitation) if either agreed to by Bonneville as reflected in Bonneville's budget submittal to Congress, or if specified by congressional directives and limitations.
- f) The Council's advance budget submitted to Bonneville will include such detailed expenditure information as Bonneville specifies is necessary to include in Bonneville's budget transmittal to Congress.
- g) Reimbursement for actual Council expenses incurred will be reimbursed by Bonneville upon receipt of a Financial Summary Statement certified by the Council's certifying officer that its expenditures have been documented and made in accordance with applicable federal laws.
- h) The Council will certify to Bonneville that the Council has an adequate accounting system to facilitate audit of its finances. A copy of each annual independent audit report of the Council, performed by a certified public accountant, shall be made available to Bonneville.
- i) Bonneville shall exercise fiscal oversight as appropriate under the Act.

D. Annual budget formulation process

The first step in the formulation of the Council budget is an internal strategic planning review for the purpose of identifying annual, high-priority goals and objectives. (January)

- This is followed by the development of budget workplans for power planning, fish and wildlife, and public information and involvement functions. Public comment on the draft workplans is invited. (February)

- The Council receives Bonneville's forecast of firm power sales. (March)
- The Council develops its draft budget in preparation for a 60-day public comment period. (April)
- Public comment period, including consultations with Bonneville and other interested parties. (May-June)
- The Council adopts a final budget. (July)
- The Council forwards its adopted budget to Bonneville for inclusion in Bonneville's budget submittal to Congress. (August)

In some years, the Council conducts a modified zero-based budget review of all major expenditure categories in a concerted effort to constrain budget growth and absorb inflationary effects through greater efficiency.

On other occasions (1997 and 2002), the Council entered into negotiated budget limitation agreements with Bonneville. These agreements reflect in part the Council's support of Bonneville cost-cutting initiatives, and in part a compromise between the Council and Bonneville over a disagreement about Bonneville's treatment of residential exchange sales in Bonneville's forecast of firm power sales.

The current four-year agreement with Bonneville limits the Council's budget to \$8.5 million in Fiscal Year 2003/2004 and \$8.7 million in Fiscal Year 2005/2006, as compared to the Council's projected expenditures of \$8.5 million to \$9.2 million during the same period. Such limitation agreements have no material effect on Bonneville's overall revenue requirements but have been useful in the Council's effort to manage its own budget growth and to establish the certainty that a business-like operation requires.

E. Funding instability

Several factors undermine the stability of the Council's funding. Chief among these is the impact of Bonneville's annual forecast of firm power sales. The forecast is an important component of the Council's funding formula, but Bonneville's firm power sales can vary substantially from year to year. This puts the Council's stable funding base at risk. Four issues are significant in this regard:

a) Residential exchange sales/loads (Sec 5 (c))

The most contentious element of the firm power sales forecast is the treatment of the residential exchange. The residential exchange is a provision of the Northwest Power Act designed to share the benefits of the lower-cost power from the Federal Columbia River Power System with the residential and farm customers of the region's investor-owned utilities (IOUs). Under the exchange, the IOUs sell to Bonneville, at their average system cost, an amount of energy equal to their residential and farm loads. Bonneville, in turn, sells the IOUs, at standard Bonneville rates, enough energy to cover these loads. The rate advantages are passed through directly to the IOU customers. This transaction has historically been a financial transfer, not one involving the delivery of any power.

Bonneville and the Council have always taken the position that the residential exchange is appropriately part of the firm power sales forecast, and Bonneville treated it as such for more than 15 years in calculating the Council's budget limit. However, for five-year rate periods beginning in 1997 and again in 2002, Bonneville began to satisfy its exchange obligations by buying out or settling those obligations. As a result, Bonneville elected to exclude such sales from its annual forecast. The Council disagreed with that decision. Regardless of how the exchange obligation is met, whether by delivery of actual power or by a financial transaction, the Council believes that the amount of power forecast to be exchanged is still appropriately part of the firm power sales forecast.

