

**Proposed Contract With Transfer Service Customers
Regarding the Initial Rate Treatment of Certain Transfer Service Costs
And Other Issues Related To Transfer Service**

Administrator's Record Of Decision

**Bonneville Power Administration
U.S. Department of Energy**

December 22, 2004

INTRODUCTION

This Record of Decision (ROD) addresses the comments and issues raised with respect to BPA's proposal to offer contracts to all its power customers that take delivery of federal power over third party transmission systems (Transfer Service). The purpose of the proposed contract is to provide a degree of certainty regarding future rate proposal treatment of Transfer Service costs to BPA's Transfer Service customers. This ROD is a determination to offer the proposed contract to the individual Transfer Service customers unsigned, which will be followed by a decision by BPA to sign the contracts if the Administrator determines a sufficient number of Transfer Service customers have returned signed contracts.

The proposed contract requires BPA to (1) continue to arrange for Transfer Service with the third party transmission owners; (2) continue to be financially responsible for specified costs of Transfer Service; and (3) propose in its initial rate proposal to continue rolling in specified costs of Transfer Service into either power or transmission rates or partly into each. The term of the proposed contract is 20 years. The proposed contract requires the Transfer Service customers to work with BPA to reasonably minimize the cost of Transfer Service. The proposed contract also describes the intent of the parties to address other Transfer Service issues in the future.

This ROD provides a background description of (1) the history of Transfer Service; (2) past rate treatment of Transfer Service costs; (3) Transfer Service customers' concerns that led up to the development of the proposed contract; (4) the process engaged to develop the proposed contract; and (5) the plan for submitting the proposed contract to Transfer Service customers unsigned. This ROD also contains a detailed description of the terms of the proposed contract. Finally, this ROD addresses comments that were received when the proposed contract was posted for comment.

BACKGROUND

A. Description of Transfer Service and the History of BPA's Involvement

BPA has an obligation to sell federal power to preference customers in the Pacific Northwest whenever the preference customers request federal power to serve load. Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act) 16 U.S.C. §839c(b)(1). BPA's transmission system was built to deliver federal power from the federal resources to the region's loads, but at the same time several other public, cooperative, and investor owned utilities were building or had already built transmission facilities in the region. In many cases it was more efficient to contract with one of these other transmission owners to deliver federal power over their facilities, rather than BPA building duplicate facilities.

The number of these contractual arrangements grew as BPA sold power to additional preference customers around the region. In 1974 the Federal Columbia River Transmission System Act (Transmission Act) limited BPA's ability to build major transmission facilities or condemn existing facilities in the region, without specific authorization by an act of Congress. 16 U.S.C. §§838b(d) and 838c. This Act and the common practice of not duplicating existing facilities

encouraged the use of Transfer Service. Currently, BPA has 79 preference customers that receive all or part of their federal power deliveries over Transfer Service.

BPA contracts for Transfer Service with all six investor owned utilities in the region and several public utilities and cooperatives. Many of these contractual arrangements have been in place, in one form or another, for several decades. Some are simple transmission agreements, while others are complex agreements such as the PacifiCorp Exchange Agreement providing for both transmission and power exchange services and Transfer Agreements. As these contractual arrangements terminate, they are usually replaced by Open Access Transmission Tariff (OATT) Service Agreements.¹

B. Past Rate Treatment of Transfer Service Costs

Prior to deregulation developments in the mid 1990's, power and transmission services were sold as a bundled product. BPA had historically rolled a component of Transfer Service costs into the revenue requirement for its bundled power rates. These costs have never been directly assigned to the individual Transfer Service customers or the Transfer Service customers as a group.² The 1996 rate case resulted in a settlement that assigned Transfer Service costs to be rolled into the unbundled power rates. In the Subscription ROD process it was determined that the initial proposal for the 2002 Wholesale Power Rate Case would roll a component of the cost of Transfer Service into power rates through 2006.

C. Transfer Service Customer Concerns

The rate treatment of Transfer Service costs has historically been an important issue for Transfer Service customers in BPA rate proceedings. The Transfer Service customers have been concerned that, if BPA were to directly assign the cost of Transfer Services to Transfer Service customers, it would have a devastating effect on their economic health. For many of the smaller Transfer Service customers, BPA's role as the middleman in arranging the Transfer Service is crucial to the quality of service they receive from the third party transmission owner.

To ensure that BPA would continue its historic practices, the Transfer Service customers have requested in various forums that BPA make a long-term commitment to roll-in Transfer Service costs. This concern was stated in a policy position paper sent to the Administrator from the Public Power Council Executive Committee dated May 20, 2003. The policy position paper addressed several Transfer Service issues including, access, cost recovery, cost evaluation, quality of service, cost due to RTO formation, non-federal deliveries, rate treatment, and direct assignment. The policy position paper also requested that resolution of these issues be memorialized in a 20-year agreement. In March of 2004, the Idaho Consumer-Owned Utilities Association prepared a cost benefit study on the value of Transfer Service to the region. While BPA expresses no opinion on the study or its results, the study compared Transfer Service to the

¹ OATT service is currently taken from Puget Sound Energy and Idaho Power for all BPA customers located in their control areas, and from PacifiCorp and Portland General Electric for a limited number of the customers in their control areas.

² Some of the cost, such as low voltage delivery service, is broken out and passed on directly to the Transfer Service customers.

potential cost if BPA had built the necessary transmission to directly connect all preference customers and concluded that Transfer Service provided a great benefit to the region. The study requested that BPA acknowledge these benefits by providing assurance that Transfer Service customers would receive treatment comparable to directly connected customers.

The Transfer Service customers have expressed concerns over several aspects of Transfer Service, but the most prevalent concern has been the future rate treatment of Transfer Service costs. The Transfer Service customers have suggested that these costs should be rolled into transmission rates, because they view Transfer Service as a substitute for BPA having built transmission facilities to serve their loads. Notwithstanding where these costs are collected, the Transfer Service customers want assurance that the costs will not be directly assigned to individual customers or to Transfer Service customers as a class.

