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May 17, 2004

Mr. Steve Wright
Administrator and Chief Executive Officer
Bonneville Power Administration
PO Box 3621
Portland, OR 97208

Dear Mr. Wright:

The Northwest Power and Conservation Council is pleased to submit to you its *Recommendations for the Future Role of the Bonneville Power Administration in Power Supply*.

These recommendations were developed through a public process referred to as the regional dialogue, and represent a broad consensus about the fundamental model for how Bonneville should fulfill its role as power supplier to its regional customers. The recommendations are intended to provide guidance to Bonneville as it develops a policy proposal through its own public process scheduled to begin in June. The recommendations focus primarily on long-term, post 2011, questions rather than on issues Bonneville has raised regarding current contracts. The Council believes there is a high degree of overlap between these long-term issues and many of the questions pertaining to current contracts. The Council believes it is important that the current contract issues are resolved in a manner consistent with any new Bonneville policy for future contracts.

Bonneville and its customers will soon need to make decisions regarding power supplies for the post-2011 period. For that reason, the Council strongly recommends that Bonneville include in this summer's policy process: 1) an identification of issues that must be resolved for the long-term; 2) the process by which they will be addressed; and 3) a schedule for their resolution that will support Bonneville offering new contracts by October of 2007. Now is the time to resolve these issues; they will not become easier to address with time.

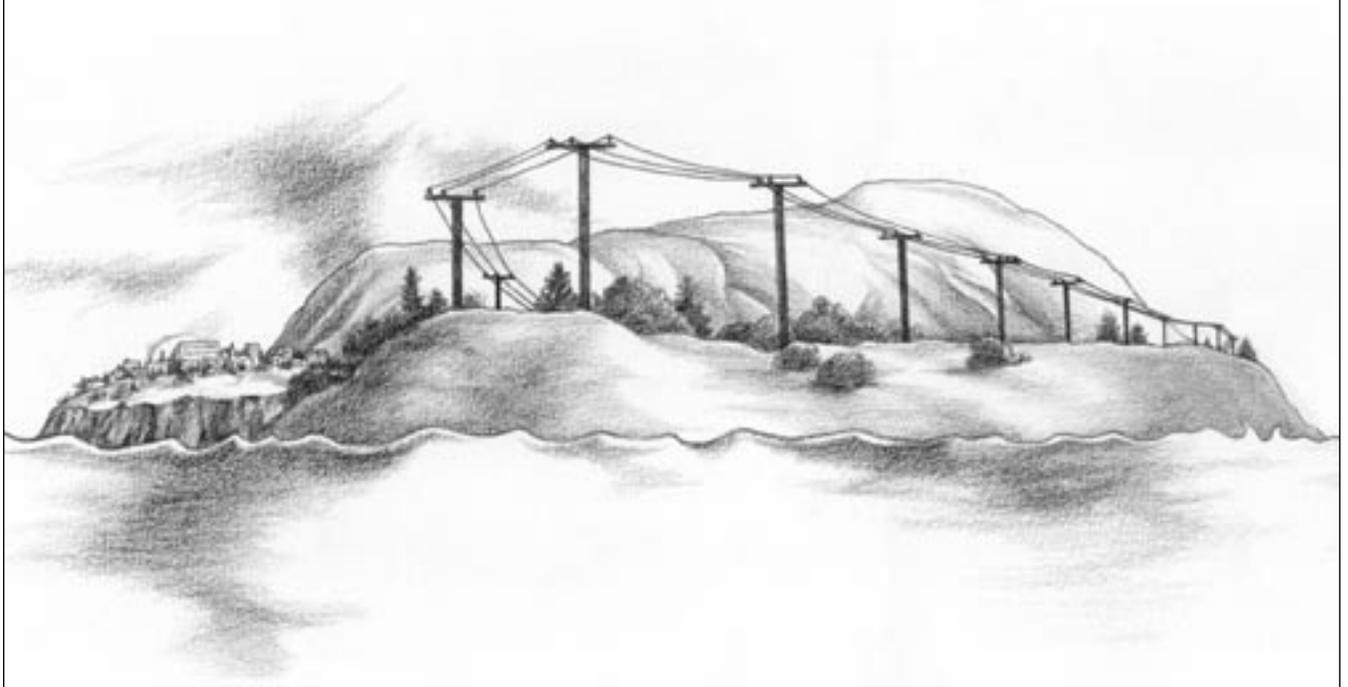
The Council looks forward to working with Bonneville, its customers, and other parties to secure the region's electricity future.

Sincerely,

~

Judi Danielson
Chair

Recommendations on the
Future Role of the
Bonneville Power Administration
in Regional Power Supply



**The Northwest Power and Conservation Council's Recommendations on
the Future Role of the Bonneville Power Administration
in Regional Power Supply**

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May 2004

Council Document 2004-05

Executive Summary

Over the past several years, the Bonneville Power Administration has faced periods of instability that have threatened its financial well being and that of its customers; hampered its ability to meet its obligations, including those to the U.S. Treasury; impeded the development of needed resources; and damaged the economy of the Northwest. The conclusion reached in several processes in recent years is that these problems have their roots in the ways in which Bonneville has carried out its role and the uncertainties that creates with respect to resource development and load-serving obligations.¹ This led to proposals for changes in Bonneville's role in power supply. The financial crisis precipitated by the Western Electricity Crisis of 2000-2001 focused renewed attention on Bonneville's role. The region's governors have asked the Council to work with Bonneville and interests in the region to resolve this issue. The Council has consulted with a number of interests in the region and has convened a broadly representative steering committee to help address the key questions.