By excluding residential exchange sales from the firm power sales forecast, the Council's funding limitation is reduced by as much as 18 percent for the remainder of the current rate period and then is increased by the same amount at the beginning of the next rate period. This volatility makes it very difficult to budget in a businesslike way (See Attachment B).

b) Load curtailment effect on firm power sales

Another way that firm sales may be significantly reduced occurs when Bonneville takes actions to secure adequate power supply during periods of volatile electricity market pricing, low water years and other conditions affecting the availability of power. Such actions occurred during the energy crisis of 2000-2001. Bonneville negotiated load reductions, bought down irrigation loads, initiated a demand exchange program to promote load switching to nonfederal suppliers and amended customer power sales contracts to allow the use of nonfederal sources to serve load.

Such actions can reduce the Council's funding limitation by as much as 14 percent.

c) Effects of the economy on firm power sales

Electricity-intensive industries, such as aluminum smelting, are proportionately harder hit by increases in electricity costs. Currently, regional electricity loads are down substantially from "normal levels." Depressed aluminum markets and the current economic slowdown have precluded many plants from returning to operation following the 2000-2001 energy crisis. Bonneville's direct service industry (DSI) loads, which include the aluminum industry, typically average approximately 1,450 average megawatts of firm power sales. Currently, these loads represent only 350 average megawatts. Bonneville's firm sales contracts with the DSIs provide for negotiated reductions in sales during periods of economic slowdown.

Economic effect is another weakness in the firm sales component of the funding formula. It has the potential to reduce the funding limitation by as much as 11 percent.

d) Future role of Bonneville and projected firm power sales

Currently, some entities in the region are advocating changes in the future role of Bonneville that would systematically reduce Bonneville's presence in the wholesale

electricity market after most of its existing power sales contracts expire in 2006. These proposals would limit Bonneville's firm power sales to the output of the Federal Columbia River Power System (approximately 6,840 average) under 20-year contracts with Bonneville's customers. This restriction in firm power sales would limit the Council's annual budget to \$5.9 million through the year 2026. This amount could be increased by approximately \$1.9 million (the cash equivalent of 2,200 average megawatts of firm power sales) if Bonneville continues to include residential exchange sales in the Council budget calculation. It is too early to determine if such a proposal will be adopted. However if enacted, it would demonstrate yet again how inappropriate it is to base the Council's funding on Bonneville's annual forecast of firm power sales.

F. Problems with the funding formula

The role of the firm sales forecast in determining the Council's funding base is only one concern. There are other problems with the existing funding formula, as well. These problems, which could not have been anticipated when the Act was written and the funding formula designed some 20 years ago, include:

a) Inflationary effects on the Council budget.

The Act's funding formula has no mechanism to mitigate cumulative inflationary pressures on the Council's expenditures. The Act anticipated that Bonneville would be the primary provider of wholesale electricity in the region. Bonneville's customers would be allowed to place additional loads on Bonneville, and Bonneville was given the authority to acquire new resources to meet that load growth. It was expected that as Bonneville's loads increased, firm power sales would increase and the funding formula would index upward. This would, in turn, help mitigate inflationary effects on Council budgets.

In reality, this anticipated increase in Bonneville loads did not occur. In 1985, Bonneville forecast firm power sales of approximately 10,960 average megawatts; in 2002, the agency forecast sales of 9,401 average megawatts. This can be explained in part by the fact that some Bonneville customers shifted loads to other energy providers in anticipation of lower prices in the deregulated wholesale power market. The decline in sales is also explained in part by the fact that the firm energy load carrying capacity (FELCC) of the hydroelectric system has been reduced by 935 average megawatts because of Endangered Species Act requirements for operating the hydro system to support salmon recovery. In addition, the acquisition of approximately 1,600 average megawatts of cost-effective conservation has deferred some of the anticipated growth in firm power requirements.

Inflation has seriously diminished the Council's independent planning capability. Historically, the Council's staffing capability was augmented by engaging independent contractors who had special analytical expertise that was not cost-effective for the Council to maintain within its own staff.

In 1985, the Council's staffing costs represented 31 percent of the budget, and contract costs were 24 percent of the budget. In 2002, staffing costs were 48 percent of the budget and contract costs are 7 percent of the budget. In addition, the Council has reduced the overall number of its full time employees by approximately 10 percent.