D. Process Engaged to Develop the Proposed Contract

BPA staff met with Transfer Service customer representatives in October 2003 to discuss these concerns. Through a series of follow-on meetings, BPA committed to work with the Transfer Service customer representatives to provide some assurances regarding the future treatment of Transfer Service costs. In March 2004, BPA staff began holding regular meetings with the Transfer Service customer representatives to determine the appropriate format and scope for the assurance. The Transfer Service customer representatives were steadfast in their desire that BPA commit to this assurance in a long-term contract.

BPA staff and the Transfer Service customer representatives continued to meet from March through August 2004 to work on the terms of the proposed contract. BPA staff wanted to ensure that a long-term contract would not infringe upon the Administrator's discretion regarding Transfer Service policy decisions. Based on these concerns, Transfer Service issues were segregated into primary issues that are addressed in the proposed contract and secondary issues that will be addressed in other BPA processes.

In August 2004, the discussions with the Transfer Service customer representatives were concluded and the resulting proposed contract was posted for comment. A letter describing the proposed contract and soliciting comments was sent to BPA customers and regional stakeholders on August 27, 2004. The comment period was originally open from September 1, 2004 to September 30, 2004, but it was later extended to October 19, 2004. BPA received 37 comments, and the proposed contract has been modified slightly based on some of these comments.

E. Plan for Submitting the Proposed Contract to Transfer Service Customers

The proposed contract would obligate BPA to propose rolled-in rate treatment in the initial rate proposal for the transmission component of Transfer Service cost in future rate proceedings for the next 20 years. Because it would be difficult to meet the terms of the proposed contract for some of the Transfer Service customers and not others, the proposed contract will be presented to each of the 79 Transfer Service customers unsigned. For this reason, the contract is not open to modification by individual customers. The customers will have until March 31, 2005, to return the signed contracts to BPA. At that time, BPA will counter-sign the proposed contract if the

Administrator determines that a sufficient number of the Transfer Service customers have returned a signed agreement. By following this procedure, BPA will not be bound by the terms of the proposed contract until it is clear that a sufficient number of Transfer Service customers have signed the agreement.

TERMS OF THE PROPOSED CONTRACT

A. Overview of the Proposed Contract

The proposed contract is composed of four interrelated commitments by BPA and the Transfer Service customer regarding Transfer Service for the next 20 years. In general, the proposed contract is intended to continue certain practices that BPA has traditionally provided to customers for federal power delivered by Transfer Service. First, sections 3 and 4 describe BPA's commitment to provide the Transfer Service customer with long-term certainty regarding BPA's role in arranging for service over third-party systems (section 3); BPA's obligation to pay for certain aspects of Transfer Service (section 4(a)); and BPA's intent to initially propose rolled-in rate treatment for certain Transfer Service costs (sections 4(b)-(d)). Second, sections 5 and 6 outline the Transfer Service customer's commitment to work with BPA to help minimize Transfer Service costs, and to take responsibility for certain costs in the event the Transfer Service customer takes actions that expose BPA to stranded costs. Third, section 7 describes BPA's commitment to address additional Transfer Service issues in future processes. Fourth, sections 8 and 9 express BPA's intent to allocate to the Transfer Service customers yet unidentified costs, certain facility upgrade costs, and costs associated with real power losses in a manner comparable to the practice BPA adopts for its directly connected customers. Finally, section 10 states that expressions of intent, such as those in section 7, are not legally binding on BPA.

B. Contract Provisions

1. Term and Definitions (Sections 1 and 2)

(i) Proposed Section 1

The proposed contract is between BPA and the signing Transfer Service customer. The term for the proposed contract is 20 years, and will expire September 30, 2024, or when the Transfer Service customer's Power Sales Contract expires without replacement. The parties intended that the obligations in the proposed contract exist independent of any similar obligations that may exist in a Power Sales Contract between BPA and the Transfer Service customer.

(ii) Proposed Section 2

The definition section describes several key components of the proposed contract. First, the definition of "Firm Power" makes clear that BPA obligations under the proposed contract only extends to firm federal power being used to serve a Transfer Service customer's load. Specifically excluded from this definition are non-federal and surplus federal power deliveries.

Section 2 also defines “Integrated Network Segment.” This is intended to mean the facilities that BPA includes as part of its Network Segmentation Study prepared in a transmission rate case.

The term “Rolled In” means a rate methodology in which costs are not directly assigned to a specific customer or to a subgroup of applicable customers. This provision also contains a specific definition for “Rolled In” for transmission and power rates. In the event BPA were to propose tiered power rates, this provision would not preclude BPA from proposing to allocate costs to whatever tier or tiers BPA determined appropriate.

“Transfer Service,” as the proposed contract describes, means all of the services provided by a third-party provider to deliver federal power to the customer. It does not include service to loads that have been annexed by the customer, except as provided for in the Power Sales Contract.

“Transmission Component Costs” means the costs for transmission services over facilities that have characteristics comparable to the facilities BPA includes as part of its Integrated Network Segment. The intent of this provision is to identify costs BPA is committing to roll-in, which is dependent on the costs associated with similar service provided over BPA’s transmission system.

2. BPA’s Commitment To Arrange For Transfer Service (Section 3)

Section 3 of the proposed contract continues BPA’s current practice of arranging for all of the services necessary to deliver federal power over a third-party’s transmission system to the Transfer Service customer. This would generally include deliveries over high and low voltage transmission facilities, ancillary services, and like services. BPA would in most cases be the party holding the respective contracts for these services with the third-party transmission provider, although the proposed contract allows for the Transfer Service customer to obtain these services if mutually agreed between BPA and the customer. By agreeing to arrange for these services, however, BPA is not committing to pay for all of the costs involved to provide the services. Rather, BPA’s obligation to pay for and roll-in Transfer Service costs are described in section 4.

