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MEMORANDUM

TO: Council Members

FROM: Dick Watson

SUBJECT: Draft Council Recommendations regarding Bonneville's Future Role in Power Supply

Attached is the current draft of the Council's recommendations. This was released for public comment with close of comments on December 9. The Power Committee will be taking public comment and making revisions to this document at its meeting on December 10. The final draft will be discussed with the Council on the Morning of December 12, at which time we will be asking for Council approval. The current draft is complete except for a revised analysis of the costs of the proposed settlement. This analysis will be ready for the December 10th meeting.

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Council Recommendations on the Future Role of Bonneville

Summary

For the past several months, the Council has participated in the Regional Dialog on the Future Role of the Bonneville Power Administration in Power Supply. At least two immediate factors were the impetus for the Regional Dialog. First, the power supply contracts of Bonneville's Direct Service Industrial (DSI) customers expire in 2006. The companies must know if they can expect service from Bonneville after 2006, and Bonneville must know how much power to supply in order to secure the necessary resources. A second and very significant factor is that after more than a year of discussions, the majority of Northwest utilities, both public and investor-owned, large and small, urban and rural, appear to have coalesced around a proposal that would significantly alter Bonneville's future role in power supply. It is significant that these disparate interests would agree on a number of issues that have been in dispute for many years. This fact alone deserves careful consideration.

These interests did not come together by accident. They came together out of recognition of a set of problems that, if not resolved, could threaten the reliability of the regional power supply and the ability of the Northwest to retain the benefits of the Federal Columbia River Power System. These problems are not the fault of the Bonneville Power Administration and its thoroughly professional staff. Rather, they are the consequence of a mismatch between how Bonneville is called upon to operate and the realities of the evolving electricity system. The problems include:

- Periodic lack of clarity regarding load-serving responsibility;
- Lack of clear economic signals to many parties in the region regarding the true costs of new power supplies and the value of alternatives;
- Exposure of Bonneville to high electricity market risks resulting from the periodic ability of customers to place load on or take load off of Bonneville;
- A perception of inequality in the distribution of the benefits of the federal power system within the region.
- The financial risk to the U.S. Treasury and the resulting political risk to the long-term interests of the region if at some time, Bonneville is unable to absorb the risks of uncertain loads, a highly variable hydroelectric system and a potentially volatile wholesale market.

These observations are not new. They were recognized formally more than seven years ago during the Comprehensive Review of the Northwest Energy System, which was authorized by the region's governors.[1] Many of the aims of the proposals on Bonneville's future that were offered by the Joint Utility Customers and the Public Interest Groups during the Regional Dialog reflect conclusions reached in the Comprehensive Review.

[1] *Comprehensive Review of the Northwest Energy System*, Document Number CR96-26, December 12, 1996.

The Council participated in the Regional Dialog public meetings around the region and reviewed the written comments and proposals that were submitted. In light of those proposals and comments and the Council's own analysis of Bonneville's situation, the Council makes the following recommendations for Bonneville's consideration as it prepares a blueprint for its future role in power. The Council's recommendations primarily are concerned with issues of efficiency and less with issues of equity. However, if equity issues are not adequately addressed in any final proposal, the likelihood of a success will be small.

Long Term Contracts –

The Council supports 20-year contracts because they will provide contractual protection from the efforts of those outside the Northwest to appropriate the benefits of the federal Columbia River system; demonstrate regional commitment to the federal system and buffer Bonneville and thereby the Treasury from the risks of losing or gaining loads with shorter contracts. The Council recognizes the customers' concern that with shorter contract terms, they lose an important tool for exercising discipline on Bonneville's costs. However, the Council finds the customer's proposals for a customer advisory committee with enforceable powers, or "off-ramps" at which customers can take some load off Bonneville if it fails to meet cost targets, to be problematic. The Council encourages Bonneville and the customers to focus on process remedies that ensure customers and other interests have the opportunity to probe and contest Bonneville's costs. Bonneville's political accountability will continue to be an important control on Bonneville's costs. The Council is willing to make itself available to Bonneville, the customers *and* other interests to help forge a solution.

Power Products – Slice –

The Council supports offering of the slice product and expanded use of that product. This product meets the needs of some customers; it results in greater diversity in the electricity market; it lessens Bonneville's impact on the market and its exposure to market and hydropower risk; it improves the liquidity of the power market; and, it provides clarity with respect to responsibility for meeting load growth and clear economic signals regarding the cost of serving load growth. However, the Council is concerned about the ability of some individual slice customers to handle the risk associated with the slice product. The Council encourages Bonneville and the customers to make sure the provisions for surcharging all slice customers when one or more are unable to make timely payment to Bonneville are robust enough to not jeopardize Bonneville's ability to make its Treasury payments. The Council recommends that slice customers be allowed flexibility in the operation of their slice so long as non-power constraints, including fish constraints, are not violated. From the standpoint of reliability, it is essential that Bonneville retain the ability to take unilateral actions on the whole system in the case of emergency.

Power Products – Requirements --

The Council supports Bonneville offering of the requirements product, as it meets the needs of many customers in the region. However, the Council is concerned about the lack of clarity regarding responsibility for meeting load growth once any surplus federal

base system resources have been absorbed. The Council recommends that Bonneville clearly indicate that the load growth will be served by tiered rates or the equivalent that charges the cost of the new resources needed to meet load growth. To do otherwise would perpetuate conflict between growing and non-growing utilities and not send appropriate price signals to the customers.

Power Products – Block

The Council supports Bonneville providing a block power product independent of the slice product. However, the Council believes that the block power product should be conditioned as described in the Joint Customer Proposal – that the costs Bonneville incurs in shaping power to the blocks be passed on to the block customer and that the block product not contain a load growth element. This is essential to aligning benefits and risks, providing clarity with regard to load responsibility and clear economic signals regarding the cost of load growth.

Investor-owned Utility/Publicly owned Utility Settlement

The Council supports settling the issue of the level of benefits provided the residential and small farm customers of the investor-owned utilities. To do so will reduce intra-regional animosities and give a broader cross-section of the region direct involvement in the well-being of the federal system. The settlement proposes a relatively simple and transparent representation of an equitable sharing of the benefits of access to federal power based on the residential exchange concept. It uses the cost of power from a combined cycle combustion turbine as a surrogate for the cost of providing power to the residential customers of investor-owned utilities. There are questions that can be raised about this approach. However, this is an equity issue, and agreement among the parties to the settlement is strong evidence that equity has been achieved. However, there are implications for Bonneville's costs, and the parties will benefit if there is broad agreement, beyond those directly at the table, that solution is equitable. If there is not equity, the customers may ultimately not settle. Or even if they do, other parties may challenge the settlement in the courts. This would increase the risk that the goals of the proposal would not be met.

Service to Direct Service Industries

The contracts for service to the Direct Service Industries expire in 2006. The companies need to know if they will continue to receive power at Bonneville's average cost in order to make decisions about the future of their plants. Bonneville needs to know whether it needs to acquire resources for those plants. Current contracts would supply approximately half of the smelter load in the region. However, at current world aluminum prices and Bonneville power rates, little smelter load can operate economically. If aluminum prices improve and Bonneville rates are not too high, more of the region's capacity could operate. The Council recognizes that the Direct Service Industries are important to local economies in the region but also recognizes that acquiring power to serve these loads will increase costs for other consumers and industries in the region.