Bonneville has announced its intent to carry out a policy process this summer that would define the agency's future role as well as address a number of issues for the period remaining on its current power sales contracts. These recommendations are intended to provide input to Bonneville as it prepares its initial proposal for that policy process, as well as to the deliberations of Bonneville's customers and other interests as they consider Bonneville's long-term future role. The focus of these recommendations is primarily on the long-term as opposed to resolving questions Bonneville has raised for the last five years under the current contracts. However, there is a high degree of overlap between the long-term issues and

many of those raised under the existing contracts. There needs to be consistency between the resolution of these issues for the remainder of the current contracts and for future contracts. The Council believes the issues must be dealt with as a package rather than separately. The Council's recommendations are summarized below.

A fundamental change in how Bonneville carries out its role in power supply

Resolving the problems that have afflicted Bonneville and the region requires a fundamental change in how Bonneville executes its role in power supply consistent with the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (the Act). Under the Council's recommendations, Bonneville would sell electricity from the existing Federal Columbia River Power System to eligible customers at its cost. Customers that request more power than Bonneville can provide from the existing federal system would pay the additional cost of providing that service.² This change would clarify who would exercise responsibility for resource development; it would result in an equitable distribution of the costs of growth; and it would prevent the value of the existing federal system from being diluted by the higher costs of new resources. This change in role ultimately should be implemented through long-term (preferably 20-year) contracts and compatible rate structures. This change in Bonneville's future role does not alter Bonneville's fundamental responsibility to serve the loads of those qualifying customers who choose to place load on Bonneville; it does not alter Bonneville's responsibility for ensuring the acquisition of Bonneville's share of all cost effective conservation and renewable power identified in the

¹ See, for example, Comprehensive Review of the Northwest Energy System — Final Report: Toward a Competitive Electric Power Industry for the 21st Century, Comprehensive Review Document CR 96-26, December, 1996. <http://www.nwcouncil.org/library/1996/cr96-26.htm>; Cost Review of the Federal Columbia River Power System — Management Committee Recommendations, Document CR 98-2, March 10, 1998. <http://www.nwcouncil.org/library/1998/cr98-2.htm>; Investor-Owned Utility/Preference Utility Proposal For The Future Role Of The Bonneville Power Administration, October 29, 2002 Draft; What Led to the Current BPA Financial Crisis? A BPA Report to the Region, also known as "The Lessons Learned" report, Bonneville Power Administration, April 2003; Northwest Power Planning Council Recommendations on the Future Role of Bonneville in Power Supply, Council Document 2002-19, December 17, 2002. <http://www.nwcouncil.org/library/2002/2002-19>; The Future Role of Bonneville in Power Supply, Council Document 2003-18, October 2003, <http://www.nwcouncil.org/library/2003/2003-18.htm>.

² Implicit in this position is that the contracts through which Bonneville would serve load growth beyond the capability of the existing system not subject other Bonneville customers to increased rates or other financial risk associated with resource acquisition authorized under Section 6 of the 1980 Power Act.

Council's Regional Electric Power and Conservation Plan (Plan); and it does not alter Bonneville's responsibility to fulfill its fish and wildlife obligations under the Act and the Council's fish and wildlife program. It does represent a change in the way Bonneville has traditionally carried out those responsibilities.

Define a clear and durable policy framework for contracts and rate-making

The Council believes that debate in the region over the future role of Bonneville is less about the end-state, a limited role for Bonneville in power supply, than about how to reach that end state. The Council acknowledges that both new long-term contracts and a revised pricing structure will be necessary to fully implement a new role for Bonneville. The Council believes, however, that a clearly articulated and durable policy regarding Bonneville's future role must guide the necessary contract negotiations with customers and future rate cases.

There is a spectrum of means by which such a policy might be established. Bonneville's planned course of action is to propose a draft policy in June, undertake consultations and a formal public comment process, and then to adopt a final policy in the fall. The Council is concerned this process may not provide the necessary durability. The most durable alternative would be to establish the policy in legislation. However, the Council believes that would entail unacceptable risks for the region. In its draft recommendations, the Council proposed a middle-ground alternative. That recommendation encouraged Bonneville establish its new role through binding policy established by substantive rulemaking. This approach, in conjunction with new long-term contracts and compatible rate structures, has the potential to avoid the risk of new legislation while providing a more binding and durable solution than Bonneville policy implementation has demonstrated in the past. However, in response to the Council's proposed recommendations, many commenters expressed concerns about a rulemaking. While the Council is not convinced those concerns are valid, it will not press for substantive rulemaking at this time.

The Council remains concerned that the policy process Bonneville is planning to undertake will not provide the durability necessary to meet expectations for long-term contract negotiations and associated rate processes,

and the region's expectations for conservation and renewable resource development. To improve the durability of the policy, it must include clear identification of the priority issues that are to be resolved, the process by which they will be addressed, and an aggressive schedule for doing so. That schedule should result in offering new long-term contracts by October of 2007.

If this process proves incapable of resolving issues within the established schedule, alternative processes should be considered. Bonneville and the Council should first determine if substantive rulemaking can be a vehicle for resolving the outstanding issues. If rulemaking 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.

Offer long-term contracts as soon as possible

Only long-term contracts will provide the certainty, continuity, and durability that customers need to make long-term resource commitments; the stability that Bonneville needs to be able to ensure Treasury repayment; and the protection the region needs for one of its most significant assets. Bonneville should offer such contracts no later than October of 2007.

The biggest impediment to long-term contracts is that Bonneville's customers are concerned they would lose the major means by which they can exercise discipline on Bonneville's costs and business practices – their ability to take load off Bonneville. Because long-term contracts have benefits for the parties and the entire region, all parties need to be open to examining ways to overcome concerns such as allocation of power, cost segregation, cost control, contract enforceability, dispute resolution, Bonneville business practices in general, and possible adverse impacts to Bonneville's public service responsibilities under the Act. The Council commits to work with Bonneville, its customers, and others to identify a workable resolution of problems that may arise.