3. BPA’s Commitment to Pay For the Transmission Component Costs of Transfer Service and the Initial Rate Proposal For Rolled In Rate Treatment (Section 4)

Section 4 describes BPA’s commitment to pay for certain Transfer Service costs and to initially propose to roll such costs into a revenue requirement. Section 4(a) provides that BPA will pay for the “Transmission Component Costs” of the Transfer Service obtained over the third-party transmission provider’s system. The “Transmission Component Costs”, as discussed above, means the costs of transmitting federal power over third-party facilities that have characteristics that are comparable to the facilities that BPA includes in its Integrated Network Segment. The intent of referring to the Integrated Network Segment in this provision is to provide a “measure” by which to determine the treatment of costs over third-party facilities. For purposes of allocation of costs between the Transfer Service customer and BPA, the third-party facilities are compared with BPA’s facilities. If the third-party facilities have characteristics that are similar to the characteristics of facilities that BPA includes as part of its Integrated Network Segment, then the costs would be included as part of the costs BPA proposes to roll into its initial rate

proposal. Conversely, if the third-party facilities have characteristics that are not like facilities that are included as part of the Integrated Network Segment, then BPA does not have an obligation to propose rolled-in treatment.

To recover the costs BPA incurs as described in section 4(a), BPA commits in section 4(b) to propose in an initial rate proposal to roll the costs into an applicable revenue requirement, or partly into one business line's revenue requirement and the rest into the other business line's revenue requirement. The term "Rolled In" is a defined term in the proposed contract, and contains a specific meaning for the Power and Transmission business lines. The proposed contract is silent on which business line must bear the costs, and therefore, BPA retains the discretion to decide which revenue requirement will contain the costs and whether a portion might be allocated to each business line so long as the total is rolled in. It does not require BPA to change its current approach to how these costs are allocated. In addition, the proposed contract only obligates BPA to propose rolled-in treatment of the costs in the initial rate proposal. Section 4(c) specifically preserves the Administrator's discretion in establishing rates based on the record material in the rate case proceeding.

Finally, section 4(d) describes BPA's commitment to initially proposing "Rolled In" treatment of the Transmission Component Costs into one of the business line's rates in the event a court or FERC rejects the proposed rate treatment. For example, as described in section 4(d)(1), if a court or FERC rejects BPA's decision to roll-in the costs in the wholesale power rates, then BPA would have an obligation to propose to roll-in the costs in the transmission initial rate proposal. If a court or FERC rejects the rolled-in rate treatment for both power and transmission rates, then, in accordance with section 4(e), BPA would no longer have an obligation to propose rolled-in treatment of the Transmission Component Costs.

4. Transfer Service Customer's Commitments (Sections 5 and 6)

(i) Proposed Section 5

Section 5 describes the Transfer Service customer's commitment to work with BPA to reduce the costs of Transfer Service, and provide certain information to support BPA in its effort to implement the proposed contract. Specifically, section 5(a) requires that the Transfer Service customer cooperate with BPA to help identify areas in which Transfer Service costs may be reduced. In addition, pursuant to section 5(b), the Transfer Service customer must provide, or cause to be provided, timely information related to the customer's long-term annual peak and energy load forecasts, including system expansions and upgrades. The Transfer Service customer also agrees in section 5(c) to provide timely notice to BPA of events that may have a significant effect on the Transmission Component Costs, such as load loss or load additions. Finally, the Transfer Service customer is to provide support for BPA's "Rolled In" treatment of the Transmission Component Costs described in section 4(b).

(ii) Proposed Section 6

Because of the duration of the proposed contract, BPA was concerned that it might incur long-term commitments to pay for Transfer Services for its Transfer Service customers. The proposed

contract, however, contained no mechanism to protect BPA in the event a Transfer Service customer takes unilateral action that reduces the customer's need for Transfer Service. BPA could then be left with a "stranded cost." To protect BPA and its other ratepayers from this individual behavior, the parties negotiated section 6 into the proposed contract.

The purpose of section 6(a) is to provide BPA with the opportunity to recover cost from a Transfer Service customer that takes unilateral action to reduce its need for Transfer Services. The scope of the stranded cost commitment by the Transfer Service customers is limited to the costs that BPA would be obligated to incur as part of the Transmission Component Costs.

During the contract negotiations, it was recognized that the Transfer Service customer should have the ability to provide input regarding whether BPA should undertake a cost responsibility which may impose a stranded cost obligation on the Transfer Service customer. In light of this concern, the parties negotiated section 6(b), which commits BPA to notifying and consulting with the Transfer Service customer before entering service arrangements that may result in a stranded cost assignment. While BPA retains the ultimate right to decide whether to purchase the additional service, the parties believe that communication between BPA and the Transfer Service customer will help the parties evaluate and identify the best and most cost effective plans of service.

5. BPA and Transfer Service Customer Joint Commitments (Section 7)

The proposed contract is a first step in resolving a number of concerns between BPA and the Transfer Service customers regarding Transfer Services. During the contract negotiations, the parties recognized that further discussions were needed to address other Transfer Service questions. The parties thus included section 7 in the proposed contract as a commitment by BPA and the Transfer Service customers to address other Transfer Service issues in other processes.

Section 7(a) recites this commitment by BPA to begin or identify these processes. BPA agreed to discuss with the Transfer Service customer in one or more public processes various Transfer Services issues. The intent of these proceedings is to allow customers to comment on future Transfer Service practices, as well as provide BPA with the opportunity to further explain and clarify its existing policies that affect Transfer Service customers. Guiding the discussions of the parties, as described in section 7(a), is an intent to apply the principle that customers served by Transfer Service be provided transmission and ancillary services that are comparable to what is provided to customers that are directly connected to the Federal Columbia River Transmission System (FCRTS).

Section 7(b) describes a commitment by the parties to begin discussions on a subset of issues that are not subject to the comparability principle of section 7(a). These sub-issues, listed in Exhibit B of the proposed contract include Transfer Services for the following: (1) non-federal power deliveries over third party systems; (2) annexed loads; and (3) Slice surplus. These issues were removed from the list of issues subject to the comparability principle in Exhibit A to avoid confusion and conflicts with BPA's existing policies and contract provisions. Instead, BPA believes these issues should be reviewed separately.

Section 7(c) provides a timetable for the identification of the processes that will address the issues noted in sections 7(a) and (b). BPA made changes to this section after receiving comments that the timeline identified in the proposed contract was very aggressive considering the variety of issues to be discussed. The provision now provides that BPA has 180 days from the execution of the proposed contract to identify the process or processes where items described in Exhibits A and B will be discussed.

