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Comments of the Northwest Power and Conservation Council on Bonneville's Long-Term Regional Dialogue Policy Proposal

September 14, 2006

The Council commends Bonneville, its customers and other regional stakeholders for their diligence in working together to reach this point in the Regional Dialogue process. The draft policy, while perhaps not reaching consensus on all issues, demonstrates significant progress toward a sustainable vision of Bonneville's future role in the delivery and marketing of the Federal Columbia River Power System (FCRPS). Bringing this process to a successful conclusion will achieve changes recommended in the 1996 Comprehensive Review of the Northwest Energy System that were supported by the Council in their recommendations to Bonneville on the Future Role of the Bonneville Power Administration in Regional Power Supply¹ as incorporated by reference and limited detail in the Council's Fifth Power Plan (Plan).

The policy change envisioned serves to preserve the benefits of the FCRPS by selling low-cost electricity from the existing system under long-term (20-year) contracts to eligible customers. Customers that request more power than Bonneville can provide from the existing federal system will pay the additional cost of providing that service. This policy accomplishes three key goals: (1) it establishes a long-term regional commitment to preserve the benefits of the FCRPS and its historically low costs; (2) it establishes regional responsibilities for meeting future load growth beyond the power capacity of the existing FCRPS; and (3) it provides correct incentives to achieve future regional growth at the "lowest cost possible," as defined in the Northwest Power Act.

The draft policy is consistent with many of the Council's more specific Regional Dialogue goals as stated in the Council's Fifth Power Plan (Plan). These goals include the following:

- Preserve and enhance the benefits of the FCRPS for the Northwest;
- Not increase and, preferably, reduce the risk to the U.S Treasury and taxpayers;
- Achieve an equitable sharing of the benefits of the federal power system;
- Develop and maintain widespread support for the federal system and reduce conflicts within the region;
- Align the costs and benefits of access to federal power;

¹ Northwest Power and Conservation Council. Recommendations on the Future Role of the Bonneville Power Administration in Regional Power Supply. May 2004. Council Document 2004-5.

- Maintain and improve the adequacy and reliability of the Northwest power system;
- Make clear who will be responsible for meeting load growth and on what terms;
- Provide clear signals regarding the value of new energy resources;
- Lessen Bonneville's exposure to market risk;
- Lessen Bonneville's impact on the market;
- Satisfy Bonneville's responsibilities for conservation and renewable resource development;
- Satisfy Bonneville's responsibilities with respect to fish and wildlife; and
- Accomplish all these goals efficiently and at as low as possible a cost to the region's consumers.

The Council recognizes the difficult negotiations and compromises that have been necessary to get to this point in the Regional Dialogue. It is essential that Bonneville stay on task to put a comprehensive policy in place by January, 2007, to define the 7(i) Long-Term Rate Methodology by the fall of 2007, and to complete negotiations and signatures on customer long-term contracts for the post-2011 period by the end of April, 2008. During this time, many details remain to be addressed. It is essential that the region not lose sight of these major goals in its efforts to resolve these details. Specifically, general policy decisions must be addressed in public regional dialogue processes and not through sequestered processes characteristic of rate negotiations and contract agreements. Adoption of currently outlined draft policies will be a landmark in regional energy policy and will fundamentally change the relationship between Bonneville and its customer utilities for the first time since the passage of the 1980 Northwest Power Act.

The Council is pleased that Bonneville has committed to acquiring its share of the conservation and renewable resources in the Council's Power Plan. We urge Bonneville to commit also to consistency with the other resource priorities in the Plan if additional resource acquisition for augmentation or Tier 2 service is necessary. Further, we would like to see a clear Bonneville commitment to implement the Council's Fish and Wildlife Program as part of its stewardship obligations.

The Council has the following comments that are intended to improve the draft policy, provide support for specific policies, clarify and strengthen some of its provisions, and highlight some areas that we think are important to address.