The Council supports a level of service to the DSIs that is more than the 600 megawatts for smelters and 50 megawatts for non-smelter loads in the Joint Customer Proposal but significantly less than the current 1,440 megawatts. The power should be offered in such a way that:

- The cost of providing the service is minimized;
- Those smelters that are most likely to be able to use the power are able to access the power that is made available; and
- The smelters are encouraged to move off of Bonneville power in the long-term.

This service should be conditioned on capturing the benefits of interruptibility of the DSIs for both reliability and short- and long-term market reasons. The Council urges Bonneville to consider contract provisions to help maintain smelter operations when aluminum prices are low and power supplies are ample, provided this can be accomplished without imposing additional costs and risks on Bonneville's other customers.

The Council would recommend an initial allocation of 100 megawatts per smelter. If the entire amount is not allocated, the remaining megawatts would be offered to those smelters who wish to take more. A smelter could take additional power provided its owner brings a resource to Bonneville in a like amount. Bonneville could purchase the power, provided that it is competitively priced, and sell it back to the DSI at Bonneville's melded rate. If the DSI were to stop taking power from Bonneville, Bonneville's obligation to purchase the power would end. The Council recommends that the contract terms be limited to 10 years with the condition that the amount of power available for DSIs in subsequent contracts would be further reduced. The Council also supports consideration of credit support for DSIs that develop incremental generating resources that would be contractually dedicated to serving that portion of the in-region smelter load not served by Bonneville.

Conservation

The Council believes it is imperative that any proposal to fundamentally change Bonneville's role in power supply include a realistic approach to ensuring that the region develops cost-effective conservation. The fact that Bonneville's customers can bring loads back to Bonneville at the end of the contract period makes the achievement of all cost-effect conservation a continuing priority. The thrust of the customer proposal that makes more customers responsible for meeting their load growth is a major step in the right direction. It is, however, not sufficient given the disincentives to utility investment in conservation, even though it is a lower-cost resource.

The Council believes that Bonneville should establish conservation budgets based on Bonneville's share of regional conservation potential identified in the Council's Northwest Power Plan and estimated program costs to capture that conservation. However, conservation savings targets and mechanisms should be designed to capture conservation on all loads of preference- customer utilities, not just the part served by Bonneville.

While the Council believes the establishment of Bonneville's conservation budgets should be based on load served by Bonneville, it also believes that Bonneville has the obligation and authority to establish conservation targets and to develop mechanisms to ensure conservation is captured for the entire load of its preference customers, not just the portion served by Bonneville. Bonneville should use its authorities to the fullest extent possible to ensure the region attains conservation goals established for the entire retail load of customers that can place load on Bonneville.

The Council believes that Bonneville's obligations and authority with respect to investor-owned utility (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 the IOU load is accomplished.

The Council supports elements of the Joint Customer and Public Interest Group proposals that would 1) rely on the Council's power plan to define the cost-effective resource; 2) rely on proven delivery mechanisms; 3) provide stabilized and enhanced funding for conservation over the duration of the new contracts; 4) reinforce the role and capabilities of the Regional Technical Forum; and 5) provide a mechanism for ensuring that cost-effective conservation is implemented.

The Council supports the use of a mechanism like the Conservation and Renewables Discount to support local implementation. However, the 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.

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. Then, the discount could 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.

The Council believes a broader range of conservation activities should be carried out at the regional level than is envisioned in the customer proposal. This is because there are number of activities that can be carried out more effectively if they are approached on a coordinated regional basis with local implementation.

Renewable Resources

In general, the Council supports some level of acquisition of renewable resources at costs above the market price of electricity. The level of above-market support should reflect the environmental and risk management benefits of such resources as determined in the

Council's planning process, as well as the need to develop additional information about the integration of such resources into the regional power system. The Council does not support the Public Interest Groups' recommendation that all regional load growth above that met through conservation be met through renewable resource acquisition if that is not supported by credible analysis.

Fish and Wildlife

The Council supports the joint customers' intent that the combination of slice/block/requirements operations will not affect the determination and implementation of Bonneville's fish and wildlife obligations. Under the proposal, Bonneville, the Corps of Engineers and the Bureau of Reclamation will continue to meet the federal government's Indian trust and treaty responsibilities. No changes are proposed in river operations required by NOAA Fisheries and the Council. In addition, Bonneville's customers will continue to pay the costs associated with Bonneville's fish and wildlife obligations. To the extent that slice contracts reduce pressure on Bonneville to alter system operations to meet load, this would be beneficial to fish and wildlife. Furthermore, greater clarity with respect to load responsibility should result in more timely development of new resources and reduce the potential periods of resource inadequacy. This should reduce the frequency with which the region would be forced to compromise fish operations on the hydropower system to maintain power supply adequacy. The Council recognizes that to the extent there are more slice customers, these customers may take a greater interest in decisions about river operations. While this may change the dynamics of fish and wildlife decision-making, the responsibility continues to reside with the federal agencies.

Background

Over the last decade, the Northwest Power Planning Council has observed and participated with the Bonneville Power Administration as it worked to define its role in the rapidly changing electricity industry. In the mid-1990s, Bonneville was buffeted by changes in the competitive wholesale power market. Very low market prices for power caused Bonneville customers to seek modification of their existing contracts to allow them to "diversify" their power supplies by taking load off Bonneville. This caused real concern about the ability of Bonneville to continue to meet its financial obligations to the U.S. Treasury. At the same time, it was recognized that in the long run, after Bonneville's obligations for repayment of the Washington Public Power Supply System had been fulfilled, Bonneville power would be extremely attractive in almost any electricity market. There was concern about whether Bonneville could remain solvent and continue to deliver the long-term benefits of the Federal Columbia River Power System to the region.

The Governors of the Northwest States were sufficiently concerned that they convened the Comprehensive Review of the Northwest Energy System. The Review, which was facilitated by the Northwest Power Planning Council, engaged 20 regional leaders in 30 day-long meetings and many additional working group meetings over the course of a year. While the Comprehensive Review was concerned generally about the changes going on in the electricity industry, much of its attention was focused on the future role of

the Bonneville Power Administration. The goals of the Comprehensive Review with respect to Bonneville were stated as follows:

> *The Steering Committee's goals for federal power marketing are to: 1) align the benefits and risks of access to existing federal power; 2) ensure repayment of the debt to the U.S. Treasury with a greater probability than currently exists while not compromising the security or tax-exempt status of the Bonneville Power Administration's (Bonneville's) third-party debt; and 3) retain the long-term benefits of the system for the region. This recommendation is also intended to be consistent with emerging competitive markets and regional transmission solutions.*

Some of the key elements of the Review's recommendations were:

- Marketing the output of the system to regional customers at cost under long-term (preferably 20-year) contracts;
- An equitable sharing of the benefits of the federal system with the residential and small farm customers of the region's investor-owned utilities;
- Limiting Bonneville's exposure to the risk of resource development by acquiring new resources to serve customers' load growth only through bilateral contracts with those customers.
- Ensuring that conservation and renewable resources continued to be developed by providing sustained funding through a "system benefits charge" amounting to approximately 3 percent of revenues from the retail sale of electricity.