Finally, section 7(d) preserves the Administrator's discretion to establish policy when addressing the issues described in sections 7(a)-(c). BPA believes that the principles expressed in section 7 are designed to guide the discussions and to set in motion various public processes to facilitate such conversations. These provisions, however, are not designed to bind the Administrator's ability to establish policy.

6. Principle of Comparability for Other Cost Categories and Losses (Sections 8 and 9)

(i) Principle of Comparability for Other Cost Categories (Section 8)

The proposed contract as a whole is designed to provide the Transfer Service customers with certain assurances of treating Transfer Service costs comparable to treatment of similar costs for service to directly connected customers. These assurances, whether expressed in affirmative obligations as in sections 3 and 4, or in statements of principles, as in section 7, are focused on existing known Transfer Service costs. During the contract negotiations, the parties recognized that future industry changes might result in the addition of new cost categories not captured in the previous sections. For these new costs, BPA wanted to assure the Transfer Service customers that it would treat such costs in a manner comparable to the allocation of similar costs to customers directly connected to the FCRTS. The parties drafted section 8 for this purpose.

Section 8(a) expresses BPA's general intent to treat costs not otherwise addressed in section 7(a) in a manner comparable to treatment of similar costs for directly connected customers. This principle is expressed in section 8 in terms of the obligations BPA "undertakes" for its directly connected customers. Thus, to the extent that BPA undertakes as yet unidentified cost obligations in the future for directly connected customers, it is BPA's intent to incur a comparable obligation for Transfer Service customers.

Section 8(b) expresses a similar intent with respect to costs associated with facilities upgrades on a third-party transmission system. Thus, if BPA incurs costs for facility expansions or upgrades on the third-party system, this provision expresses BPA's intent to assign (or not assign) those costs to the applicable Transfer Service customer depending upon how BPA would treat the same or similar upgrade or expansion on its own transmission system.

(ii) Principle of Comparability for Losses (Section 9)

Section 9 commits BPA to providing real power losses, or the costs associated with real power losses, for federal power deliveries in a manner comparable to the treatment of real power losses for directly connected customers. It does not require BPA to change its current treatment of

losses. For purposes of determining comparable treatment, BPA will treat the applicable Transfer Service customer as if it were directly connected to the FCRTS.

(iii) Miscellaneous Provisions (Section 10)

The proposed contract contains general miscellaneous provisions in section 10. Because of the high level nature of the Transfer Service issues described in the proposed contract, BPA included section 10(d), which makes clear that expressions of intent in the proposed contract are designed to be statements of principle between the parties rather than contractual obligations. BPA believes this provision is important to ensure that it retains flexibility as it adopts future policies and practices that affect Transfer Service customers.

RESPONSE TO PUBLIC COMMENTS

On August 27, 2004, BPA sent a letter to interested parties in the region, attaching the proposed contract and asking for public comments. The public comment period ended on October 19, 2004. BPA received a total of 37 comments. Of these, 34 of the comments were supportive of the proposed contract. Most of the supporting comments were from Transfer Service customers or organizations that represent these customers. Many of the supportive comments noted that their major concern was the possibility that Transfer Service costs might be directly assigned in the future and this proposed contract would alleviate those concerns.

Issue 1: *Should the second sentence of section 2(g), which defines Transfer service as not including annexed loads, be removed from the proposed contract?*

Comments: Big Bend Electric Cooperative and Inland Power & Light Company (Inland) commented that the second sentence of section 2(g), which excludes service to annexed load from the definition of Transfer Service, is in conflict with the references to “service to annexed load” as an issue in Exhibit A to be addressed in a future process. Inland also suggested that this exclusion from the definition of Transfer Service could have a negative impact on Transfer Service customers if they decided to merge with another Transfer Service customer.

Evaluation: BPA’s policy regarding annexed loads is addressed in the Power Sales Contracts. Currently, BPA is not obligated to pay for the cost of Transfer Service to serve annexed load, unless the annexed load is already served by Transfer Service at the time of annexation. It is important that the proposed contract not conflict with the current policy or terms contained in the Power Sales Contracts. Thus, BPA believes that the second sentence in section 2(g) is necessary. As for an apparent conflict between this definition and the inclusion of “service to annexed loads” in Exhibit A, the issues listed in Exhibit A are intended to be discussed in a future public process and “service to annexed loads” will be an issue when policy regarding new Power Sales Contracts is addressed. In reviewing section 2(g), BPA staff noted that there may be an inconsistency in including “service to annexed loads” in Exhibit A, because section 7(a) refers to an intent to use a comparability principle for issues listed in Exhibit A. Arguably the “service to annexed loads” is only a Transfer Service issue and would not be comparable to directly connected customers. Accordingly, BPA has added an Exhibit B and edited section 7(b) to refer to issues not covered by the intent to use the comparability principle.

Regarding Inland’s concern that excluding annexed loads from the definition of Transfer Service may have a negative impact if two Transfer Service customers merge, the proposed contract is not intended to modify the existing Power Sales Contract between the Transfer Service customer and BPA. BPA recognizes that the current Power Sales Contract provides an exception for annexed loads that are served by Transfer Service at the time of annexation. To ensure consistency between the Power Sales Contract and the proposed contract, BPA will add the phrase “except as provided for in such Power Sales Agreement(s)” to the end of the second sentence in section 2(g).

Decision: BPA will not remove the second sentence that would exclude annexed loads from the definition of Transfer Service from section 2(g) of the proposed contract. However, BPA will add language to the section to recognize the excepted circumstances allowed under the current Power Sales Contract.

Issue 2: *Does the reclassification of facilities by a Third Party Transmission Provider affect the definition of BPA’s “Integrated Network Segment”?*

Comments: Orcas Power & Light Cooperative’s (OPALCO) comment questions whether the reclassification of facilities by a third party transmission provider from transmission to distribution would have any effect on the definition of Integrated Network Segment as it is used in the proposed contract. OPALCO raised this concern by pointing out that the Transmission Component Costs as defined in section 2(h) of the proposed contract only includes “non-federally owned facilities that have characteristics comparable to the characteristics used to define BPA’s Integrated Network Segment.” The Transmission Component Costs are the costs that BPA is obligated to roll-in under section 4(b) of the proposed contract.

