

INFORMAL COMMENTS OF THE WESTERN PUBLIC AGENCIES GROUP
IN RESPONSE TO THE DRAFT TIERED RATE METHODOLOGY PAPER

Introduction and Scope of Informal Comments

These informal comments are submitted by the utilities of the Western Public Agencies Group (WPAG) in response to the draft Tiered Rate Methodology (TRM) discussion paper (TRM Draft) released by BPA. The purpose of the TRM Draft was to initiate the discussion of the many complex issues presented by the implementation of tiered rates. As a consequence, comments such as these are informal in nature and will not be included in the formal record that may be compiled on the TRM. Any positions taken in these comments are not binding on the parties submitting them, and failure to comment on any aspect of the TRM Draft does not and will not be treated as agreement thereto.

The utilities that comprise the WPAG appreciate the effort that went into the TRM Draft, as well as the opportunity to provide informal comments on its structure and contents. It is only through such a collaborative effort that the difficult issues presented by the implementation of tiered rates can be resolved to the satisfaction of both BPA and its preference customers. And without such mutually acceptable resolutions, tiered rates will not be capable of successful implementation.

These comments are presented in three sections. The first will address major themes or elements of the TRM Draft that are overarching in nature, and which require additional evaluation and revision. The second will address gaps or omissions in the TRM Draft that will need to be included in subsequent drafts. The third will provide feedback on specific issues or approaches contained in the TRM Draft that the WPAG utilities feel are in error, or are not likely to work well.

Given the short time period available to review, understand and evaluate the TRM Draft, these comments should not be considered complete in any sense of that word, but rather a first cut at comments that are intended to improve the next draft of the TRM.

1. Major Themes of the TRM Draft That Should Be Evaluated

Tiered rates have been promoted as a means of accomplishing a variety of objectives over the past few years. Two of the primary objectives were to promote the development of non-federal resources to serve preference customer load growth, and to provide preference customers certainty that they would be getting all of the power supply that the Federal base system is capable of providing at the costs of those resources. Based on the content of the TRM Draft, it does not appear that this document is designed to optimize the achievement of these two goals.

Non-Federal Resource Development – The timing and duration of the load growth resource decisions, combined with the relative inflexibility in the way that non-federal resources can be deployed to load, are major impediments to non-federal resource development. Additionally, BPA has reserved the right to change the TRM, and the TRM appears to permit tier 2 costs to be shifted to tier 1 with relative ease. All of these factors when taken together tend to make the substantial capital commitment required to develop a non-federal resource look like a relatively unattractive option. Both the TRM, the tier 1 rate design and the products must be gone through with the objective of structuring them so they promote, rather than discourage, the development of non-federal resources.

Cost/Price Surety – Cost and price surety are provided by a rate design that is stable over time, tier 1/tier 2 cost segregation that is certain, and a TRM that is enforceable by customers even when BPA is being pressured to diverge from it. These three items have not been fully achieved in the TRM Draft. And one of them, TRM enforceability, has not yet received serious and sustained attention. All three of these objectives must be achieved if tiered rates are to offer any benefit to preference customers compared to the current approach.

The TRM Draft evidences a clear intention by BPA to materially alter the business paradigm between BPA and its preference customers. However, the successful implementation of tiered rates requires not only a change to the way preference customers do business with BPA, but it also requires fundamental change to the way BPA conducts its own business. In other words, tiered rates will require not only preference customers but also BPA to fundamentally alter the way it does business. For example, BPA should be willing to take on some financial and operational risk in order to provide preference utilities that actually develop new resources more operational flexibility so they can benefit from the investment of their customers' money. Other examples could include BPA eliminating the prohibition the use of non-federal resources to serve load growth under the Shared Rate Plan, and the unnecessary limitations on the Renewable Vintage Tier 2. Without such a paradigm shift for both BPA and its preference customers, tiered rates will only be a more complicated and less certain way to buy power from BPA.