Subsequently, efforts were made to implement elements of these recommendations through a "subscription" process, in which customers entered into new contracts for service for Fiscal Year 2002 and beyond. The contract lengths turned out to be predominantly for 10 years rather than 20. Bonneville remains responsible for meeting the load growth of many of these customers and does so by "melding" the cost of new resources with the power of the Federal Base System. However, a number of customers decided to purchase a new product – "a slice of the system" -- that gives them a percentage of the output of the Federal Base System, whatever that output might be. Those customers are responsible for meeting their load growth and paying the cost and managing the risk of the variable output of their slice of the system.

Unfortunately, the timing of the subscription process and signing of new contracts coincided with the onset of a drought and a dramatic upturn in the power market prices. The net effect was a significant increase in the loads placed on Bonneville in Fiscal Year 2002 and beyond, and the need for Bonneville to secure additional resources to serve those loads during a period when prices were at historical highs. Bonneville's current financial difficulties are in large part the consequence of those high costs, combined with lower-than-expected revenues from secondary power sales in the recently depressed power market. In retrospect, it could be argued that if responsibility for meeting load growth had been more clear in the late 1990s, additional resources might have been added to the system and the power crisis of 2000/2001 might not have been as severe.

As part of the new contracts, Bonneville, investor-owned utilities and the state utility regulatory commissions worked out a means of sharing the benefits of the federal system between residential and small farm customers of investor-owned utilities. This arrangement, however, has been challenged in the courts. Unless that challenge is settled amicably, the region could face continued animosity between public and private power entities.

Based on the experience of the last decade, the Council believes that changes in the way Bonneville markets federal power in the future are necessary. In less than 10 years, Bonneville has gone through a swing from losing load and increased risk of not making its Treasury payments to increased load and additional power supply costs during adverse market conditions. This could force either large rate increases or reduced probability of Treasury repayment. The ability of public utility customers to periodically place load on Bonneville or take it off exposes Bonneville to inordinate market risk. Unlike other wholesale suppliers, Bonneville cannot refuse a public customer's request to serve its load. Customers will want to take load off of Bonneville when market prices are low and Bonneville's fixed costs make it difficult for it to compete. Conversely, customers will want to place additional loads on Bonneville when market prices are high, forcing Bonneville into a high-cost market. This translates into risk that Bonneville will not be able to make full and timely payment of its Treasury debt. With much of the rest of the country envious of the Northwest's access to federal system power at cost, failure to make Treasury payments increases the risk that the region may not be able to preserve the benefits of the system.

A corollary to the risk associated with load uncertainty is the uncertainty of developing new resources. Will Bonneville be purchasing for a customer's load growth, or will the customer purchase for its own needs? When would the purchase decision be made? How does the timing of that decision fit with the timing of resource development? Will it be a short-term purchase that doesn't support development of new resources, or will it be long-term? This uncertainty puts reliability and price stability at risk. In the most recent situation, had Bonneville known earlier what its load obligation was going to be, it might have been able to enter into supply contracts at attractive prices rather than at the inflated prices in 2000-2001. The same would be true if the customers had been acquiring the resources.

Bonneville also has a very large presence in the power market. One of the basic characteristics of a well-functioning, competitive market is many buyers and many sellers. Bonneville is frequently a very large seller, such as when it is marketing secondary power, and sometimes a very large purchaser, as when it must acquire additional resources to meet new loads placed upon it or to shape the output of the system to load. In either event, Bonneville's actions can move the market, frequently not to its own advantage or the advantage of other regional participants. This is not market manipulation. This is just the effect of the size of Bonneville's presence in the market.

The pricing of Bonneville's power at average or melded cost is also a long-standing issue affecting the efficiency of the market. Average pricing shields the customer from the true

costs of load growth and inefficiency. It does not provide the price signal that would make, for example, the development of local efficiency improvements or combined heat and power applications attractive. The cost of new resources added to meet the needs of growing customers also raises the rates of those with stable or declining loads and creates animosity between those two customer groups. While Bonneville could change its pricing practices, it has not.

Allocating benefits of the Federal Columbia River Power System between the customers of publicly owned utilities and those of investor-owned utilities is also a continuing issue. The Northwest Power Act was created at least in part to ensure an equitable sharing of those benefits. The Act created the "residential exchange" that was intended to share the benefits of the federal system with the residential and small farm customers of investor-owned utilities. However, implementation of the exchange satisfied no one. Public utilities believed the benefits to residential customers of the investor-owned utilities were too high. The investor-owned utilities believed the exchange was manipulated to reduce the benefits their customers were due. The resulting animosity is dangerous when regional unity is needed to protect the benefits of the federal system.

Finally, Bonneville's responsibilities for developing conservation and renewable energy resources are difficult to fulfill in the current environment. In the mid-1990s, Bonneville found itself competing in an competitive wholesale power market. This was made more difficult because other market participants did not have similar responsibilities. When the Comprehensive Review addressed this issue, Bonneville's customers assured the Review that they would continue to develop conservation independently. Some clearly did. However, in aggregate, conservation acquisitions fell to levels well below the cost-effective levels identified in the Council's Fourth Northwest Power Plan (1998). While conservation enjoyed a resurgence during the high market prices of 2000-2001 and the subsequent retail rate increases, it is unclear how it will fare in the future. Conservation and renewables expenditures have historically been treated as relatively discretionary when Bonneville experiences rate pressures. This inevitably leads to the roller-coaster pattern of activity observed in the past. The Review recommended sustained funding for conservation and renewables supported through a system benefits charge. While two states in the region followed through on this, at least in part, others have not yet done so. It is time to re-examine how conservation and renewables are developed, and the role of Bonneville in that development.

Goals for Bonneville's Future Role in Power Supply

The Federal Columbia River Power System managed by the Bonneville Power Administration is the centerpiece of the Northwest's power system. Significant changes in Bonneville's future role in power supply are not trivial considerations. On the other hand, there are indications that the current structure may not be sustainable and may lead to inefficiencies in the development and operation of the power system. A careful consideration of changes to the system probably is overdue. However, changes should only be undertaken if the goals are clear, and only if the region has reasonable confidence that the changes will lead to achieving those goals. The Council believes the relevant goals are:

- To preserve and enhance the benefits of the Federal Columbia River Power System for the Northwest;
- To not increase and, preferably, to reduce the risk to the U.S. Treasury and taxpayers;
- To achieve an equitable sharing of the benefits of the federal power system;
- To develop and maintain widespread support for the federal system and reduce conflicts within the region
- To better align the costs and benefits of access to federal power;
- To maintain and improve the adequacy and reliability of the Northwest power system;
- To improve clarity regarding responsibility for meeting loads;
- To provide clear signals regarding the value of new energy resources;
- To lessen Bonneville's exposure to market risk;
- To lessen Bonneville's impact on the market;
- To satisfy Bonneville's responsibilities for conservation and renewable resource development;
- To satisfy Bonneville's responsibilities with respect to fish and wildlife; and
- To accomplish these goals at an acceptable cost to the region's consumers.

The Council has reviewed the proposals and comments received during the Regional Dialog process on the future of Bonneville in order to identify those elements that do or do not further the goals. The focus was primarily on "efficiency" issues, i.e., how to make the regional system function better, rather than issues of equity. However, unless the relevant parties are satisfied that equity issues have been successfully resolved, it is unlikely that any of the proposals can go forward. Consequently, achieving an equitable resolution of those issues is a necessary condition.