Evaluation: The term Integrated Network Segment, as used in the proposed contract, refers to the facilities of the FCRTS that are defined in a BPA rate case. Reclassification of facilities by a third-party transmission provider will not affect the definition of Integrated Network Segment, because the definition is only dependent on how BPA defines its facilities. For purposes of the comparison described in the definition of Transmission Component Costs, the actual characteristics of the facilities will be compared. In general, this will be determined based on voltage levels of the facilities, and the type of use may also be considered. The fact that a Third Party Transmission Provider has reclassified its facilities would not be a consideration. If BPA changes its definition of Integrated Network Segment in a future rate proceeding the new definition would be applied to the definition of Transmission Component Costs.

Decision: A Third Party Transmission Provider’s reclassification of facilities will not affect BPA’s definition of “Integrated Network Segment,” and it will not be a factor in the comparison described in the definition of “Transmission Component Costs.”

Issue 3: *Should section 6 of the proposed contract imposing stranded cost obligations on the Transfer Service customer be clarified to limit this obligation to only cases in which the Transfer Service customer is solely responsible for the stranded cost?*

Comments: OPALCO, Canby Utility, and Wells Rural Electric Company (WREC) commented on the stranded cost obligations addressed in section 6 of the proposed contract. OPALCO stated that under the terms of section 6(a), if OPALCO had an unusually large peak one winter, the third party transmission provider could force BPA to acquire more Transfer Service capacity. When normal conditions return, OPALCO is concerned that it would then be responsible for the cost associated with the additional Transfer Service capacity BPA purchased. Canby Utility stated that section 6 is worded too broadly and could be read to impose a stranded cost obligation if the utility switches from a full requirements contract to a partial requirements contract or if it institutes a conservation or load shedding program reducing the amount of Transfer Service needed to serve its load. WREC suggested additional language to add to section 6(a) to clarify that stranded cost obligations would not arise if the cause of the stranded cost is beyond the control of the Transfer Service customer.

Evaluation: Section 6 is part of the Transfer Service customer's commitment to work with BPA to keep Transfer Service cost at a reasonable level. The purpose of this section is to place responsibility on the Transfer Service customer when decisions are being made to expand Transfer Service capacity. If the Transfer Service customer is requesting additional service, and BPA incurs costs in reliance on the customer's request, but thereafter the customer changes its plans, BPA needs to be able to pass the cost of those actions through to the customer.

OPALCO's concern is tenuous, because it is in BPA's interest to keep Transfer Service costs under control, and BPA would not accept the terms of an increase in Transfer Service capacity that is based on one or a few unusual events. This is not an issue for most Transfer Service contracts, because they are based on demand.

BPA also does not agree with Canby Utility's position that this section is open-ended and could be manipulated by BPA in the future to impose stranded cost obligations based on legitimate load reduction decisions. BPA has historically encouraged its customers to do the things Canby Utility suggested, and it is not BPA's intent to use this proposed contract to penalize customers for using their initiative. In addition, section 6(b) of the proposed contract ensures that the Transfer Service customers are involved in the decision to incur the additional costs.

WREC suggested an addition to section 6(a) which would remove the obligation if the cause of the stranded cost is beyond the control of the Transfer Service customer. This addition is problematic because it places the risk of potential load losses and other unforeseen events on BPA and its other customers. For example, a stranded cost obligation could arise when the Transfer Service customer requests a new point of delivery for a new industrial customer. If BPA agrees to incur the additional cost and contracts with the third party transmission provider, and then the industrial customer backs out, it would arguably be beyond the control of the Transfer Service customer. In this situation, it would be unreasonable for BPA and its customers to bear the cost obligations or the risk that should fall on the Transfer Service customer.

Decision: Section 6 of the proposed contract captures the intent of the parties and will not be modified.

Issue 4: *Should charges for low-voltage delivery service be rolled-in and treated the same as Transmission Component Costs?*

Comments: Umpqua Indian Utility Cooperative (UIUC) and Western Montana Electric Generation & Transmission Cooperative (WMG&T) stated that low voltage service should be included in the Integrated Network Segment, and Transfer Service customers should not be charged separately for a low voltage delivery charge. WMG&T commented that it appreciates that this issue is included in Exhibit A to be addressed in a future process, but that charging its members for low voltage delivery is inequitable when the third party transmission provider that serves WMG&T members does not charge BPA separately for low voltage delivery.

Evaluation: Currently, the PBL low voltage delivery charge is applied to all Transfer Service customers that are interconnected below 34.5 kV, unless the particular low voltage facilities have been directly assigned. A similar rate is applied to BPA's directly connected customers through the TBL low voltage delivery charge, which is based on the cost of low voltage facilities owned by BPA. At present, the two rate levels are the same.

WMG&T is correct in pointing out that some of BPA's Transfer Service contracts with third party transmission providers do not include a separate charge for low voltage delivery. This reflects one of the differences between OATT service and older Transfer Service contracts. Under the OATT service, there is usually a separate charge for low voltage delivery or distribution. Most of the contracts that BPA has with third party transmission providers that have not yet been converted to OATT do not have a separate low voltage delivery or distribution charge. The costs of the lower voltage facilities are still included in the rate BPA is charged. If BPA were to follow WMG&T's suggestion, BPA would directly assign low voltage delivery charges to only those Transfer Service customers that receive service under an OATT, and the result would be that some Transfer Service customers would pay significantly more than directly connected customers, while others pay nothing.

BPA included the low voltage delivery service in Exhibit A, because this issue will be addressed in a future process. Currently, the PBL low voltage delivery charge is equivalent to the TBL low voltage delivery, even though the underlying cost for the services are different. In the future process, BPA will examine if this is equitable, and other approaches to calculating the low voltage delivery charge may be considered.

Decision: Low voltage delivery charges will not be included in the Transmission Component Costs and consequent rolled-in treatment, and the low voltage delivery service will be addressed in a future process.