Service to Public Utilities:

The proposal for service to public utilities accomplishes the essential recommendations of the Council Plan. The Council recognizes that most of the provisions contained in this draft policy originated with the Public Power Council proposal and contain various provisions that address equity concerns among the public utility customers of Bonneville. For the most part, the Council accepts such provisions as necessary to achieve the main goals of selling the FCRPS at cost to eligible customers and putting responsibility for new resource decisions, along with the correct incentives to inform those decisions, in the hands of the utilities.

Bonneville should provide solid assurances that any augmentation required to implement the post-2011 contracts is the full extent of augmentation that will be allowed during the contract

period. Bonneville should also recognize that augmentation of the FCRPS is a resource acquisition under the Northwest Power Act and, as such, is required to be consistent with the Council's Plan.

Augmentation, as provided for in three situations in the draft policy, dilutes the value of the system and raises its costs. The Council's preference would be to minimize augmentation, except as necessary to achieve regional consensus. The limits to augmentation in the draft policy are appreciated, but it could still add up to more than 1,100 average megawatts, or 15 percent, to the FCRPS. This could increase the cost of Tier 1 power by more than 10 percent.

The Council supports Bonneville's commitment that, to the greatest extent possible, Tier 2 costs will be completely separated from Tier 1 costs. Tier 2 costs and product offerings should not be structured in a way that uses Bonneville's Tier 1 costs to subsidize Tier 2 products. In general, Bonneville should be encouraged to compete fairly with other entities to provide a variety of Tier 2 products that are consistent with the Council's Plan.

Residential Exchange:

The Council encourages investor-owned utilities and public utilities to reach a financial settlement of their residential exchange rights. The exact form and amount of these settlements is a matter of equity for agreement among utilities and state regulators.

From the historical standpoint of prior Council recommendations to Bonneville, the Council believed the Fiscal Years 2007-2011 Residential Exchange Program (REP) settlement would be a possible starting point for a long-term solution to the residential exchange benefits issue that would provide certainty beyond the current (Fiscal Years 2000-2005) contract period. This settlement proposal included an investor-owned utility benefits formula based on 2,200 average megawatts of benefits multiplied by the difference between a flat market price forecast and Bonneville's Residential Load Firm Power rate, or in certain circumstances, Bonneville's lowest-cost Priority Firm (PF) rate. The proposed settlement also established an investor-owned utility benefit cap of \$300 million per year and a floor of \$100 million per year through Fiscal Year 2011. Most utilities in the region accepted this range of investor-owned utility benefits, but the settlement failed when there was not unanimity among all utilities in accepting the settlement as a whole. In 2004, Bonneville and the investor-owned utilities signed a separate agreement that incorporated the \$100 million - \$300 million residential exchange benefit over the period Fiscal Years 2007-2011.

The currently proposed (2006) Bonneville settlement amount of \$250 million annually is a proposal credited by Bonneville as incorporating a range of assumptions that uses forecast utility average system costs (ASCs) and projected Bonneville costs that are held reasonably to replicate the results of the rate case model for Fiscal Year 2012. Additionally, in the out-years following Fiscal Year 2012, a rate period adjustment is proposed to be implemented that will be "[b]ased on the ratio of changes in a weighted average approximate calculation of investor-owned utility ASCs to changes in a proxy Bonneville Priority Firm (PF) Power rate for a public agency full-requirements customer."

The Council reiterates its position that, in the past, the mechanisms for sharing investor-owned utility residential exchange benefits established in the 1980 Northwest Power Act have satisfied

no one. By the same token, the Council has also stated that it cannot judge what is equitable in the eyes of the parties. In the absence of regional consensus on Bonneville's Long-Term Regional Dialogue Policy Proposal, moving to the "fallback" position, or retrenching in litigation, provides no assurance that new mechanisms designed to define investor-owned utility residential exchange benefits will fare any better than past efforts. The danger then becomes regional efforts to redefine the language in the 1980 Power Act. Attempts to fix these features of the Act through legislative action could have broad regional ramifications. The Council is opposed to such legislative action and again calls on all parties to consider carefully the benefits to be derived from expeditious resolution of investor-owned utility residential exchange issues.