Recommendations

Contract Term

Although long-term contracts are not common in today's electricity industry, the Council favors 20-year sales contracts as proposed by the Joint Customers. The primary reason is that Bonneville, unlike other participants in the wholesale power market, when offering contracts must provide power to those public customers that choose to place their net load on Bonneville. Conversely, those customers are under no obligation to keep that load on Bonneville at the end of a contract period and have, in fact, been successful in gaining relief from existing contracts when it was advantageous to do so. The region has observed the result with customers pressuring Bonneville to take load off Bonneville when market prices are low and bringing load back to Bonneville when prices are high. In both instances, this behavior precipitated a financial crisis for Bonneville and put the ability to make Treasury payment at risk. While this risk would still exist at the beginning and end of the contract period, a 20-year contract will at least minimize the opportunity for this behavior within the limits established by current law.

An additional benefit of a long-term contract is that it will provide contractual protection against extra-regional efforts to take away or dilute the benefits of the Columbia River System for the Northwest. While this issue has been relatively dormant for the last few years, it could flare again. Contractual protections, while not perfect, would be another tool that the region and its Congressional delegation could use to protect the benefits for the region. Twenty-year contracts would also demonstrate the willingness of the region to back the federal system and accept its risks as well as its benefits over a long term.

The customers are concerned that with 20-year contracts they lose important leverage in controlling Bonneville's costs, i.e. the ability to take load off Bonneville if their costs get out of control. The customers have proposed the formation of a customer cost advisory committee with "enforceable" powers to provide them with the leverage they believe the need. Alternatively, they have suggested "off-ramps" where customers could take some load off Bonneville if the cost targets stipulated in their contracts are not met.

The Council has concerns about both these approaches. Giving a non-federal body such as a customer advisory committee enforceable powers over decisions about Bonneville's cost would not be legal. Ultimately, such decisions reside with the Administrator. Similarly, load off-ramps would not make legitimate costs go away and would make it necessary for Bonneville to raise rates on its remaining load or risk failing to make a Treasury payment.

The Comprehensive Review called for the creation of a customer advisory committee and a contractual ability for the customers to call for binding arbitration on specific matters unrelated to fish and wildlife spending. If Bonneville can subject itself to binding arbitration this may be a viable approach, as long as it is not used as a means to cut back important activities that are not popular with customers.

The Council believes it is most appropriate to focus on process remedies that ensure that customers ***and*** other interests have opportunities to examine, probe and contest Bonneville's costs and make their views known in Bonneville's decision-making. This could be in the context of a rate case or through some other forum. The Council encourages Bonneville, the customers and other interests to continue the dialog on this issue. The Council is willing to make itself available to this process if it can help forge a solution. Ultimately, Bonneville is politically accountable. If Bonneville is not responsive to legitimate concerns, Bonneville can be -- in fact, it has been in the past -- held accountable by the Congressional delegation and the Governors.

Finally, the Council believes that 20-year contracts must, in fact, be 20-year contracts. The objectives of long-term contracts will be negated if customers can force renegotiation at shorter intervals.

Slice Service

A significant component of the Joint Customers' proposal is that Bonneville offer a "slice of the system" product. With the slice product, the customer gets a percentage of the federal base system output and pays the corresponding percentage of the base system

costs. The slice customers also get a limited amount of flexibility in the operation of their slice (e.g., some storage, pondage, and limits on the rates at which energy can be released) that allow them to have some control over when they take their share. Bonneville establishes the limits on that flexibility to ensure that the obligations and constraints on the system can be met. Because of the variability of the hydropower system, the output of the federal system can be quite large in some years and much smaller in others. In some months and years, slice customers will have secondary hydropower to sell. In others, they will be purchasers. It is up to the slice customer to manage the variability in the output, and the market opportunities and risks that entails. By the same token, these customers are not exposed to risks associated with the operational and marketing decisions made by other slice customers or Bonneville. The slice contract also would not have a growth component. The slice customer is responsible for meeting its own load growth.

The Council favors the offering of the slice product and believes that there will be a significant amount of load that takes the slice product. Bonneville currently has approximately 1,600 average megawatts of slice contracts. While there has certainly been a learning curve for both Bonneville and the customers, the slice product has proven to be operationally feasible. The Council would expect new slice contracts to reflect this learning to address issues that have arisen. This year, with its low market prices and Bonneville's cost exposure, has probably been less advantageous to slice customers than they had hoped. Some current slice customers may choose not to contract again for the slice contract. But others may decide that there are advantages to the slice product over the longer term. The Council does not believe there should be a minimum amount of load that must go slice or that obstacles should be placed in the way of those who wish to purchase other power products. Customers should have the opportunity to choose.

There are a number of reasons why the Council believes a significant portion of the federal system should be sold through slice contracts. A number of slice customers, each with somewhat different load and resource characteristics, each making their own operating and marketing decisions within the operational limits established by Bonneville, will result in greater diversity in the electricity market, potentially lowering overall risk. And because there will be more buyers and sellers, the market will be more liquid, reducing the impact that any one player has on the market.

The Council also favors the slice product because the slice customers are responsible for meeting their own load growth. This aligns the benefits and costs of resource acquisition, eliminating conflicts between growing and non-growing utilities. It also means that slice customers see clear economic signals regarding the cost of new resources and the relative value of local opportunities in conservation, load management, and distributed generation, including generation on the customers' side of the meter. The clarity with respect to the load-serving responsibility should also result in more efficient resource acquisition and a greater assurance of maintaining resource adequacy. Smaller and more dispersed resource decisions will also minimize the impact on the market and probably lead to greater resource diversity.

The slice product also reduces Bonneville's *direct* exposure to hydro and market risk. The risk associated with the slice product is transferred to the slice customers. However, Bonneville's real risk is reduced only to the extent that the individual slice customers are able to manage their share of the risk. The Council is concerned about the exposure of individual slice customers to hydro/market risk – risk that could be large in relation to an individual customer's ability to hedge that risk. If customers fail to make timely payment to Bonneville, Treasury payments could be at risk.

The existing slice contracts already contain provisions intended to ensure the credit worthiness of the slice customer. However, the fact that Bonneville has indicated concern about the financial ability of current slice customers to handle the risk suggests they are concerned that these provisions may not be adequate. The Joint Customer Proposal has responded to this concern by including "step up" provisions where slice customers would accept a surcharge to cover the shortfall if there are customers who experience problems. This is a constructive response; however, it needs to be developed in considerably more detail. Is there a timing issue that might leave the Treasury payment at risk even though in the long run Bonneville would recover the costs? How robust a mechanism is this? What if multiple customers find themselves in financial trouble? The Council encourages Bonneville and the customers to make sure that the provisions ensure Bonneville will make full and timely payments to the Treasury.

The Council does not agree with the argument that slice will necessarily result in a less-than-optimum operation of the power system. From the standpoint of optimizing the physical output of the system, this could very well be the case. However, from the standpoint of optimizing the economic value of the system to the customers, it is not necessarily the case. Slice customers will optimize operations of their slice, within the flexibility allowed, to maximize the ***economic value*** they derive from the system, given the characteristics of their own loads, resources and so on.

The Council does not support the Public Interest Groups' proposal that slice customers get no flexibility in the operation of their slice. To do so would forego the diversity benefits of the slice product and forego the potential for greater value to be derived from the system. It is Bonneville's responsibility to establish the constraints on flexibility accorded slice operators to ensure meeting fish and wildlife and other non-power constraints. As long as slice customers operate within those flexibility limits, there should be no significant impact on fish and wildlife.