Issue 5: *Should all the Transfer Service issues recognized in Exhibit A be resolved and incorporated into the proposed contract before it is offered to the Transfer Service customers?*

Comments: Canby Utility stated that the proposed contract does not provide a complete package because several important Transfer Service issues remain unresolved. These issues are identified in Exhibit A as issues to be discussed in future processes. Canby Utility commented that without knowing the outcome of these issues it is difficult to decide whether to accept the

proposed contract. Canby suggests that the proposed contract is a good start, but BPA should continue negotiations with the public power representatives until all the Transfer Service issues are resolved and included in the proposed contract.

Evaluation: The original goal of the proposed contract was to provide some certainty to Transfer Service customers regarding future rate treatment of Transfer Service costs. During the negotiation process, several other Transfer Service issues were discussed, but BPA staff and the Transfer Service customer representatives recognized that it was important to keep the focus of the proposed contract narrow to achieve the original goal. Many of the issues listed in Exhibits A and B impact other BPA policy decisions and should be addressed in the processes focused on similar issues.

Decision: The issues listed in Exhibit A will be addressed in future BPA processes and will not be resolved prior to offering the proposed contract.

Issue 6: *Should the proposed contract include a provision for the collection of attorney fees in the event that a party is required to pursue legal action to enforce or interpret the terms or conditions of the proposed contract?*

Comments: WREC suggested language to allow for the collection of attorney fees by the prevailing party if legal action is necessary to enforce or interpret any term or condition of the proposed contract. WREC commented that this provision is necessary because under Nevada law if the proposed contract does not provide for attorney fees, parties are not entitled to claim attorney fees under most circumstances.

Evaluation: If a party pursues legal action to enforce or interpret the proposed contract, the claim will be subject to federal jurisdiction and Nevada state law will not apply. As such, issues regarding attorney fees will be a matter of the applicable federal law governing the dispute. BPA does not generally include an attorney fees clause in contracts.

Decision: BPA will not include a provision regarding attorney fees in the proposed contract.

Issue 7: *Do sections 4(d) and (e) give FERC jurisdiction over BPA rates or the authority to eliminate rolled-in rate treatment for Transfer Service costs and should these sections be rewritten to limit FERC jurisdiction?*

Comments: Ravalli County Electric Cooperative (Ravalli) expressed concerns about sections 4(d) and (e) providing additional FERC jurisdiction over BPA rates and allowing FERC to order BPA to directly assign Transfer Service costs to individual customers. Ravalli suggested new language for sections 4(b) and (d) intended to require FERC to recognize rolled-in treatment of Transfer Service costs in either transmission or power rates and to limit FERC jurisdiction by only allowing FERC to approve or disapprove rolling the cost into transmission rates. Ravalli also requested that section 4(e) be deleted from the proposed contract because section 4(e) appears to give FERC the authority to reject the obligation BPA would incur under the terms of the proposed contract. In a follow-up comment, received after the close of the comment period, WMG&T supported Ravalli's position on this issue.

Evaluation: Section 4(d) of the proposed contract recognizes the potential that FERC or a court with jurisdiction may reject rolled-in treatment of Transfer Service costs in either transmission or power rates. In such case, the proposed contract requires BPA to submit an initial proposal for rolled-in treatment in the rates that were not subject to this determination. This recognition is necessary to allow flexibility as to where these costs are rolled-in without excusing BPA's obligation in the case of one rejection. Section 4(e) is necessary to account for the situation in which rolled-in treatment is rejected for both power and transmission rates. BPA needs this protection to avoid a situation in which it would be forced to breach this proposed contract due to FERC decisions or rulings by a court with jurisdiction.

FERC's limited jurisdiction over BPA is established by statute and BPA cannot increase or limit FERC jurisdiction through the proposed contract. Currently, FERC jurisdiction over power rates is limited to a determination that BPA will recover its costs, but it is impossible to predict whether this jurisdiction will be expanded in the next 20 years. Both 4(d) and 4(e) refer to a court with jurisdiction over BPA rates, and, as with FERC jurisdiction, it is difficult to determine what statutory changes may occur in the next 20 years or what jurisdiction a court may assert over BPA.

In section 4, BPA has promised to propose rolled-in treatment in either power or transmission initial rate proposals and to propose the rolled-in treatment in the other if this treatment is rejected. BPA must retain section 4(e) to protect against breaching the proposed contract if the rolled-in treatment is rejected in both power and transmission rates.

Decision: Sections 4(d) and 4(e) do not expand FERC jurisdiction over BPA rates, and these sections need to be included as written in the proposed contract.

Issue 8: *Should the term of the proposed contract be modified to coordinate with the term of the Transfer Service customer's Power Sales Contract?*

Comments: Tacoma Power suggested that the term of the proposed contract be shortened to coincide with the term of the current Power Sales Contract. Tacoma Power stated that it is highly likely that many changes could take place over the 20 year term of the proposed contract and that having a Transfer Service commitment that overlaps BPA Power Sales Contracts may frustrate the process and implementation of new Power Sales Contracts.

Evaluation: A primary feature of the proposed contract is to provide a degree of certainty for the Transfer Service customer for a term of 20 years. The Transfer Service customers were adamant in their request for a 20-year term for the proposed contract. Their primary goal was to gain some certainty regarding rate treatment of Transfer Service costs. BPA's commitment in the proposed contract to initially propose rolled-in treatment of Transfer Service costs is a rate design issue. The proposed contract allows BPA enough flexibility to avoid most conflicts that may arise between the commitments in this proposed contract and future Power Sales Contracts. Many of the issues listed in Exhibit A for further discussion in future processes may have a substantive impact on the development of new Power Sales Contracts, and those future processes should help with the development of the new Power Sales Contracts.

Decision: The term in the proposed contract will be 20 years as agreed upon by BPA and the Transfer Service customer representatives.

Issue 9: *Should Transfer Service costs be rolled into the Transmission Business Lines network rate revenue requirement?*

Comments: Tacoma Power stated that since Transfer Service is essentially wheeling agreements executed as a least cost alternative to building transmission, the cost should be treated like any other BPA transmission facility and rolled into BPA's transmission revenue requirement for Network rates.