2. Gaps or Omissions in the TRM Draft

The following gaps or omissions in the TRM Draft are *not* presented in their order of importance.

- a. TRM Should Be Directive – The text of the TRM Draft is description in tone and nature, which is appropriate for a working draft. However, this is the document that will deliver on the promised benefits of tiered rates, including delivery of power at the cost of the FBS for tier 1 service, and the exclusion of tier 2 costs from tier 1 rates among others. As a consequence, it will be essential that subsequent drafts of the TRM be written in a directive and prescriptive manner, so that it is clear what the respective obligations of BPA and the preference customers are under the TRM.

- b. Products Catalogue – At the current time, the product catalogue that will describe in detail the products that will be offered is not available. A complete product catalogue is essential to constructing a TRM that will operate successfully and permit preference customers to conduct business under the tiered rates construct. This is because the TRM and the products must operate together to create a coherent business environment.
- c. Timeline for Decisions – As currently envisioned by BPA, the tiered rate construct requires preference customers to make power supply decisions that are both long-term in nature, and made well before they take effect. These decisions have material cost implications for the retail end-users of these preference customers. These decisions require substantial amounts of information that may, and in some cases will, change from rate period to rate period. This information includes the capability of the tier 1 resources, changes to the contract high water mark (CHWM), the rate period high water mark (RHWM), and the net requirement for each preference customer among other matters. The TRM should contain a timeline that lays when each of these pieces of information will be available, and overlay onto that the points in time when customers will be required to make decisions regarding how they will provide service to load in excess of tier 1.
- d. Dispute Resolution Process – Many of the pieces of information crucial to preference customer decision making regarding power supply for load growth, such as the CHWM, RHWM and net requirement, are susceptible to good faith disputes. It is expected that the method(s) for the resolution of such disputes will be matters of contract. However, the timing of such dispute resolution processes must be integrated into the decision timeline set out in 2(c).
- e. Decision Processes – Information regarding the capability of the tier 1 resources, changes to the CHWM, the level of the RHWM and the determination net requirement for each preference customer will be determined in various processes. As part of constructing the TRM, the process that will be used to determine each of these important matters, the rules that will govern these processes and where all of these will be codified (contract, TRM, other) must be discussed and determined.
- f. Resource Acquisition Decisions – BPA will be making resource acquisitions to augment the capability of the Federal base system, and preference customers will be relying upon and paying for these resources. The TRM should describe in some detail the decision process that BPA will engage in to determine what resources it will acquire for augmentation purposes, and how the preference customers who will pay the bill will be involved in making these decisions.

- g. Lock Down – Preference customers are being asked to make substantial long-term resource decisions each rate period based on the CHWM, the tier 1 resource capability, their individual RHWM and net requirement. The TRM should articulate when each of these elements will be finalized and not subject to change (locked down) in the 7(i) rate process.
- h. Cost Recovery/Costing Table – The ability of preference customers to rely on the assurance that tiered rates will successfully insulate tier 1 power costs from tier 2 costs will hinge on the rules that will govern BPA’s ability to place tier 2 costs into tier 1, and its ability to alter over time the tier 1 costing table. The development of the TRM should include a discussion regarding that rules and processes that will govern such matters, and the place (contract, TRM, other) where such rules and processes will be codified.
- i. Cost Shifts Between Tier 2 Products – There is concern that costs may be shifted among tier 2 products offered by BPA. The TRM should clearly articulate the safeguards that BPA intends to put in place to ensure that there are no cost shifts between tier 2 products that it may offer.
- j. PF Exchange Rate – There is little question there will be a Residential Exchange Program (REP) in place during the term of the new contracts. The level of REP costs paid by and to preference customers will be governed, in part, by the manner in which the PF Exchange Rate is constructed. The design of this rate must be set out in the TRM, and it must be clearly establish the right of preference customers with existing resources to be eligible for and participate in the REP unless mutually agreeable buyouts can be arranged.
- k. Capacity Augmentation – From time to time BPA has indicated that it believes that the Federal base system may need to be augmented by capacity resources to fulfill all of its obligations. While energy augmentation is discussed in detail in a variety of Regional Dialogue documents, including the TRM Draft, there is no comparable discussion of capacity augmentation. The TRM will need to address the process of deciding if capacity augmentation is needed, how and when this will be done, and how the costs of capacity augmentation will be allocated.
- l. System Obligations – The TRM Draft suggests that existing system obligations will be an “off the top” reduction to the tier 1 system, and that future system obligations may further reduce the capability of the tier 1 system. The treatment of current system obligations is discussed in section 3 below. However, the TRM development must include a discussion of the process for and the rules that will govern how and when future BPA obligations are