Maintaining reliability is a top priority. Consequently it is imperative that Bonneville retain rights to take unilateral actions on the whole system in case of emergency. There should be a proportional sharing of any costs or revenues from such operations with the slice customers. Similarly, Bonneville's Power Business Line (PBL) should continue to provide ancillary services to the Transmission Business Line (TBL) as a system obligation, with revenues credited to the defined federal base system. When and if a market for ancillary services is established, then slice customers can participate directly in selling ancillary services to the TBL.

Requirements Service

The requirements product is the traditional Bonneville product whereby Bonneville is a full-service power provider, providing power shaped to the customer's load and meeting the customer's load growth. The Council supports the offering of a requirements product primarily because it meets the needs of the region's smaller customers. However, the Council believes that some changes in the product are necessary to meet the Council's goals. Currently, the requirements product includes load growth and melds the cost of resources purchased to serve load growth with the costs of the federal system. The problem with this is two-fold. First, it results in a misalignment of the cost and benefits of new resources. Non-growing utilities bear part of the cost of the resources purchased to serve the load growth requirements of growing utilities. Second, the low melded rate obscures the actual cost of new resources. Consequently, requirements customers do not see the actual value of conservation or local generating resources and have less incentive to pursue cost-effective alternatives. While in the past Bonneville considered implementing a tiered rate to address these issues, it has always backed down in the face of customer opposition.

The initial public draft of the Joint Customer Proposal was clear that once any excess base system resources allocated to the requirement pool had been used, growing requirements customers would face the actual cost of power acquired to meet their load growth, either through bi-lateral arrangements with Bonneville or a tiered rate mechanism. However, this was not clear in subsequent drafts of the proposal. The Council believes that it is essential that requirements customers see the costs of resources that must be purchased to meet their load growth. Failure to do so will perpetuate the inequities and inefficiencies of the current melded pricing.

Customer representatives have said to the Council that once load growth in the requirements pool exceeds the unused capacity of the federal system available to the requirements pool, if any, load growth should be met through a tiered-rate mechanism. The Council supports that approach and asks that it be made explicit in any Bonneville proposal. The Council supports the ability of requirements customers to take responsibility themselves to acquire resources to serve their load growth, so long as notice provisions are such that Bonneville is not exposed to the costs of acquiring resources for these customers.

Block Sales

In general, the current block product consists of heavy-load-hour and light-load-hour blocks of power that may be constant for a year or vary month to month. The amount of the block purchased for any period may not exceed a reasonable estimate of the customer's net requirements for that period. The product has a load growth component in that the customer can pay "step up" charges for amounts over the first-year amount.

The Joint Customer Proposal does not permit the purchase of the block product independently. To get the block product, the customer must first purchase a slice and, for an additional charge, may convert all or part of the slice to block for all or part of the contract period. The conditions placed on the block product are: 1) that the blocks are

fixed at their first year levels for the duration of the contract (i.e., no load growth component), 2) the costs of the block are set by Bonneville to recover the additional costs of serving the customer's block shape, and 3) there is a true-up to ensure that Bonneville's actual costs in serving the block are recovered.

The Council does not see why customers should be forced to purchase a slice and then convert the slice to a block if what the customer wants is a block product. Requiring the customer to first purchase a slice might somewhat increase the amount of slice product sold. But, while the Council appreciates the diversity benefits associated with the slice product, other benefits, such as alignment of costs and benefits, clear economic signals as to the cost of load growth and clarity with respect to responsibility for load growth can be accomplished by conditioning the block sales as proposed in the Joint Customer Proposal. The Council recommends offering a block product directly provided that the sale is conditioned as proposed in the Joint Customer Proposal.

IOU/POU Settlement

The Council is very much in support of achieving 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 broader cross-section of the region seeing a direct, long-term interest in preserving the Federal Columbia River Power System for the region.

The Council sees the proposed settlement in the Joint Customer Proposal as an attempt to create a transparent surrogate for the residential exchange provisions of the Northwest Power Act. The residential exchange was intended to provide the benefits of access to federal power to the residential and small farm customers of investor-owned utilities, and it set up an elaborate process for achieving this objective. However, many people perceived the process as a "black box" that was subject to manipulation.

The surrogate that the Joint Customers proposed is an annual cash payment to the IOUs equal to the difference between the cost of serving 3,300 average megawatts of IOU residential and small-farm load with power from a combined cycle combustion turbine (CCCT) and serving them at the net cost of the slice product (net of the value of the secondary power the slice customers receive). The cost of power from the CCCT would be determined by an equation in which the 10-year rolling average cost of natural gas is the primary variable. Because it would be based on documented, historical data, it would be impossible to manipulate. And, because the rolling average gas price is used, the volatility associated with natural gas prices is greatly reduced.

There are certainly questions that can be raised about the model the Joint Customers chose to use in the settlement. However, this is a question of equity. The only ones who can really judge whether the settlement is equitable are the parties to the settlement. The

fact that there is agreement between the parties is strong evidence that equity has been achieved.

At the same time, it is important to recognize that there are those who have not been parties to the negotiations who will weigh in on any agreement that has been reached. The settlement has implications for Bonneville's rates. The Council estimates that the impact is approximately $1.50 per megawatt hour for every $100 million by which the settlement exceeds the current subscription benefits to the residential customers of IOUs.

Because the settlement can have some impact on Bonneville rates, it is certain than large end-use customers of publicly owned utilities and, potentially, the DSIs, will have significant interest in the settlement. The parties should ensure that there is broad satisfaction with the equity of the solution. If there is not, the customers will ultimately not settle, or even if they do, the settlement will be challenged in the courts by other parties. In either case, it is likely that the goals sought by the parties and the Council will not be achieved.

Initial Allocation

The Joint Customers propose that slice customers be allocated their slices of the system first and then the remainder be available for requirements service. This is predicated on analysis that indicates that there should be sufficient base system power available to serve the needs of the requirements customers with some left over to serve their load growth for some time.

If, for whatever reason, that analysis proves incorrect, additional resources would have to be added to the system and the cost would fall entirely on the requirements pool. Requirements customer representatives have indicated that is a gamble they are willing to take in return for the possibility that there would be sufficient power to cover their load growth for some time. The Council is concerned that gamble may not look as attractive as planning evolves over the coming months and could prove a stumbling block to a final settlement. The Council encourages Bonneville and the customers to consider alternatives that would lessen that possibility.

Service to Direct Service Industries

There are currently approximately 2,800 megawatts of aluminum smelter load in the Northwest, although only a small fraction of that load is currently in operation. This comprises the great majority of Bonneville's Direct Service Industry (DSI) load. The current contracts expire in 2006. These contracts are take-or-pay contracts with the DSIs subject to liquidated damages and amount to a total of 1,440 megawatts, or about half the potential load.[2] Both Bonneville and the DSIs need to resolve the question of DSI service after 2006 – the DSIs to be able to make plans for their facilities after 2006 and Bonneville to know to what extent it needs to augment its system to serve DSIs. While there is some dispute about whether the DSIs have a legal right to new contracts for

[2] If a take-or-pay customer does not take the contracted amount, it is subject to liquidated damages in the amount of the difference between what Bonneville would have received at the applicable rate and what it was able to recover selling the power on the market.

power supply at Bonneville's melded rate, the fact that Bonneville limited the current contracts to 1,440 megawatts suggests that the DSIs rights are limited at best.