Evaluation: Section 4 of the proposed contract allows for rolled-in treatment of Transfer Service costs in either power or transmission rates or partly into each. Currently and historically BPA has rolled these costs into power rates, but BPA recognizes that this practice may change in the future. The proposed contract was drafted so as not to foreclose this option. BPA anticipates that a decision to move Transfer Service costs to transmission rates would be strongly opposed by some affected parties, and BPA could face legal challenges. If FERC policy changes in the future or an RTO type organization is developed that is conducive to rolling these cost into transmission rates, BPA will have the flexibility to initially propose rolling Transfer Service costs into transmission rates. BPA's intent is to keep this option open, and a decision as to which rates these cost will be assigned to is not part of the proposed contract.

Decision: BPA will keep this option in the proposed contract, and this decision will not be made a part of the proposed contract.

Issue 10: *Does the proposed contract significantly depart from BPA's existing Transfer Service practices?*

Comments: Avista Corporation, Idaho Power Company, Northwestern Energy, PacifiCorp, Portland General Electric Company, and Puget Sound Energy, Inc., (Transmission Customers) submitted joint comments regarding the proposed contract. The Transmission Customers expressed concern that the proposed contract is a departure from the services BPA has historically provided to the Transfer Service customers. Specifically, the Transmission Customers contend that the proposed contract may require BPA to roll-in Transfer Service losses into the main grid segment, thereby causing the Transmission Customers to pay for Transfer Service losses. In addition, the Transmission Customers are concerned that the "comparability" principle may be read too broadly and require BPA to undertake unintended obligations, such as capital improvements of low voltage facilities. Finally, the Transmission Customers express concern that the proposed contract creates open-ended obligations that could potentially result in additional costs being rolled in to the main grid segment. The Transmission Customers conclude that each of the above-mentioned issues would be a clear departure from existing Transfer Service practices.

Evaluation: The proposed contract does not require a departure from BPA's existing Transfer Service practices. First, sections 3 and 4 of the proposed contract are, in effect, a continuation of

BPA's existing Transfer Service practice. BPA has in the past arranged the Transfer Service for delivery of federal power to the Transfer Service customers and rolled-in certain aspects of the Transfer Service costs into a revenue requirement. Sections 3 and 4 of the proposed contract express BPA's acknowledgement that this practice will continue, subject to certain restrictions, for a term of 20 years.

Similarly, sections 7 and 8 do not require a departure from BPA's existing Transfer Service practices. BPA agrees that sections 7(a), 8(a) and 8(b) are unique in that they are termed as an expression of BPA's intent to provide the Transfer Service customers with "comparability" on certain issues. However, these provisions do not require BPA to depart from its existing Transfer Service practices. Rather, the operative language of these sections provide that BPA and the customer intend to discuss certain issues and seek to find a measure of comparability with directly connected customers. Section 10(d) of the contract makes it clear that these expressions of intent are not legally binding on BPA or the other party. Thus, BPA does not agree that the principles expressed in the proposed contract would compel BPA to undertake the specific obligations suggested by the Transmission Customers.

Finally, where appropriate, BPA has included language in the proposed contract that specifically preserves the Administrator's discretion in establishing policies and practices. These provisions, and section 10(d), were included to ensure that the Administrator retains flexibility when implementing the principles of the proposed contract. Thus, BPA believes sufficient protections are built into the proposed contract to prevent any unintended and unlimited obligations.

Decision: The proposed contract does not require a departure from BPA's existing Transfer Service practices. Section 10(d) has been added to the contract to make it explicitly clear that expressions of intent are not legally binding on the parties.

Issue 11: *Should BPA limit the scope of the proposed contract by defining the term "comparability"?*

Comments: The Transmission Customers note that the proposed contract is unusual in that much of the document is an expression of "intent." While the parties may intend this language not to be binding, the Transmission Customers warn that a court or FERC may interpret the language differently. The Transmission Customers recommend that BPA carefully limit its commitments under the proposed contract. Specifically, the Transmission Customers suggest that BPA define the concept of "comparability" in the proposed contract. In addition, BPA should find other ways of clarifying and limiting the scope of the proposed contract.

Evaluation: BPA believes the language in the proposed contract strikes the proper balance between providing assurances to Transfer Service customers regarding future Transfer Service practices as well as preserving BPA's flexibility. Defining the term "comparability" could prove too restrictive when attempting to adapt the principles of the proposed contract to the myriad of situations that may occur during its 20-year term. Instead, BPA intends the proposed contract to provide the "high level" principles that will guide the parties in developing policies for the future. In some parts of the proposed contract, BPA found that in addressing broad principles it was necessary to avoid precise definitions of certain terms.

BPA recognizes the concern the Transmission Customers note with respect to the interpretation of some of the provisions. To limit the risk of unintended interpretations by a reviewing judicial body, BPA has included in the proposed contract section 10(d), which makes clear that expressions of intent are not binding until they are incorporated into a specific agreement between the customer and BPA. BPA believes that the addition of this provision will enable BPA to agree to the broad principles in the proposed contract without subjecting itself and other customers to the unlimited risk noted by the Transmission Customers.

Decision: BPA will not define the term “comparability” or otherwise limit the scope of the proposed contract. BPA has, however, added a provision which makes clear that references to expressions of intent are not to be binding until reduced to a separate agreement.

Issue 12: *Will other customers be allowed to participate in the Transfer Service discussions described in the proposed contract?*

Comments: The Transmission Customers are troubled that BPA did not seek the input of non-Transfer Service customers until August of 2004 on the proposed contract. The Transmission Customers expressed concern about the consequences to them if BPA were to adopt a similar approach with respect to the further issues that the parties agree to discuss in the proposed contract. In particular, they noted that Transfer Service customers are not the only entities impacted by the resolution of the enumerated issues, and that the Transmission Customers could suffer potentially major impacts from the resolution of such issues. Thus, the Transmission Customers request that BPA make a commitment to include them in any further discussions or proceedings.