Allocation of the existing system

Fundamental to implementing changes in Bonneville's role in power supply is allocating the power from the existing federal system among eligible customers. Any

allocation should be done in such a way as to minimize opportunities for gaming the process. For that reason, the Council believes that, lacking agreement on any alternative, allocation should be based on customers' historic net requirements, normalized for economic and weather effects. In the case of new or annexed public utility loads, it is the Council's understanding that Bonneville ultimately must serve all qualified public utilities on a comparable basis. Doing so would require a reallocation of the system. However, before any reallocation there should be a waiting period of sufficient duration to permit Bonneville and its customers to take the necessary long-term resource actions. The Council recognizes that some Bonneville customers may lose load over time. If this occurs, Bonneville should ensure that such customers' long-term access to federal power at the embedded cost of the existing system is not unnecessarily diminished.

Tiered rates under existing contracts?

Tiered rates would be the clearest practical indication of how Bonneville will be carrying out its role in the future. If Bonneville defines its role as the Council recommends, and if critical issues are resolved in a timeframe consistent with the schedule established in Bonneville's policy; and if new contracts are negotiated and offered by October of 2007; then the Council would not press for tiered rates under the current contracts for the next rate period. However, the Council reserves the right to reconsider this recommendation if those conditions are not met.

Products

Customers should have access to the full range of products that are currently available, such as requirements, block, and slice products. Importantly, the costs of each product should be confined to the purchasers of that product. Every effort should be made to eliminate cross-subsidies among products. In the process of negotiating new contracts, customers should have the opportunity to choose the products that best meet their needs.

Direct Service Industries (DSIs)

If a DSI has been a responsible customer of Bonneville, there may be an opportunity to provide a limited amount of power for a limited duration under specified terms and conditions. The existing federal system is

roughly in load/resource balance. Consequently, some level of augmentation probably will be necessary to provide reasonably continuous service. If power is to be made available to DSIs, the amount and term should be limited; the cost impact on other customers should be minimized; and Bonneville should retain rights to interrupt service for purposes of maintaining system stability and addressing temporary power supply inadequacy.

Benefits for the residential and small farm customers of investor-owned utilities

The Council strongly supports resolution of the issue of benefits for the residential and small-farm customers of investor-owned utilities (IOUs) for a significant period. The Act established a mechanism for sharing benefits of access to low-cost federal power. That 24-year-old mechanism has operated in such a way that it satisfies no one. However, "fixing" that feature of the Act through legislation could have broad ramifications. The Council favors a long-term settlement that provides benefits in the form of dollars. The Council cannot judge what is an equitable settlement. However, the necessary characteristics of a settlement can be defined. A settlement must provide certainty, it must be transparent, and it must not be subject to manipulation. The proposed settlement that collapsed in early 2004 contained these elements and was supported by nearly all of Bonneville's Northwest customers. The Council believes this could be the template for a long-term settlement.

Fulfilling responsibilities for conservation and renewables

The Council expects Bonneville and the region's utilities to continue to acquire the cost-effective conservation and renewable resources identified in the Council's power plans. Bonneville should employ mechanisms similar to the current Conservation and Renewables Discount (C&RD) program and provide essential support activities to encourage and facilitate utility action. Bonneville's role will be substantially reduced to the extent that customers can meet these objectives. But if necessary, Bonneville must be prepared to provide a backstop mechanism to ensure that these objectives are met. Bonneville must retain the ability to secure its regional share of cost-effective conservation and renewables identified in the Council's power plan that are not otherwise secured by

its customers. The costs of the backstop actions would be paid by utilities that fail to meet their responsibilities. The C&RD program has been instrumental in motivating many utilities to pursue conservation and renewables activities. But the rate discount needs to be refined as outlined in the Council's December 2002 recommendations on the future role of Bonneville. The focus needs to be on determining how to reliably acquire all the cost-effective conservation at the lowest cost to the utility system. Bonneville and the Council should facilitate a collaborative process to refine the details of a rate discount and produce recommendations by early 2005.

However, a rate discount should not necessarily be the only mechanism available to encourage utilities to acquire conservation and renewable resources. There are a number of activities that can be carried out more effectively if they are approached on a coordinated regional basis with local implementation. These include activities like market transformation, limited development and demonstration activities, and program design and administration where there are significant economies of scale to be gained. Bonneville should continue these activities and, in addition, its support of low-income weatherization.

The Council continues to believe that levels of renewable resource development should be guided by the Council's Plan. The C&RD could be used to support customer acquisition of renewable resources so long as cost-effective conservation is also acquired.

Bonneville is uniquely suited to pursue some renewable resources development that would not happen without its participation. These activities benefit all of Bonneville's customers, and their costs should be recovered from the existing system. These include activities such as: 1) removing barriers to cost-effective renewable resource development; 2) developing storage and shaping services, developing transmission re-dispatch products and making transmission acquisition for renewable resources easier; and 3) limited, region-specific research and demonstration. The costs of providing services like storage and shaping should be paid by the purchaser.

With regard to acquiring the output of new renewable resources, the Council believes Bonneville's activities should be consistent with the Plan. Bonneville should acquire new renewable output to meet new

or replacement resource needs placed on the agency, provided resources are cost-effective after accounting for any risk reduction or other benefits the resources provide. The Council encourages those utilities that choose to take responsibility to meet their own load growth to use their best efforts to acquire renewables consistent with the Council's Plan and for Bonneville to use its capabilities to facilitate such acquisitions.

Resource adequacy

Even without changes in the way Bonneville carries out its role in power supply, the issue of resource adequacy, and the possible need for an adequacy standard or target to ensure that adequate power supplies are maintained, has been a major concern of the Council and others in the region. A change that results in more of the risk and responsibility of meeting future load obligations being borne by individual utilities instead of by Bonneville does not reduce overall risk. The Council is aware that new policies may be necessary to ensure that adequate information and safeguards exist to determine the power system's adequacy. In particular, the Council is concerned about the possibility that a severe deficit by any one utility could have detrimental effects on other utilities in the region. This risk can only be removed if all utilities ensure an adequate level of resources for their own load-serving responsibilities.