The future of several of the region's plants is questionable. Several are old, relatively inefficient and relatively high-cost producers compared to the rest of the industry. The long-term trend in aluminum prices has been downward, and the expectation of significant amounts of new smelter capacity in China and elsewhere suggests that at least for a few years aluminum prices are likely to stay relatively low. The industry average price of power of $20 per megawatt-hour is well below Bonneville's current rate, suggesting that many of the plants in this region are likely to be "swing" plants, operating only when aluminum prices are high and/or Northwest electricity prices are very low. However, the Council staff have seen analyses that suggest there is some smelter capacity in the region that can operate profitably with aluminum prices at or somewhat above current prices with electricity prices in the low $30s to high $20s per megawatt-hour.

The question of Bonneville service to the DSIs is a difficult one. On the one hand, acquiring resources to serve the DSIs could add something like 50 cents to $1 per megawatt-hour for each 500 megawatts of DSI load served, depending on the cost of the resources acquired. These costs will have adverse impacts on other consumers in the region. On the other hand, DSIs are important elements of some local economies in the Northwest.

In light of the foregoing, the Council recommends that limited service be provided to DSIs at Bonneville's melded rate. The amount of this service should not be less than the 600 megawatts proposed in the Joint Customer proposal and should be significantly less than the current 1,440 megawatts. In addition, 50 megawatts for non-smelter DSI loads should also provided. The power should be offered in such a way that:

- The cost of providing the service is minimized;
- Those smelters that are most likely to be able to use the power are able to access the power that is made available; and
- The smelters are encouraged to move off of Bonneville power in the long-term.

To reduce the cost of providing service, the Council recommends that DSI contracts be structured to ensure that Bonneville can capture the value of interruptibility of the DSI load to offset the costs of serving that load. There are three forms of interruptibility that are potentially of value. First, there are very short-duration interruptions for system stability purposes. Second, there are economic interruptions of a few hours duration that would allow Bonneville to sell the power at high market prices. This requires that smelter operations be modified to permit cutting back to a partial load operation. Finally, there are long-duration curtailments in the event of poor water or power supply conditions, such as were experienced in parts of 2000 and 2001. The ability to curtail DSI loads under such conditions reduces the need to have standby generation available. Bonneville should analyze the cost and benefits of such operations.

Absent significant changes in world aluminum markets or Northwest electricity prices, aluminum smelters are likely to be volatile and uncertain loads for the region. The Council encourages Bonneville to consider contract provisions to help maintain aluminum plant operation during periods of low aluminum prices and adequate electricity supplies if this can be accomplished without imposing additional costs on other customers.

As proposed by the Joint Customers, the available power should be made available to the smelters in 100-megawatt blocks. Non-smelter loads would have 50 megawatts made available. If the DSI allocation is not taken through the initial offering of 100-megawatt blocks, DSIs may take additional amounts of the remaining allocation provided they offer Bonneville resources in like amounts that Bonneville judges to be competitive or otherwise demonstrate that they have taken steps to be able to supply their own power independent of Bonneville. This may not include purchases from Bonneville preference customers. Any obligation of Bonneville to purchase a resource from the DSI customer would cease if and when the customer no longer purchases power from Bonneville.

The Council recommends that contract terms be limited to 10 years with the condition that the amount available to DSIs for a subsequent contract period would be further reduced and that no power would be available after 20 years.

Finally, the Council recommends that Bonneville consider providing credit support to DSIs that develop generating resources that they are willing to dedicate to serving in-region smelter loads not served by Bonneville.

Conservation

The Council believes it is imperative that any proposal to fundamentally change Bonneville's role in power supply include a realistic approach to ensuring that the region fully develops all cost-effective conservation. The Council believes that capturing cost-effective conservation has great value in reducing long-run regional electricity costs and will require continued vigilance and encouragement as the structure of the electric industry evolves. The region's interest in acquiring this conservation is not changed under any revised federal power marketing approach. Least-cost planning and implementation should continue to be carried out region wide. The Council believes Bonneville should use the full extent of its authorities to ensure all cost-effective conservation is captured in a timely way.

The Joint Customers propose that more Bonneville customers see marginal wholesale prices and take more responsibility for meeting load growth. This will improve price signals and more clearly communicate the value of conservation. This is a step in the right direction. It is not, however, sufficient to relieve Bonneville of its charge to promote and give first priority to energy conservation, for two reasons. First, there are still disincentives to acquiring conservation from the utility-interest perspective, even at marginal wholesale prices. Conservation is a capital-intensive resource, which places it at a disadvantage when compared to low short-run market prices or resources whose costs are predominantly fuel costs. Further, conservation makes rates go up somewhat in

the short term due to lost-revenue effects and its capital-intensive nature, even though it makes total costs lower in the long term.

Second, securing cost-effective conservation in an effective way requires coordinated planning and implementation among many entities. The best approaches require a combination of coordinated local utility efforts, regional efforts, local, state and federal governments, system benefits charge administrators, market transformation and sufficient administration. The mix of approaches changes over time as efficiency technologies and markets for products and services change. Bonneville's interest extends both to conservation approaches best done regionally and approaches best implemented at the local level. Consequently, the Council believes Bonneville should retain a strong and active role in the coordinated planning and implementation of conservation efforts across the region.

The extent of the conservation obligation

Bonneville has broad authorities for retaining an active and strong role to promote the acquisition of conservation even under the proposed settlement, in which some customers agree not to place additional loads on Bonneville for the duration of the contract. Bonneville retains an interest because at the end of the 20-year contract period, public customers will be able to bring loads back to Bonneville. To the extent that the cost-effective conservation has not been acquired, loads brought back to Bonneville could be unnecessarily high.

The proposals of the Joint Customer Group and the Public Interest Groups share some common themes that the Council supports. These include using the Council's integrated resource plans to guide conservation targets and budgets while stabilizing and enhancing funding for conservation over the duration of the new contracts. The proposals each support the concept that both regional and local approaches to conservation implementation are needed and should be supported through Bonneville. Both proposals recognize the need to reinforce the role and capabilities of the Regional Technical Forum. Both proposals acknowledge the value of relying on existing institutions and proven delivery mechanisms. Both share the goal that the mechanisms developed do, in fact, ensure implementation of the cost-effective conservation that they target.

However, the joint customers and the public interest groups diverge on several key conservation issues. One of these is the extent of the conservation obligation that resides with Bonneville – whether it is for all customer loads or only the portion of loads placed on Bonneville, how the funding for conservation would be collected, and the basis by which Bonneville would allocate the funds collected to various conservation activities.

The Council believes that Bonneville should establish conservation budgets based on Bonneville's share of regional conservation potential identified in the Council' power plan and estimated program cost to capture that conservation. However, conservation savings targets and mechanisms should be designed to capture conservation on all loads of preference-customer utilities, not just the part served by Bonneville. The Council will estimate energy conservation potential for the region as a whole. This estimate has

historically been divided between public and private utility pools, by residential, commercial, industrial, and irrigation uses and by existing versus new buildings and equipment. It could further be apportioned to public and private loads served by Bonneville to identify conservation budgets for the portion of loads served by Bonneville.