denominated as system obligations that are “off the top”, and thereby reduce the tier 1 system capability.

- m. Rate Case Exclusions – In the last two power rate cases, BPA has taken the position that it can preclude preference customers from submitting testimony on a topic by including in the Federal Register Notice commencing the rate case a list of topics on which it will not permit testimony during the rate proceeding. It is also clear that BPA currently intends to resolve many issues vital to preference customers under the tiered rate construct in the rate case process. This makes it imperative that BPA find a binding and enforceable way to limit the use of its claimed right to unilaterally restrict testimony that preference customers can submit in rate proceedings. Otherwise, preference customers will have no assurance that they will be able to contest tiered rate issues consigned to the rate process.

3. Comments on Specific Issues

The issues discussed in this section are matters that need reconsideration because they appear to be wrongly decided.

- a. DSI Resource Placement – BPA has indicated that the decision as to whether to provide service to the DSIs has not yet been decided, and no comment is offered on that matter in this context. However, the suggestion that if such service is provided, the resources acquired to do so will be included in tier 1 as Federal base system resources to protect tier 1 purchasers is highly objectionable. Treating these resources in this manner means that tier 1 preference customers will again be asked to subsidize the operation of the DSIs. The full costs of any resources acquired to serve the DSIs should be charged to them, and these resources should not be included in the tier 1 system.
- b. Tier 1 Rate Design – During the Regional Dialogue workshops, BPA committed to the proposition that if the preference customers could come up with a rate design which they could agree upon, BPA would implement it. The tier 1 rate design contained in the TRM Draft does not comport with the rate design upon which the preference customers agreed. It contains the following elements that differ from the preference customer recommended tier 1 rate design:
 - i. Load Following Charge - It contains a load following charge that was not discussed or agreed to, and which appears to charge preference customers twice for the same product, once through the capacity charge and again through the load following charge.

- ii. Shaped Demand Charge - The marginal demand charge is not flat, but is shaped to the months apparently based on the variation in the market price of energy. It was a crucial element of the preference customer consensus that the marginal demand charge be flat in all months. Shaping the marginal demand charge accentuates the problems caused by BPA's unwillingness to permit preference customers to respond to changes between months in the peaks on BPA. Under this approach, BPA is sending a price signal and forbidding customers to respond to it.
- iii. Grandfathered Demand – BPA is using actual loads in 2010 to establish tier 1 energy rights. However, it is proposing to use the average of 2005-2007 peak loads, and to reduce this average by ten percent, to establish tier 1 capacity rights. The use of old peak data and a ten percent reduction is a double hit to smaller utilities that cannot manage their peak on BPA, and will be especially difficult for utilities with large residential load sectors to respond to over time. This use of this combination of old peak load data and a ten percent reduction is unnecessary to accomplish BPA's goal of ensuring that some customers face the marginal price of capacity in year one of tiered rates.

BPA should stick to its commitment to public power, and incorporate into the TRM the consensus rate design recommendations provided by public power.