Evaluation: BPA believes that it is important to include the opinion and positions of non-Transfer Service customers when addressing the issues described in the proposed contract. This concern is why BPA posted the proposed contract for general public comment. As noted by the Transmission Customers, the Transfer Service customers may not be the only customers impacted by the resolution of the issues listed in Exhibits A and B. When and where such input should be included, though, should be governed by the processes that address the enumerated issues. Since the proposed contract is between BPA and the Transfer Service customers, BPA does not believe it would be prudent to include in the proposed contract a blanket commitment to include other customers in all future discussions. Rather, BPA believes that meaningful opportunities for involvement by other customers will be a function of the processes used to discuss the future Transfer Service issues.

Decision: BPA will not include a commitment in the proposed contract to include non-Transfer Service customers in future discussions.

Issue 13: *Should BPA limit the issues to be addressed in the discussions described in section 7?*

Comments: The Transmission Customers noted that BPA over committed itself by agreeing in section 7(a) to address the Transfer Service issues identified in Exhibit A as well as “other”

issues. The Transmission Customers stated that this provision created an open-ended obligation to resolve virtually any issue related to Transfer Service that is not expressly covered by the proposed contract. The Transmission Customers suggested removing the “including, but not limited to” language from section 7(a) of the proposed contract to limit the number of issues BPA intends to address.

Evaluation: BPA agrees that this provision is worded too broadly, and therefore has removed the “including, but not limited to” language from section 7. BPA believes that it is the intent of section 7 to limit the number of issues BPA commits to review to those listed in Exhibits A and B. It is more conducive to achieving the goals of the proposed contract if the parties focus on the enumerated issues. This approach does not preclude addressing additional issues not stated in the Exhibits. Whether other issues are addressed is subject to the scope and parameters BPA sets around the public processes or discussions at the time such processes begin.

Decision: BPA will remove the terms “including, but not limited to” from section 7(a).

Issue 14: *Should the proposed contract specify that it is only applicable to existing Transfer Service customers and existing Transfer Service territories?*

Comments: The Transmission Customers are concerned that because of the broad nature of the principles in the proposed contract, BPA may be obligating itself to pay the cost of transmission facilities acquired by Transfer Service customers through annexation. The Transmission Customers asked BPA to revise the proposed contract to make it clear that the proposed contract relates only to BPA service to existing Transfer Service customers in their existing service areas.

Evaluation: BPA believes an express provision stating the proposed contract is going to be offered to existing Transfer Service customers is unnecessary. First, BPA will offer the proposed contract to customers that are currently served by Transfer Services. Included in this group of customers will be one potential Transfer Service customer that was recognized as a requirements customer in BPA’s 2002 power rates proceeding, but is not yet taking federal power. For this one customer, the proposed contract will be contingent on it meeting the obligations of its Power Sales Contract.

Second, the proposed contract already has provisions that address the issue of annexations by Transfer Service customers. As noted in response to Issue 1, section 2(g) excludes service to territory annexed by the Transfer Service customer after the execution of the proposed contract, unless the annexed load is already served by Transfer Service at the time of annexation.

Decision: The proposed contract will only be offered to existing and recognized Transfer Service customers. The current provisions already limit BPA’s obligations to serve annexed territory, and BPA will not make the revisions suggested by the Transmission Customers.

Issue 15: *Should the timeline for initiating and concluding the discussions described in section 7 be modified?*

Comments: The Transmission Customers noted that the six-month timetable BPA agreed to in section 7(c) is unworkable and unrealistic. They stated that the proposal assumes BPA can simultaneously prosecute the pending transmission rate case and resolve the enumerated issues in Exhibits A and B relating to Transfer Service issues within a very short period of time. The Transmission Customers are concerned that this timetable is overly aggressive, and point to the two-and-one-half years of negotiations that led up to the proposed contract as demonstrating that the parties will be unable to accomplish the goals set out in section 7 within the six-month timeline.

Evaluation: BPA agrees that the timeline stated in section 7(c) should be changed to allow for a more purposeful review of the relevant issues. BPA initially agreed to the timeline as a placeholder pending an evaluation of what process or processes are needed to address the enumerated issues in the Exhibits. BPA believes that agreeing to an arbitrary timeline would not be a prudent way of addressing these issues. Nevertheless, a commitment should be made to the Transfer Service customers to ensure that the issues listed in the proposed contract are addressed. As such, BPA will change the language in section 7(c) to commit BPA to identify the process or processes which will address the issues listed in Exhibits A and B. BPA will inform the Transfer Service customers regarding the chosen processes within 180 days of both parties signing of the proposed contract.

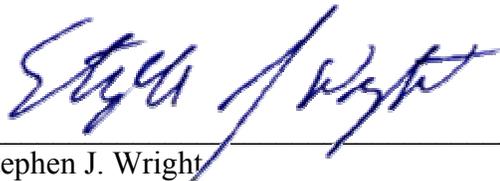
Decision: BPA will remove the six-month timeline from section 7(c) and replace it with a commitment by BPA to identify the process(es) which will address the enumerated issues in the proposed contract.

CONCLUSION

The proposed contract provides a degree of certainty regarding future rate treatment of Transfer Service costs to BPA's Transfer Service customers. The proposed contract would commit BPA to propose certain Transfer Service costs into an initial rate proposal for a term of 20 years. In addition, the proposed contract allows BPA to address specified Transfer Service issues in other processes. Finally, the proposed contract provides valuable protections for BPA and the Transfer Service customers in terms of providing the Administrator discretion and flexibility to address future changes in federal policies.

I have reviewed and evaluated the record compiled by BPA on the proposed contract. As part of this review, I have reviewed the proposed contract for National Environmental Policy Act (NEPA) concerns. I have determined that the proposed contract does not implicate NEPA and, moreover, falls within the scope of previous NEPA documentation prepared by BPA. Based on the record, the reasoning contained therein, and all requirements of law, I hereby offer the proposed contract unsigned and subject to the following restrictions: Transfer Service customers will have until March 31, 2005 to return a signed copy of the proposed contract to BPA. On or before April 15, 2005, BPA will counter-sign the proposed contract if I determine a sufficient number of Transfer Service customers have returned signed copies of the proposed contract.

Issued at Portland, Oregon on December 22, 2004.



Stephen J. Wright
Administrator and Chief Executive Officer