While the Council believes the establishment of Bonneville's conservation budgets should be based on load served by Bonneville, it also believes that Bonneville has the obligation and authority to establish conservation targets and to develop mechanisms to ensure conservation is captured for the entire load of its preference customers, not just the portion served by Bonneville. Bonneville has interest in seeing the entire conservation potential is tapped because that load may return to Bonneville and because conservation accomplishments cannot be segregated based on whether or not the load is served by Bonneville. Bonneville should use its authorities to the fullest extent possible to ensure the region attains conservation goals established for the entire retail load of customers that can place load on Bonneville. There are several methods to accomplish this including placing terms and conditions on a conservation rate discount mechanism.

Bonneville's obligations and authority with respect to investor-owned utility conservation is, we believe, limited to the load subject to the IOUs' residential and small farm loads 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 for all the IOU load is accomplished. The Council is prepared to work with the commissions and, where applicable, the agencies administering state systems benefits charges, to accomplish this goal.

Local Implementation

The Council believes a rate discount-like mechanism similar to the current Conservation and Renewables discount can be an effective way to encourage local utility conservation acquisitions. However, the existing mechanism was intended to keep regional utilities "in the game" at time when conservation activity was at low ebb. If it is to serve as the primary mechanism for ensuring that the region captures all cost-effective conservation, the mechanism needs to be modified. After review of the existing mechanism, the Council believes it should be redesigned to assure it is producing targeted cost-effective conservation. Bonneville should evaluate the performance of the discount mechanism under its initial year of operation to identify elements that are successful and areas that could benefit from improvement. The Council believes Bonneville should begin the transition to a revised discount mechanism as soon as possible, regardless of the outcome of the settlement discussions because the mechanism is in place now and will continue through the end current rate period.

The Council has several recommendations regarding the discount mechanism:

- Bonneville can ensure conservation addressed under the discount is cost-effective by qualifying measures and programs based on their cost-effectiveness. Currently, the approved measure list allows the rate discount for measures regardless of their cost-effectiveness. While this may have spurred rate discount activity in the

initial year of operation, it is counterproductive in the long run, increasing the cost of the regional power system.

- Under guidance from the Regional Technical Forum and the Council, Bonneville should tailor rate discount incentives to encourage the best measures and practices and, where appropriate, to encourage regionally coordinated efforts. The ability to provide more or less incentive for some programs and measures can be used by Bonneville as a tool to help manage the overall coordination of conservation activity throughout the region, supporting timely initiatives or filling gaps as necessary.
- Bonneville should include incentives to minimize the cost of conservation acquisition to the region, without sacrificing cost-effective savings. The current Conservation and Renewable Discount system pays for the value of the avoided power purchases. The result can be very high credits to the utility for little actual investment on the utility's part.
- Bonneville should establish criteria to assure credit is claimed for *incremental* investment in cost-effective conservation activity.
- Bonneville should provide more specific criteria for, as well as maintain limits on, expenditures on infrastructure, research and development, contributions, education and information programs and other activities that don't produce or clearly support the development of tangible savings. The Council supports the need for activities that don't produce tangible savings. But in aggregate, the discount mechanism should produce a portfolio of efforts that is cost-effective including costs of activities that produce intangible savings.
- The mechanism should include protocols for timely and informative self-evaluation of local conservation efforts. Evaluation is a key tool to help customers identify successes and needed improvements in the mix of conservation activities they adopt. The RTF should make recommendations to Bonneville on what efforts would benefit most from evaluation.
- Bonneville should provide the discount incrementally on demonstration of progress – not solely rely on the threat of taking back the discount for inaction after the fact. An initial discount payment should be provided to address the customers' cash flow requirements. But subsequent discounts should be made on demonstration of progress.
- Bonneville should not require a decrement in the customers' net requirements for savings achieved. Such a decrement would be a strong disincentive to active participation by the customers in the development of conservation.
- Bonneville should credit activities undertaken under state system benefit charge programs that result in incremental investment in new cost-effective conservation and satisfy other program requirements such as evaluation.
- Finally, the Council recommends that the mechanism should be designed to reduce the incidence and magnitude of any Bonneville "backstop", should utilities not qualify to claim their discount. A backstop in which Bonneville is expected to collect charges from customers that fail to implement sufficient conservation puts Bonneville in a difficult position in relation to its customers. As a consequence, it is unlikely to be implemented and will result in lost conservation opportunities in the interim.

It is far preferable that Bonneville work with customers, up front, to implement good opportunities and approaches and to structure incentives to encourage local utility conservation. This approach would require that Bonneville work with customers on developing annual conservation plans providing customers with some assurance that utility conservation efforts will qualify for the discount while at the same time providing an opportunity to minimize and direct potential backstop activity. Bonneville should step in and invest in conservation to make up for a shortfall only where the customer consistently does not demonstrate progress, or where local utilities choose to have Bonneville administer local programs. Bonneville and the customers should develop a mechanism for resolving disputes regarding demonstration of progress.

Regional Implementation

The Council supports recognition in both the Public Interest Groups and Joint Customers proposals that there will continue to be the need for a regional implementation of activities including low-income weatherization, research and development, market transformation and evaluation. The Council also supports the idea that some level of certainty between regional versus local pools will provide stability. At the same time, some degree of flexibility to modify amounts in the respective pools must be maintained due to the changing nature of the conservation resource. However, the groups have not come to agreement on how much should be regional implementation versus local acquisition. The customers generally favor a larger local component. The Council believes that there is a broader range of activities that should be carried out at the regional level than envisioned in the Joint Customer proposal, including significant efforts in support of the Regional Technical Forum, coordinated program development and management, evaluation efforts and overall administration.

The need for regional activity is a result of the nature of the conservation resource and the fact that much of it cannot be developed effectively on a piecemeal basis. Conservation experience over the last decade provides many examples of regional implementation and coordination providing valuable benefits and reducing the cost of conservation. For example:

- The market-transforming efforts of the Northwest Energy Efficiency Alliance developed retail supply chains necessary to the successful local delivery of 8 million compact fluorescent light bulbs during the 2001 energy crisis. Both regional market transformation efforts and local utility rebates were required in that effort.
- Codes and standards are upgraded in cycles that require coordinated planning and implementation efforts between demonstration of technologies often best carried out at the local level and code adoption efforts that are best carried out at the state or national level.
- Regionally designed programs can reduce the cost and deployment time for efforts like efficient beverage vending machines, where there are a small number of beverage companies that service most of the region's equipment.
- Regionally consistent program designs, standards, specifications and in some cases "incentives" enhance the effectiveness of conservation delivery in

certain sectors of the economy so that third-party providers are not faced with inconsistent requirements across utility boundaries.

- Regional coordination can identify areas where early-stage research and development are needed to facilitate technology transfer and fill the pipeline of emerging efficiency measures and practices.
- And finally, regional coordination can identify and address gaps where efforts are needed to address hard-to-reach markets or end users.

A coordinated approach on a regional or greater level is necessary to effectively and inexpensively tap energy conservation potential. The Council recommends that Bonneville take a strong and proactive role in coordinating conservation efforts across the region by 1) allocating a significant fraction of its conservation budget to regionwide acquisition approaches; 2) taking a key role in the coordination of conservation efforts across the region 3) tailoring incentives to promote local utility programs that support regional initiatives; and 4) providing financial support for the Regional Technical Forum and for program evaluation.