The Council is committed to working with Bonneville, utilities, the states, regulatory commissions, and other regional and West-wide organizations to ensure that appropriate adequacy policies are in place and that the data and other tools to implement the policies are available. The Council believes these policies need to be in place prior to the implementation of long-term contracts.

Fulfilling responsibilities for fish and wildlife

The Council believes these recommendations will not affect Bonneville's fish and wildlife obligations. Those obligations will be determined in a manner consistent with the requirements of the Act and the Council's Columbia River Basin Fish and Wildlife Program. Bonneville's mitigation costs should be allocated to the existing federal power system.

The Council's Goals

The Council recommends that efforts to change the way in which Bonneville carries out its role in power supply should be directed toward achieving the following goals:

- Preserve and enhance the benefits of the Federal Columbia River Power System 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;
- 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 Scope of the Recommendations

The Council's recommendations are focused primarily on achieving long-term resolution of the question of how Bonneville carries out its role in power supply in the future. The recommendations are intended to guide Bonneville as it develops its "future role" proposal in June, 2004, and to serve as a reference during "future role" deliberations among Bonneville, its customers, and interested parties over the coming months and years. The Council believes that decisions resulting from this deliberative process should be implemented as quickly as possible, and in a way that will provide the certainty, continuity, and durability required for the resource decisions that Bonneville and its customers will need to make over the next few years.

It is important for Bonneville and its customers to resolve near-term issues affecting current contracts, most of which do not expire until 2011. The Council also recognizes the right of customers to stay with their current contracts. However, the pressure of near-term issues should not be allowed to detract from the efforts to resolve Bonneville's future role for the long-term. Moreover, there is a great deal of overlap between many of these near-term issues and the long-term issues addressed here. Using the Council's recommendations as a guide, Bonneville and its customers should resolve near-term contract issues in a manner consistent with a transition to Bonneville's long-term future role. The Council intends to be an active participant in Bonneville's "future role" process as it evolves.

Recommendations

A fundamental change in how Bonneville carries out its role in power supply

The region's governors, the Council, most customers, and interested parties who have been engaged in recommending a new role for Bonneville believe a fundamental change is required in traditional power supply business practices. Those with a stake in the benefits of the Federal Columbia River Power System (FCRPS) believe Bonneville should transition toward a new role in marketing the FCRPS, providing power to eligible customers from the existing federal system at its embedded cost, and serving load growth that exceeds the capability of the existing federal system in such a way that customers requesting such service bear its costs and risks. This would result in an equitable distribution of the costs of growth. Customers that choose to take responsibility for their own load growth would not be exposed to the costs of new resources undertaken to serve the needs of other customers. Those that choose to have Bonneville serve their load growth would pay only the costs of serving their growth. Such a change would prevent the value of the existing federal system from being diluted by the higher costs of new resources.

The change in Bonneville's future role that the Council recommends does not alter Bonneville's fundamental responsibility to serve the loads of those qualifying customers that choose to place load on Bonneville; it does not alter Bonneville's responsibility for ensuring the acquisition of Bonneville's share of all cost effective conservation and renewable power identified in the Council's Plan; and it does not alter Bonneville's responsibility to fulfill its fish and wildlife obligations under the Act and the Council's fish and wildlife program. It does represent a change in the way Bonneville has traditionally carried out those responsibilities.

Conceptually, this revised role for Bonneville developed as an outgrowth of the 1996 Comprehensive Review and was carried forward in the 2002 Joint Customer "future role of Bonneville" proposal. Subsequent Council recommendations to Bonneville, and comment received during the latest round of regional dialogue discussions largely support the concept. Bonneville's

planned course of action in concluding the regional dialogue process is to submit a draft regional dialogue policy proposal to the region in June, to undertake consultations and a formal public comment process, and to adopt a final policy in the fall.

Define a clear and durable policy framework for contracts and rate-making

The Council believes that debate in the region over the future role of Bonneville is less about the end-state, a limited role for Bonneville, than about how to reach that end-state. The Council acknowledges that both new long-term contracts and compatible rate structures will be necessary to fully implement the vision. However, the Council also believes that significant policy changes involving allocation of the existing federal system and re-structuring of Bonneville's role in serving load growth and acquiring resources should not be accomplished through contract negotiations and associated rate processes; processes in which participation is practically and legally limited. The issues involved are matters of fundamental public policy that cut across the entire range of agency missions and can potentially affect the region in profound ways. A clear and durable policy framework established with broad regional participation is necessary.

Beginning with the 1996 Comprehensive Review, the Council, many Bonneville customers and other interested parties have engaged in processes that ultimately recommended that Bonneville limit and condition its role in the region's power supply in ways compatible with what is recommended here. Bonneville has attempted to satisfy regional resource objectives under the Act using tools such as policy statements, strategies, and records of decision leading to contract negotiations and rate processes. However, the Council, many Bonneville customers, and others do not believe these tools have been sufficient to provide the necessary level of policy durability. Customers are concerned that future power supply decisions will be made, only to discover that the intended changes in Bonneville's role have not been implemented.

There is a spectrum of means by which regional objectives might be definitively established. The most

durable alternative would be to establish policy through new legislation focused on specific issues. However, the Council believes the process of seeking legislation could entail unacceptable risks for the region. It is the Council's position that desired objectives should first be attempted without legislation.

In its draft recommendations, the Council proposed a middle ground alternative—encouraging Bonneville to take a decisive step and establish its new role through a substantive rulemaking that would create a binding policy before beginning contract negotiations and associated rate cases. Such a rule could have the force of law, similar to a statute, and bind the agency and those affected by the agency in all future implementing actions unless the formally established rule is amended or rescinded through the same administrative procedures process that establishes it. This approach, in conjunction with new long-term contracts and compatible rate structures, has the potential to avoid the risk of new legislation while providing a more binding and durable solution than Bonneville policy implementation has demonstrated in the past.