Under current exchange agreements, investor-owned utilities receive a portion (approximately \$10 million annually) of their residential exchange benefits through Bonneville's conservation rate credit program. A financial settlement of the residential exchange should include consideration of the value of this benefit. The Council further notes, if agreement is reached on the exchange, Bonneville should not count the exchange load in computing its share of the region's conservation target, nor should it count savings achieved on those loads toward achievement of its targets. If there is no exchange settlement, Bonneville should count the investor-owned utility exchange loads in computing its share of the region's conservation targets. Bonneville also should count the savings achieved on those loads, through Bonneville funding, toward achievement of those targets.

The Council agrees that both the public residential exchange and billing credits are inconsistent with the basic goals of the Regional Dialogue and, therefore, must be settled for the concept to be viable.

Under the fallback proposal, Bonneville would implement the exchange provisions of the Northwest Power Act and would develop a new average system cost methodology. The Council reminds Bonneville that under Section 5(c)(7)(A) of the Act, Bonneville is to develop the average system cost methodology "in consultation with the Council, the Administrator's customers, and appropriate state regulatory bodies in the region."

Direct Service Industries:

The Council and Bonneville have concluded that benefits for the direct service industries should be considered relative to the employment benefits they may provide to the region. Bonneville has left open the possibility of providing limited physical power to aluminum companies and augmenting the FCRPS to provide that power. The Council's Plan suggested that if physical power were to be provided to direct service industries, it should be for a limited amount and duration. In addition, if physical power were provided, Bonneville should secure interruption rights for purposes of maintaining system reliability and adequacy. This provision was not mentioned in the Regional Dialogue alternative for physical power to the aluminum plants, and it should be added.

Conservation:

The Council supports Bonneville's commitment to meeting its share of the conservation targets in the Council's Plan. The proposal to credit self-funded utility conservation savings between 2007 and 2010 toward their high water marks reduces concerns about conservation disincentives

in the period leading up to the effective date of the post-2011 contracts. The Council strongly supports the provision that credited conservation be cost-effective and verified. The Council recommends that Bonneville use the Regional Technical Forum to verify independently the amount and cost-effectiveness of savings from self-funded utility conservation.

The proposal should clarify that savings from Northwest Energy Efficiency Alliance programs that are allocated to individual utilities and savings achieved through the conservation rate credit program between now and 2010 will be treated as self-funded conservation and credited fully to the utilities' high water mark. In addition, incentives paid by utilities above the amount reimbursed by Bonneville in order to acquire conservation should be counted as self-funded conservation. Bonneville's proposal to share 50 percent of the conservation savings it funds with its customer utilities does not provide an incentive for utilities to share in more than 50 percent of the cost of acquiring conservation. In fact, it may discourage any incremental investment by utilities, because utilities can secure 50 percent of the savings without any cost-sharing. Bonneville should credit utilities' high water marks with a 75 percent or higher fraction of savings achieved through Bonneville's funding because it will provide stronger incentives for utilities to participate in Bonneville conservation programs.

The Council shares Bonneville's view that exposure of utilities to Tier 2 costs will greatly enhance the incentive to acquire increased energy efficiency. We support offering a variety of conservation programs and recovering their cost from Tier 1. We believe Bonneville's focus in conservation programs should remain in Tier 1 because improved efficiency extends the capability of the FCRPS, and because the cost-effective efficiency measures in the Council's Plan are based on the equivalent of avoided Tier 2 costs.

Renewable Resources:

The Council supports Bonneville's proposal to acquire its share of renewable resources called for in the Council's Plan. We agree that the \$21 million cap should be reviewed each rate period. The cap should be adjusted as necessary, based on Bonneville's success in reaching its share of the Council's renewable resource goals. Bonneville should consider the potential effects of state renewable portfolio standards on utilities' ability to access their high water marks. The list of proposed activities promoting renewable resources under Tier 1 seems reasonable. We support preserving the possibility of optioning or purchasing renewable resources ahead of need, if significant economies result and if appropriate acquisition strategies are developed.