The Council recommends that Bonneville budget for regional implementation based on the guidance in the Council's power plan and recommendations of the Regional Technical Forum. The Council fully expects the regional/local share of conservation efforts will change significantly over time as the region successfully completes some conservation initiatives and as new technologies and initiatives are identified. Budget allocations to regional versus local implementation should be flexible enough to accommodate up to a 30 to 50 percent regional share to cover both regional acquisition and coordinated planning and the administrative support such as the Regional Technical Forum and evaluation efforts. Bonneville should retain the flexibility to contract with utilities or other parties to implement regional acquisition programs. Bonneville should evaluate regional-approach programs and measures to improve cost and savings estimates and the efficacy of program design and implementation. The Council recommends that the RTF make recommendations to Bonneville on the scope and timing of such evaluations.

Regional Technical Forum

The Council recommends that, beginning as soon as possible, the Regional Technical Forum (RTF) be more formalized as a technical body, with dedicated funding, a small staff and members that are independent of financial interests resulting from its recommendations. The Regional Technical Forum is a pivotal implementation tool for the region under any future role of Bonneville. The Council recommends a 13- to15-member RTF board selected by the Council. Members would be paid for their time similar to the Council's Independent Economic Advisory Board. A majority of board members would be from entities not eligible for the credit or rebate mechanisms, in order to avoid conflicts of interest. Utilities and other users of the credit or rebate mechanisms would be kept to a minority. Approximately three people would staff the RTF board and provide administration. The staff would be housed inside the Council.

The RTF would:

- Identify and catalogue costs and savings of conservation measures and programs;
- Make recommendations on how best to coordinate conservation approaches among the many entities in the region;
- Make policy recommendations to Bonneville on areas where the settlement agreement has flexibility, such as the local/regional allocation determinations;
- Identify evaluation needs and make recommendations for systematic evaluation of performance;
- Make recommendations for research, development and demonstration.

Role of the Council

The Council would continue to periodically prepare a regional power plan that identifies cost-effective levels of energy conservation, regional conservation savings targets and the estimated programmatic cost to acquire those targets. The Council would estimate the regional savings targets by customer pool, including pools for preference customers and the small-farm and residential customers of IOUs.

The Council would also select RTF members and house the RTF staff. In collaboration with the RTF, the Council would make recommendations to Bonneville on

- Bonneville's conservation targets and budgets;
- The mix of regional versus local program approaches and associated budgets best suited to capture that conservation;
- The structure of incentives in the discount mechanism;
- Appropriate levels of Bonneville conservation planning and coordination activities and prioritization of regional conservation initiatives;
- Levels of activity and budget for research and development;
- Levels of activity and budget for evaluation of conservation efforts;
- Elements within the budget that may change from rate period to rate period to reflect changes in technology, standards, cost-effectiveness and other key factors; and
- The evaluation and reporting mechanisms necessary to ensure accountability.

The Council would continue to work with the region's regulatory commissions and local boards to encourage conservation activities and investments sufficient to capture all cost-effective conservation in the region.

Renewables

In general, the Council supports some level of acquisition of renewable resources at costs higher than the market price of electricity. The level of above-market support should reflect the environmental and risk management benefits of such resources as well as the need to develop additional information about the integration of such resources into the regional power system. These values should be determined through the Council's planning process.

Fish and Wildlife

The Joint Customers intend that the combination of slice/block/requirements operations will not affect the determination and implementation of Bonneville's fish and wildlife obligations. Under the proposal, Bonneville, the Corps of Engineers and the Bureau of Reclamation will continue to meet the federal government's Indian trust and treaty responsibilities. No changes are proposed in river operations required by NOAA Fisheries and the Council. In addition, Bonneville's customers will continue to pay the costs associated with Bonneville's fish and wildlife obligations.

The Council agrees that these are appropriate objectives. The proposal must not alter any of Bonneville's and the Council's current fish and wildlife obligations and responsibilities. Fish and wildlife operations must continue to be developed as "non-power" constraints and decided in forums that are not focused on maximizing power generation. As well, Bonneville's direct expenditures on fish and wildlife activities must continue to follow the process currently guided by the Council and Bonneville to meet the objectives of the Northwest Power Act, Endangered Species Act and other federal statutes.

There are three primary areas relating to fish and wildlife operations and expenditures that concern the Council, in general: 1) river operations, 2) Bonneville's budgeted and actual fish and wildlife funding levels, and 3) fish and wildlife project review and selection.

With regard to river operations, the Council would not support changes to the current processes that specify operational parameters for the Federal Columbia River Power System, and does not believe the Joint Customer proposal would result in such changes. The biological opinions and the Council's program must be taken into account as they are currently. Except in the case of regional power emergencies, the federal system must be operated in a manner to meet the objectives of the biological opinions, and the Corps and Bureau must take the Council's program into account during their decision-making processes. Bonneville will continue to be required to act in a manner consistent with the Council's program. The Council does not believe that the changes proposed should increase the incidence of regional power emergencies.

The Council historically has been concerned about, and involved in, determining the annual funding level of Bonneville's fish and wildlife program. Although the Joint Customer proposal should not affect the process by which Bonneville's expenditure levels are established currently, the Council would support a more regular, if not formal, regional process to determine annual spending levels. For example, the re-establishment of a process to develop formal memoranda of agreement that would specify funding levels for Bonneville rate periods, or some other period of time, would be welcomed in assuring the region's fish and wildlife interests that Bonneville's obligations will be met. But regardless of the method used, a transparent process that involves all regional entities and the public must be established and made available to ensure adequate funding levels.

The Joint Customer proposal will not alter the current regional process for reviewing and selecting fish and wildlife projects funded by Bonneville. Section 4(h)(10)(D) of the Northwest Power Act will still be in effect. It requires independent scientific review of project proposals by the Independent Scientific Review Panel, and final funding recommendations to Bonneville will still be made by the Council after examining the reviews made by both the fish managers and the ISRP. The Joint Customer proposal in no way alters this process or diminishes the responsibilities of any of the parties that implement this section of law.

The Council also recognizes that there are potentially direct advantages for fish and wildlife that may result from implementing the Joint Customer proposal. For example, slice contracts may result in a significant and direct benefit to fish and wildlife populations by reducing Bonneville's obligation to serve loads in excess of the output of the federal base system in low water years. Bonneville would be under less pressure to alter spill and flow to squeeze more electricity out of the system to satisfy its power sales contracts if a greater portion of its obligations were capped by the system's firm energy generating capability. It is unclear exactly what the overall impact would be of a combination of slice/block/requirements contracts, but it appears that for every slice contract there would be a diminution of pressure on Bonneville to alter system operations to meet load. If so, this would be beneficial to fish and wildlife.

In addition, one of the important objectives of the Joint Customer proposal is to clarify who has responsibility for acquiring new generating resources. Having a clear understanding of this, in combination with a properly functioning electricity market that provides the appropriate economic incentives for the development of new resources, would make it more attractive for the region's utilities to acquire new resources. The development and acquisition of new resources would reduce pressure to alter hydrosystem operations in low water years, and thus would be beneficial to fish and wildlife populations.

Some believe that slice customers will feel they have a greater stake in the operational decisions affecting the power system and will take a more active role in those processes. They are further concerned that this will change the dynamic of decision-making. These groups taking a more active interest in the decision-making is not necessarily a bad thing. The decisions themselves remain the responsibility of the federal agencies acting under the applicable federal laws.