During comment on its draft recommendations, many in the region, including Bonneville, had misgivings about the rulemaking process. These misgivings included whether Bonneville actually had the authority to undertake such rulemaking, whether such rulemaking would conflict with statutory directives regarding the establishment of rates, and whether such rulemaking might expose the region to risks of external federal reviews not typically associated with Bonneville decision processes. The Council is not convinced these concerns have had sufficient study. They may be valid, or they may not. However, the Council is sensitive to the concerns expressed in the region and will not press for substantive rulemaking at the present time.

Policy should include the process and schedule for resolving issues

Given the foregoing, the Council accepts Bonneville's present course of action to submit a draft policy proposal to the region in June; to undertake consultations and a formal public comment process; and to adopt a final policy in the fall. Nonetheless, the Council remains concerned that this policy process is not uniquely different from previous Bonneville policy pro-

cesses. Bonneville needs to take steps to ensure that the final policy provides the durability necessary to meet Bonneville customer expectations for long-term contract negotiations and associated rate processes; and that the region's expectations for conservation and renewable resource development are fulfilled.

To improve the durability of the policy, the policy must include: clear identification of the priority issues that are to be resolved before the region can move to developing new contracts and rates; the process by which the issues will be addressed; and a detailed and aggressive schedule for doing so. Among the issues, the policy must be responsive to concern among customer utilities that the scope of the policy include sufficient "process" detail to guide utility decisions in long-term resource planning; the inclusion of provisions by which Bonneville intends to extend assurances of contract durability and enforcement in areas such as Bonneville cost control, dispute resolution, continuation of Bonneville's role in conservation and renewables, fish and wildlife mitigation, and allocation of the existing federal power system. The schedule should include offering new contracts no later than October of 2007.

Consider alternative processes, if necessary

Should activities undertaken in response to the Bonneville policy prove inadequate to meet the schedule established for resolution of regional issues leading to development and offering of new contracts by October of 2007, then alternative means of resolving these issues should be considered.

Some Bonneville customers may advocate legislative changes to the Act as a means of resolving difficult issues. The Council remains convinced that diverse proposals to amend the Act can introduce instability in a region already precariously balanced between opposing agendas for power, conservation, renewable resources, and fish and wildlife mitigation within the Columbia River Basin. Before considering legislation, the Council recommends that Bonneville and the Council work jointly to determine if substantive rulemaking under the Administrative Procedure Act can be a vehicle for resolving the outstanding issues. If so, such a rulemaking should be promptly undertaken. In preparation for this possibility, the Council will continue to work with

Bonneville and regional interests on the relative merits of substantive rulemaking.

Lacking agreement that substantive rulemaking is an appropriate substitute for a proposed amendment of the Act, the Council recommends that Bonneville and the Council work jointly to seek specific language for the proposed amendment. Public comment gathered through the public process could then be forwarded to the Northwest Congressional Delegation with separate recommendations or comments from Bonneville and the Council, as appropriate. Legislation should not be recommended without broad regional support, including consensus among the four Northwest governors.

Offer long-term contracts as soon as possible

Long-term contracts (preferably 20-years) based on the Bonneville policy should be offered no later than October of 2007. New long-term contracts should be offered as soon as possible to provide as much certainty as possible for the development of new resources that will be needed. Resource decisions will almost certainly need to be made well before 2011. Although it would not be necessary for the new contracts to take effect before 2011, offering new contracts by 2007 would provide the business certainty that the customers need regarding load serving responsibility after 2011.

To be implement the new role for Bonneville, new contracts should be consistent with Bonneville's policy in describing how power from the existing federal system will be allocated to customers, and the terms under which Bonneville will serve additional load beyond the capability of the existing federal system. The contracts must also incorporate necessary checks and balances to protect customers from unwarranted costs while ensuring that Bonneville is able to fulfill its responsibilities, including conservation and renewables, fish and wildlife mitigation, and timely repayment of debt.

Cost Control and Business Practices

The biggest impediment to long-term contracts is the customers' concern that by entering into long-term contract they will give up a major point of leverage to exercise discipline on Bonneville's costs and business practices — their ability to take load off Bonneville. Issues of contract enforceability are prominent among the customers' concerns. Bonneville and the customers have

taken steps to provide greater transparency to Bonneville's costs and decision processes through the Customer Collaborative and Sounding Board processes. These efforts should be continued. However, that is only part of the customers' concerns. In particular, many customers are concerned by what they see as Bonneville's practice of defining issues in such a way that disputes are adjudicated in the Ninth Circuit Court of Appeals, where the scope of judicial review is limited to the record established by Bonneville. The agency should use the upcoming regional dialogue policy to make clear the scope and limits to Bonneville's authority in dispute resolution.

The Council believes that if the basic business construct proposed in these recommendations is implemented, a major pressure on Bonneville's costs — the cost of augmentation for load growth beyond the capability of existing federal power system — will be limited. At the same time, the Council recognizes a different category of costs derived from Bonneville's broader public purpose responsibilities under the Act. The successful fulfillment of these responsibilities will continue to require an active role by Bonneville, guided by the Council's power plan and fish and wildlife program, and informed by broad public involvement, including input from Bonneville customers.

The benefits of long-term contracts are sufficient that all parties need to be open to examining ways in which concerns can be overcome. These concerns include system allocation, cost segregation, cost control, contract enforceability, dispute resolution, Bonneville business practices in general, and possible adverse impacts to Bonneville's public service responsibilities under the Act. The Council commits to work with Bonneville, its customers, and others to identify a workable resolution of problems that may arise.

Allocation of the existing system

Fundamental to implementing the changes in Bonneville's role in power supply is allocating the power from the existing federal system among eligible customers. In the long-term model, it is a utility's allocation of this power that would be purchased at the lowest embedded cost rate. A utility's requirements above this level would either be met by the utility itself or by Bonneville, with the customer bearing the cost and risk of the additional resources required. Any implementation of tiered rates

under existing contracts should be consistent with the long-term model.