In effect, the Council has had to eliminate its capability to contract for independent analysis in specialized areas in order to absorb inflation and retain most of its core staffing capability (See Attachment C).

b) Council Fish and Wildlife Funding Requirements.

The Council develops and tracks implementation of its fish and wildlife program, which has evolved to one of the leading species recovery efforts in the nation. The Council provides leadership and guidance in the selection, prioritization, funding and scientific review for approximately \$130 million in projects funded annually by Bonneville. In 2002, about 55 percent (\$4,600,000) of the Council's budget supports fish and wildlife planning activities. In 1985, 32 percent (\$2,186,000) of the Council's budget was allocated for fish and wildlife planning. Much of the Council's added fish and wildlife responsibility stems from the 1996 amendment to the Act.

Basing the Council's funding formula only on firm power sales provides no correlation or recognition of that portion of the Council's budget allocated to carry out responsibilities related to fish and wildlife recovery. Indeed, today well over half the Council's budget supports its fish and wildlife planning responsibilities.

If the Council's workload were limited only to power planning, the firm sales forecast might be in some way an appropriate measure of the budget limit. The magnitude of fish and wildlife work the Council does, however, simply shows once again how inappropriate the firm power sales forecast is as a measure of the Council's funding requirements.

c) Acquiring Cost-Effective Energy Conservation Reduces the Council's Budget.

Cost-effective energy conservation is the highest priority resource in the Northwest Power Act to meet future demand for electricity in the Northwest. Ironically, to the extent that the region is successful in acquiring conservation, Bonneville's firm power sales are reduced. This reduction is reflected in the annual forecast of firm power sales, and the Council's funding capability is reduced as a result.

Since 1985, 1,600 average megawatts of cost-effective conservation have been acquired in the region as the result of the Council's planning. The funding formula has no means for taking this into account, either through a form of crediting or some other offsetting mechanism.

Were it not for cost-effective conservation, firm power sales would have increased by approximately 15 percent, thereby providing the Council with additional funding capability but also likely requiring the construction of new power plants. Given the region's disastrous attempt to augment the hydropower supply with major new thermal power plants in the 1970s, it is clear that Congress intended to set a new course for the region in 1980 through the Northwest Power Act. By emphasizing energy conservation in the Power Act, and by creating the Council to guide regional energy planning, Congress intended that the Northwest would use electricity more efficiently -- and use less of it -- over time. But the funding formula in the Act essentially makes the

Council a victim of its own success. The Council should not suffer reduced funding as the result of successfully implementing the Act.

G. Council/Bonneville roles and responsibilities

The Act establishes certain oversight functions for the Council and Bonneville in carrying out their respective responsibilities for energy planning and fish and wildlife recovery. The current funding formula could give rise to conflicts in carrying out those responsibilities.

Bonneville has the authority and opportunity to influence the Council's funding levels. Funding instability can be disadvantageous to the Council's capability to provide high quality, independent analysis on matters of regional importance.

Conversely, the Council has oversight over Bonneville's activities in areas such as acquiring new resources, achieving cost-effective conservation, implementing the Council's fish and wildlife program and ensuring an adequate, economical, reliable and efficient power supply for the region. In some instances the Council might develop analyses that could conflict with Bonneville's preferred policies or practices.

The checks and balances oversight roles between the Council and Bonneville could cause both entities to avoid or minimize conflict in certain situations. However, there is no indication that this potential conflict has been a deliberate consideration on the part of either the Council or Bonneville to influence the other's decision-making capability.

H. Conclusions

1. The treatment of residential exchange sales in Bonneville's forecast of firm energy sales needs to be clarified and resolved so that a more stable funding base can be projected for the Council.
2. The funding formula, applicable to the Council, as set forth in the Northwest Power Act of 1980, is not suitable in today's electricity market conditions and constrains the Council's independent planning capability.
3. The oversight roles of both Bonneville and the Council create the potential for decision and policy-making conflict between each entity.