The Council believes that it is important to confirm the region's ability to integrate the amount of wind in the Council's Plan into the Northwest's power system. Given the popularity of renewable portfolio standards, it may be necessary to integrate even more wind than what is included in the Council's Plan. Bonneville should continue to aggressively develop and market renewable integration services. The Council will continue to work with Bonneville to develop and implement a Regional Wind Integration Action Plan to help identify ways to maximize cost-effective regional integration capability.

Resource Adequacy:

The Council agrees that the Resource Adequacy Forum has made good progress in developing energy and capacity measures and the standards and procedures for implementing them. It is

important that regional utilities provide accurate data on their loads and resources, and the Council supports including provisions in the contracts to require such reporting.

The forum has generally agreed to a regional implementation plan that addresses the issues raised in the Phase I implementation description. The Regional Dialogue proposal notes two items for Phase II of implementation. The forum has not yet addressed the first of these items, developing procedures or guidelines for translating regional energy and capacity standards to individual utilities, but intends to do so in the fall. The second item, creating incentives for developing adequate resources beyond those necessary for purely physical adequacy, is not a part of the forum's current implementation plan. The Council recommends that Bonneville update this part of the proposal to include the current implementation plan, which we expect will be brought before the Council for public release in September, and adopted by the Council after public comment in November.

Cost Control and Dispute Resolution:

The Council supports Bonneville's efforts to provide opportunities for their customer utilities, stakeholders, and the public to help control costs and to resolve disputes. Utilities that are making a 20-year commitment to Bonneville need to have some assurance that the cost of power will remain competitive and that their concerns about implementation and interpretation of the contracts can be heard. The Council believes the draft policy reflects a good faith effort by Bonneville to inclusively seek customer and stakeholder input while preserving the responsibility for the administrator to make budget decisions.

Long-Term Contracts:

The Council finds that the contract proposal substantially meets the recommendation in the Council's Plan for long-term contracts to secure the benefits of, and ensure cost recovery for, the FCRPS.

Fallback Policy Proposal in the Absence of Regional Consensus:

The premise for Bonneville's incorporation of this section in the Long-Term Regional Dialogue Policy Proposal is that the region failed to achieve consensus to such an extent that effective implementation of outstanding key policy proposals is not possible. This situation would highlight a Council concern expressed briefly in the Council's Plan, and more completely in the Council's 2004 recommendation to Bonneville on the future role of Bonneville (Council Document 2004-05). The Council expressed concern that the policy process undertaken by Bonneville would not provide the durability necessary to meet expectations for long-term contract negotiations and associated rate processes, and the region's expectation for conservation and renewable resource development.

The Council further noted that if this process proves incapable of resolving issues within the established schedule, Bonneville and the Council should first determine if substantive (administrative) rulemaking could be a vehicle for resolving outstanding issues. If rule-making is considered inappropriate, Bonneville and the Council should work together to identify specific

legislation and seek comments from the public. Legislation should not be considered if there is not broad regional support, including consensus among the region's governors.²

The Council encourages Bonneville and the utilities to reach agreement on remaining items of disagreement. The basic objectives are more important than many of the details that have the potential for stalling progress on the policy.

President's Budget Proposal:

The relationship of this proposal to the regional dialogue contracts is not clear. The budget proposal was an unexpected addition to the draft policy. The proposal would devote secondary revenues greater than \$500 million in any one year to early repayment of Bonneville's treasury debt. The Council is on record opposing the proposal because of its potential adverse effects on Bonneville's rates and on the regional economy.³ Bonneville has voluntarily made early payments on its debt as part of an integrated business plan for coordinating financial reserves, power rates, and treasury repayment.

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² Northwest Power and Conservation Council. The Fifth Northwest Electric Power and Conservation Plan. May 2005. Page 11-5.

³ Northwest Power and Conservation Council. Preliminary Staff Analysis: Proposed Application of BPA's Secondary Revenues for Advanced Federal Debt Payments as Proposed in the President's Fiscal Year 2007 Budget. February 8, 2006. http://www.nwcouncil.org/library/releases/2006/bpa_analysis.pdf