- c. Demand Billing Determinant and Product Flexibility – During the Regional Dialogue workshop process, BPA made a number of modifications to the load following product to permit customers a modest ability to respond to the demand price signals in the proposed tier 1 rate design. These changes did not include any ability to respond the shifts in peak loads between months. In the name of simplification, BPA has severely limited the ability of preference customers to respond to the demand price signal it is taking such pains to construct. Although the product catalogue for load following products is not available, it appears that the demand billing determinant in the tier 1 rate design may not be compatible with the modest flexibility BPA agreed to include in the load following product. This is one example of how important it is that the TRM and the products be carefully scrutinized to ensure that they work together successfully. In this case it appears that they do not.
- d. System Obligations – The TRM Draft contains a list of obligations which it suggests are “off the top” obligations that will decrease the size of the tier 1 system. Most of these are existing obligations for which BPA has an established treatment. Some of these are unremarkable, such as the requirements of fish obligations, and continue to be treated in

the same manner as presently. Others, however, must be re-evaluated in light of how they impact preference customers under tiered rates. For example, providing services to non-preference customers from the Federal base system, decrementing the available tier 1 system for such services, and providing the preference customers the revenues from such services may no longer be an appropriate approach, since the revenues so provided may not be sufficient to cover the cost incurred by preference customers to replace the lost tier 1 resource. The propriety of treating these obligations as “off the top” must be reconsidered.

- e. Tier 2 Administrative Charge – The administrative charge for providing tier 2 service appears to be based on a good-faith guesstimate of the costs incurred by BPA to provide these services. To the extent that this charge fails to collect all of the costs of providing these services, it will shift costs inappropriately to tier 1. A more rigorous method must be established to determine the costs providing tier 2 services imposes on BPA, so that they can be collected from the proper customers.
- f. Allocation Principles – The TRM Draft states six principles that are ostensibly intended to govern the allocation of costs to and between tier 1 and tier 2. These principles are so general that they provide little or no cost protection to tier 1. And some of them are inimical to the separation of tier 1 and tier 2 costs, and to the idea that the TRM will provide long-term cost and rate design certainty to preference customers (Principle #4).
- g. Augmentation Before Need – The TRM Draft proposes that BPA will likely acquire tier 1 augmentation resources in advance of need, and suggests certain limits on its ability to do so. The propriety of such advance resource acquisitions, including need, timing, costs and decision process need a thorough examination. Although this may be a plausible cost reduction strategy, whether it should be routinely engaged in is open to question.
- h. Net Requirement Determination – It appears that BPA is thinking about using an annual net requirement that is made each year, even though it is asking preference customers to make multi-year (longer than rate period) commitments to BPA and non-federal resources. This places an unnecessary and unreasonable risk on preference customers. The period for which the net requirement determination is made should sync up with the resource commitment and relevant rate period. The net requirement determination period should extend from the point in time that preference customers are required to make resource commitments until the end of the next rate period.
- i. Low Density Discount – The TRM Draft indicates that the low density discount (LDD) as provided for in the Regional Power Act will be offered under tiered rates. However, it is suggested that LDD discounts will be limited to tier 1 purchases, and will not apply to

tier 2 purchases. Further, such discounts on tier 1 purchases will be inflated to mimic the discount that would have been available under melded rates. Under this approach, a utility that provides for all of its load growth from non-federal resources will receive LDD benefits for its non-federal power purchases indirectly by receiving artificially inflated tier 1 LDD discounts. Providing LLD benefits to customers as if they were purchasing power from BPA when they are not doing so is contrary to the statute that established the LDD. That statute authorizes BPA to provide discounts to the power purchased from BPA. It does not authorize BPA to provide such a discount when the customer elects to rely on non-federal resources, rather than BPA, for its power supply. BPA should not stretch the meaning of the statute to promote its own policy goals. The LLD should be applicable to rates under which preference customers buy power from BPA, and such discounts should not be artificially inflated to provide benefits for load served by non-federal resources.