Any allocation should be done in such a way as to minimize opportunities for gaming the process. For that reason the Council believes that, lacking agreement on any alternative basis, allocation should be based on customers' historic net requirements placed on Bonneville, normalized for economic and weather effects.

New or Annexed Public Loads

It is the Council's understanding that Bonneville must ultimately serve all qualified public loads on a comparable basis. This includes the loads of newly formed public utilities or the loads of areas annexed by public utilities. The Council understands the dilemma that potential new public loads present. The possible dilution of the benefits of the existing system resources reduces certainty for customers.

Serving new or annexed public loads from the existing system would require either a reallocation of the existing federal system, which would result in all customers getting a reduced share, or augmentation of the existing federal system with the costs of that augmentation included in the cost of the existing federal system. However, before reallocation or augmentation would take effect, a waiting period of reasonable duration is needed to allow existing customers and Bonneville to make and implement necessary resource decisions.

To make this process as equitable as possible, the amount of the new or annexed load that would qualify for service from the existing system should be determined on the same basis as the system allocation for existing public utilities described earlier. Utilities requiring additional power above that level would pay for the resources required to serve those loads—or the utilities could serve those loads themselves.

Until reallocation took place, new publics or annexed areas could be served by Bonneville at the cost of the resources required to serve them—or by the new or annexing public itself. In cases where a new public was formed from IOU territory or IOU territory was annexed, a proportional part of the residential and small farm benefit would transfer to the new or annexing public utility until a reallocation of the federal system is carried out.

Existing customers whose allocation is reduced as a result of new or annexed public loads would have the option of having Bonneville serve the amount of load that can no longer be served by the existing federal system at the cost of the resources required—or they could serve the loads themselves.

Reduced Public Utility Loads

There is the potential for a utility's net requirements to fall below its allocation of existing system resources. This could well be a temporary phenomenon. The Council encourages Bonneville to use what flexibility it has to ensure that a utility's long-term ability to access existing federal system power at its embedded cost rate not be unnecessarily diminished. In particular, the Council believes the risk of diminished access to existing system power would be a disincentive to development of cost-effective conservation. Should this become an issue, the Council encourages Bonneville to implement mechanisms to mitigate the problem.

Loss of Existing Federal System Resources

There is always the potential for the loss of resources from the existing federal system. If such loss were to occur, customers should have the option of having Bonneville replace their share and charge them the cost of replacement or of replacing the resource themselves.

Tiered rates under current contracts?

Tiered rates would be the clearest practical indication of how Bonneville will be carrying out its role in the future. Nonetheless, if Bonneville's role is defined as recommended and: 1) critical issues are resolved in a timeframe consistent with the schedule established in Bonneville's policy; and 2) new contracts are negotiated and offered by October of 2007; the Council will not press for tiered rates under the current contracts for the next rate period. However, the Council reserves the right to reconsider this recommendation if the region is not meeting these conditions.

Products

Customers should have access to the full range of products that are currently available, e.g., requirements products, block products, and slice. What is important is that the costs of each product be confined to the purchas-

ers of that product. The costs of serving load growth should be confined to those purchasing that service, and every effort should be made to eliminate cross-subsidies among products. In the process of negotiating new contracts, customers should have the opportunity to choose the products that best meet their needs.

Service to:

Direct Service Industries

While Bonneville may contract to supply power to Direct Service Industries (DSIs), it is not required to do so. However, the decision not to serve some DSI load cannot be taken lightly. Some DSIs are still important sources of employment in their respective local economies. If a DSI has been a responsible customer of Bonneville—that is, if the DSI has not imposed stranded costs on Bonneville by substituting market purchase for federal power; has not rejected its Bonneville power contract in a bankruptcy proceeding; and has not defaulted on its payment obligation under an existing contract, there may be an opportunity to provide a limited amount of power for a limited duration under specified terms and conditions.

The existing federal system is roughly in load/resource balance. Consequently, some level of augmentation will probably be necessary to provide reasonably continuous service. If power is to be made available to DSIs, the amount and term should be limited; the cost impact on other customers should be minimized; and Bonneville should retain rights to interrupt service for purposes of maintaining system stability and addressing temporary power supply inadequacy.

New Large Single Loads

Moving to a system whereby power from the existing federal system is allocated, and where additional power requirements are met at the cost of the power to serve them, essentially makes the question of new large single loads moot. Power for service to new large single loads would be served at the cost of the resource acquired to serve them. The choice of whether to meld those costs at the retail level would be the decision of the retail utility.

Until such time as an allocation is made, the existing new large single load policy should be adhered to and such loads should not be included in subsequent calculations of a customer's allocation of the existing federal system. DSI

loads should not be allowed to migrate to local utilities and be included in the utilities allocation calculation.

Benefits for the residential and small farm customers of the region's investor-owned utilities

The Council supports a resolution of the issue of benefits for the residential and small farm customers of investor-owned utilities (IOUs) for a significant period. Accomplishing this would be an indication of having achieved an equitable sharing of the benefits of the federal system between the customers of publicly owned utilities and the residential and small farm customers of the investor-owned utilities; it would resolve significant public/private disputes and would result in a broad cross-section of the region seeing a direct, long-term interest in preserving the Federal Columbia River Power System for the region.

This was the objective of the exchange settlement under the existing contracts. Given the litigation surrounding that settlement, the question of benefits for residential and small farm customers of the IOUs under the existing contracts may be decided by the courts. Otherwise, Bonneville should fulfill its obligations under the existing contracts within its existing authorities.

For the longer term, there is general agreement that the mechanism for sharing the benefits established in the Act has operated in such a way that it satisfies no one. However, "fixing" these features of the Act through legislative action could have broad regional ramifications. The Council is opposed to such legislation.

This would appear to leave settlement as the only option. The objective of the exchange provisions of the Act was an equitable sharing of the benefits of low-cost federal power to the residential and small farm consumers of the region, no matter who served them: publicly-owned utilities or investor-owned. Under a settlement, benefits could be provided in the form of power or dollars. The Council believes that providing the benefits in the form of power is more risky for Bonneville and could make the question of allocation more difficult.

The Council cannot judge what is equitable in the eyes of the parties. It is clear, however, that there are some desirable characteristics of a settlement that can be defined. It must provide certainty, it must be transparent,

and it must not be subject to manipulation. Certainty requires that the cost impact on publicly owned customers be capped on the upside and that there be a floor under the benefits for the residential and small farm customer of the IOUs. Transparency requires that the benefit be calculated in such a way that it is easily understood. And if it is not to be manipulated, the key parameters must be subject to independent verification.

The recent proposed settlement contained these elements for the period of the current contract and was supported by most of the customers in the region. The Council believes this could be the template for a long-term settlement. One of the objections raised about the settlement was that it did not provide long-term certainty beyond the current contract period. Using this settlement as the starting point for the long-term solution would address that concern.

The Council encourages all parties to carefully consider the benefits to be derived from substantially reducing the uncertainty surrounding the benefits to be provided for the residential and small farm customers of the IOUs. The Council believes this value is the basis for a successful compromise.

Fulfilling responsibilities for conservation and renewables

The Act requires Bonneville to prioritize cost-effective conservation and renewables in its role of providing new resources for the region. It is critical that these priority resources continue to be developed in the new role envisioned for Bonneville. The Council expects Bonneville and the region's utilities to continue to acquire the cost-effective conservation and renewable resources identified in the Council's power plans. Bonneville should employ mechanisms similar to the current C&RD program and provide essential support activities to encourage and facilitate utility action. Bonneville's role will be substantially reduced to the extent that customers can meet these objectives. But if necessary, Bonneville must be prepared to provide a backstop mechanism to ensure that these objectives are met. Bonneville must retain the ability to secure its regional share of cost-effective conservation and renewables identified in the Council's

Plan that is not otherwise secured by its customers. The costs of the backstop actions would be the responsibility of the individual utilities that fail to meet their responsibilities. Contracts have to be consistent with preserving Bonneville's ability to fulfill this obligation.

Conservation

Many of the comments received raised serious questions with the Council about whether the Act's directive to secure all cost-effective conservation would be met. These comments imply that if utilities face a marginal price signal, as is proposed in these recommendations, decisions regarding the implementation of conservation will be at the discretion of utilities, and utilities will have sufficient incentive to pursue these resources. The Council believes this ignores what the Northwest and other parts of the country have experienced. Conservation faces significantly greater obstacles than conventional generating resources, even though conservation may be more cost-effective.³ This region has compiled an admirable record of conservation achievements over the last 20 years. However, it has not been easy. It has required constant attention from the Council and state regulatory agencies, and it has required significant institutional support from Bonneville. In particular, the role Bonneville has played in providing necessary regional infrastructure has been essential. While providing utilities with a marginal price signal should improve the situation, it is not sufficient. If it were, the record of conservation achievement in other parts of the country where utilities have uniformly faced marginal price signals would be much better than it is.

The Act places a special emphasis on conservation. One of the fundamental premises of the Act is that by increasing the efficiency of all electricity consumption, from generation through transmission and distribution to its final end use, the region could extend the economic benefits of the region's low cost hydroelectric system. The Act created an ongoing responsibility for Bonneville to acquire conservation to "reduce load," not just meet load growth. And while the Council's recommendations may reduce Bonneville's responsibility for meeting load growth in the region, they would do so only for the duration of the contracts. Nothing prevents customers from bringing additional net requirements to

³ These impediments include the fact that, due in part to the way in which many utilities currently structure their retail rates, conservation reduces utility revenues in the short term even while reducing long-term costs.

Bonneville at the end of the contract period. For these reasons, the Council continues to support its conservation recommendations. They are fundamentally the same as its December 2002 recommendations.⁴ In summary, those recommendations were:

- The system for conservation development should: 1) rely on the Council's Plan to define the cost-effective resource; 2) rely on proven delivery mechanisms; 3) provide stabilized and adequate funding for conservation over the duration of the new contracts; 4) reinforce the role and capabilities of the Regional Technical Forum; 5) provide a mechanism for ensuring that cost-effective conservation is implemented; and 6) capture conservation at as low a cost to the power system as possible.
- Bonneville should establish conservation budgets based on Bonneville's share of regional conservation potential identified in the Council's Plan and estimated program costs to capture that conservation. However, conservation savings targets and mechanisms should be designed to encourage conservation on all loads of preference- customer utilities, not just the part served by Bonneville.
- Bonneville's obligations and authority with respect to IOU conservation is limited to the residential and small farm loads of those utilities that are subject to the residential exchange. The Council, however, will continue to encourage and support the work of the states' utility regulatory commissions to use their authorities and least-cost planning regulations to ensure that the cost-effective conservation on all IOU load is accomplished.
- Conceptually, the Council supports the use of a mechanism like the C&RD program to support local implementation. However, the existing mechanism must be redesigned to ensure cost-effective acquisitions, encourage best practices, and minimize the cost of acquisition consistent

with achieving the savings. The mechanism also must limit expenditures on activities that do not clearly support the development of tangible savings and ensure accountability.

- Further, the Council believes the mechanism should be designed to reduce the need for any Bonneville backstop mechanism. A better alternative would be to work with utilities at the outset to identify good opportunities and approaches. The discount could then be provided incrementally, addressing the local utilities' immediate cash flow requirements. Subsequent payments would be made on demonstration of progress. Bonneville would step in only as a last resort.

Customers prefer a mechanism in which they are granted the full discount at the outset and only charged if a customer fails to take the actions necessary to achieve its target. The Council is willing to give consideration to such a model, but only if there are frequent (annual) progress checks and the ability for Bonneville to take action, if necessary, in response to the results of those progress checks.

- The Council believes a broader range of conservation activities should be carried out at the regional level than what is described in the original customer proposal. This is necessary because there are a number of activities that can be carried out more effectively if they are approached on a coordinated regional basis with local implementation. These include activities like market transformation, limited development and demonstration activities, and program design and administration where there are significant economies of scale to be gained. In addition, Bonneville's support of low-income weatherization should be continued.

Since these recommendations were developed, a few things have become clear. Customers have expressed an interest in continuing the status quo through the next rate period. The status quo is a half mill rate discount

⁴ Council Document 2002-19, op. cit. pages 20-27

with considerable built-in flexibility for “local conservation,” some funding of regional conservation approaches, as well as qualifying renewable resource activities from system revenues paid by all. That solution alone is not likely to capture all cost-effective conservation that has been identified during the development of the Council’s Fifth Power Plan.

The region has benefited tremendously from the last 20 years of conservation development. It has reduced loads about 2,800 average megawatts at a cost less than half of that of adding similar amounts of generation. The Council expects its future Plans will continue to identify significant cost-effective conservation potential that the region should pursue. This conservation is valuable to the region regardless of whether the region is developing new generation or not. However, given recent large retail rate increases, the Council believes Bonneville and the utilities may find it difficult to raise rates to adequately fund conservation activities as they have been implemented in the past.⁵

Therefore, the Council believes it is increasingly important that the region continue to enhance its conservation efforts to ensure that it is achieving conservation at the lowest cost to the utility system. Bonneville should use the full extent of its authority to ensure that all cost-effective conservation is captured in an efficient, low-cost, and timely way; and Bonneville should retain a strong and active role in the coordinated planning and implementation of conservation efforts across the region.

Bonneville should continue to support a rate discount mechanism for some conservation. However, a rate discount should not necessarily be the only mechanism. The C&RD program has been instrumental in motivating some utilities to pursue conservation and renewables activities, and it clearly expanded the portfolio of activities and measures deployed across the region. Those attributes should not be lost. But the rate discount needs to be refined along the lines recommended in 2002.⁶ Bonneville and the Council should facilitate a collaborative process to refine the details of a rate discount and produce recommendations by early 2005.

Furthermore, in addition to a rate discount, Bonneville should establish budgets and other mechanisms, including bilateral contracts with its customers, to ensure the development and local implementation of conservation and the full portfolio of activities and approaches.

The Council believes there is a need for increased budgets for regional implementation activities including market transformation, cross service territory program design and marketing activities, and evaluation activities. Guided by the Council’s Plan, the region should come to agreement on the level of funding for regional implementation of conservation through a process facilitated by the Council. The goal should be to capture conservation at as low a cost to the power system as possible.

Renewables

The C&RD mechanism has been used to support development of renewable resources, and the Council supports continuing this policy, so long as the cost-effective conservation is also acquired.

Some advocate a pattern of “sustained orderly development” for renewable resources such as wind. This would translate into a megawatts-per-year target for renewables development. The Council continues to believe that levels of renewables development should be guided by the Council’s Plan that evaluates resources on the basis of cost and risk mitigation values. Where Bonneville is serving load growth, the Council expects Bonneville’s resource acquisitions to be consistent with the Council’s Plan, including renewable resources. The Council encourages those utilities that choose to take responsibility for meeting their own load growth to use their best efforts to acquire renewable resources consistent with the Council’s Plan, and for Bonneville to use its capabilities to facilitate such acquisition.

There are some renewable resource development activities that Bonneville is uniquely suited to pursue, and that would not happen without its participation. These activities benefit all of Bonneville’s customers, and their costs should be recovered from the existing system. These include activities such as: 1) removing barriers to cost-effective renewable; 2) development of services

⁵ Conservation and renewables work group discussions.

⁶ Council Document 2002-19, op cit.

and products such as storage and shaping, transmission re-dispatch products, and making transmission acquisition for renewables easier; and 3) limited, region-specific research and demonstration. The costs of actually providing services like storage and shaping should be paid by the purchaser.

The Council expects this portfolio of activities will change over time as new cost-effective resources emerge and new implementation barriers are discovered. The Council's Plan will identify some of these barriers. Bonneville and the Council should facilitate a process to periodically review and identify renewable resource activities and budgets suitable for funding by all Bonneville customers.

Resource adequacy

Even without changes in the way Bonneville carries out its role in power supply, the issue of resource adequacy, and the possible need for adequacy measures to ensure that adequate power supplies are maintained, has been a major concern of the Council and others in the region. A change that places more risk and responsibility for meeting future load obligations on individual utilities rather than on Bonneville does not reduce overall risk. The Council is aware that new policies may be necessary to ensure that adequate information and safeguards exist to determine the power system's adequacy. In particular, the Council is concerned about the possibility that a severe deficit by any one utility could have detrimental effects on other utilities in the region. This risk can only be removed if all utilities ensure an adequate level of resources.

The Council accepts the responsibility of working with all regional players including Bonneville, utilities, the states and their regulators, and other regional and West-wide organizations to ensure that appropriate adequacy policies are in place, and the data and other tools to implement them are available. The Council believes that these policies need to be in place prior to the implementation of long-term contracts.

Some of the commentors objected to the idea of a regulatory adequacy standard. The Council did not intend for a resource adequacy standard to be the only means for achieving resource adequacy. At this time, there is also no obvious mechanism to create or enforce an adequacy

standard for all load-serving entities in the Northwest. There are, however, other options. For example, the Council could facilitate the development of adequacy benchmarks for the region and for individual utilities. These benchmarks would permit a systematic review of regional adequacy and allow utilities the opportunity to assess their own individual performance against their appropriate adequacy benchmark. There are, no doubt, other approaches to adequacy that the Council can help the region evaluate and ultimately implement.

Fish and Wildlife

The Council believes these policies will not affect Bonneville's fish and wildlife obligations. Those obligations will be determined in a manner consistent with the requirements of the Act and the Council's Columbia River Basin Fish and Wildlife Program. Costs should be allocated to the existing system.



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