Melinda S. Eden
Chair
Oregon

Joan M. Dukes
Oregon

Frank L. Cassidy Jr.
"Larry"
Washington

Tom Karier
Washington

Northwest Power and Conservation Council

Jim Kempton
Vice-Chair
Idaho

Judi Danielson
Idaho

Bruce A. Measure
Montana

Rhonda Whiting
Montana

May 3, 2005

MEMORANDUM

TO: Council Members

FROM: Dick Watson

SUBJECT: Bonneville's Draft Closeout Report: BPA's Proposed Changes to Power Function Review Base Costs for conservation

Bonneville's Power Function Review was the process through which Bonneville laid out its initial assumptions regarding the various cost components going into the FY 2007-FY 2009 rate case. In its April 26 letter, the Council commented on those initial assumptions and raised concerns that Bonneville was not planning on sufficient funding to achieve Bonneville's share of the 5th plan's conservation targets.

Today, Bonneville released the Draft Closeout Report in which they document the changes they propose to make to their base costs. The section pertaining to conservation is attached. We have not yet analyzed the report in detail, but our initial reaction is that the bottom line is unchanged and that level of funding is unlikely to achieve Bonneville's share of the 5th plan's target.

Bonneville is taking comment on the Draft Closeout Report through May 20. Staff will provide a more detailed review of the proposed changes and a suggested response later in the week.

851 S.W. Sixth Avenue, Suite 1100
Portland, Oregon 97204-1348
www.nwcouncil.org

Steve Crow
Executive Director

503-222-5161
800-452-5161
Fax: 503-820-2370

Draft Closeout Report: BPA's Proposed Changes to PFR Base Costs

CONSERVATION PROGRAM

	Average Expense	Average Capital
FY 2002-2006 Conservation Program (including rate credit)	$66 M/yr	$27 M/yr
FY 2007-2009 PFR Base Forecast	$71 M/yr	$32 M/yr
FY 2007-2009 Proposed PFR Forecast	**$70 M/yr**	**$28 M/yr**

The portfolio of energy efficiency programs BPA is proposing for the post-2006 period is very similar to what is currently available. BPA relied heavily on the Post-2006 Conservation Workgroup's recommendations in designing its proposed program approach. The key features of the proposed program are as follows:

1. a **rate credit program** (similar to the current C&RD with key changes, such as paying for only cost-effective measures, BPA incentives based on a % of what it costs to install measures and not value to the system, and requiring that measures be incremental, measurable, and verifiable with appropriate oversight and more frequent reporting);

2. a **bi-lateral contracts program** for our utility and federal agency customers (similar to the current ConAug program);

3. a **3rd party bi-lateral contracts program** for cost-efficient, region-wide approaches (similar to the VendingMi$er program and includes BPA's support for the NEEA);

4. support of critical **infrastructure** elements, especially evaluations so we know if we are getting what we are paying for;

5. a separately funded **renewable resource option**; and

6. a proposed spending amount of **$75 million/year** to capture BPA's 52 aMW/year share of the Northwest Power and Conservation Council's (Council) regional cost-effective conservation target at an overall cost of **$1.4 million/aMW.**

Through the PFR process, several areas where decisions are yet to be made were identified as either potential savings or increases to the Conservation spending level from the PFR base. Each of these areas were discussed and taken into consideration when developing the proposed FY 2007-2009 Conservation forecast.

Possible Decreases Identified

1. **Proposal: Credit conservation done by utilities "on their own nickel" against BPA's target, reducing BPA's spending** - BPA's conservation target is based on cost effective conservation as defined in the Council's 5th Power Plan and reflects only loads BPA serves. Also, BPA serves only a fraction of some public utilities' loads. BPA agrees that if those utilities are effectively meeting some of BPA' target through their own non-BPAfunded programs, then BPA should not separately forecast for the same conservation MWs. BPA does not believe that currently there is enough information on how much cost-effective conservation public utilities are accomplishing on their own to warrant

forecasting a reduction now. However, BPA will track this going forward and adjust its forecast accordingly. If this can be done before final studies are done for the FY 2007-2009 rate period, this adjustment will be made before the final rate decisions are made. **Draft Conclusion: Do not include this reduction in Initial Proposal, but possibly include it in final rate studies.**

2. **Proposal: Reduce BPA target for "naturally occurring" conservation** - BPA originally set the target at 40%, which is roughly the percent of the regional load BPA serves (7,782/20,472 aMW= 38% based on FY 2003 White Book information). This calculation is fully consistent with the methodology for setting conservation targets in this FY 2002-06 period, as agreed to between BPA and the Council. After consultation with the Council's staff, BPA estimated which specific measures are likely to become standard practice in absence of any BPA/utility conservation programs. Based on this analysis, BPA estimated that roughly 7% of the Council's targets would be naturally occurring. Seven percent equates to roughly 4 aMW out of BPA's 56 aMW annual target. Based on the loads BPA serves, our share of the Council's regional target over the FY 2007-2009 period is 168 aMW (40% of 420 aMW). This equates to an annual target of 56 aMW. We anticipate that the "naturally occurring" conservation will come in at about 7% or 4 aMW/year. This would give us a 52 aMW/year target and a 156 aMW target over the 2007-09 period. While there has been some comment that the Council has set too high a target for conservation, BPA believes it appropriate and achievable. The Council conducted an extensive public process as conservation potential was analyzed, and BPA and many others in the region participated in that process. Thus, BPA concludes the 52 aMW per year is the right target. **Draft Conclusion: Include $4 million annual capital and $1 M annual expense reductions in the rate case initial proposal.**

3. **Proposal: Don't require load decrement on rate credit** - PFR participants commented that it will be harder for BPA to meet its MW targets for conservation within its spending level limit if it requires block and slice customers to reduce their load on BPA by the amount of conservation they accomplish under the conservation rate discount program. Consistent with the advice of its Post-2006 Conservation Workgroup, BPA has now proposed not to require load decrements from slice/block customers under the rate credit program, but continuing to require load decrements under the new bi-lateral contract program. **Draft Conclusion: Make the change recommended, but no reduction in costs.**

Possible Increases Identified

4. **Proposal: Do not count IOU conservation BPA pays for toward BPA's target, or count these MW's but also add IOU residential conservation to BPA's target** - BPA proposes to count toward the 52 aMW annual target any cost effective conservation it helps ensure through its funding mechanisms, including the conservation achieved by IOUs under the rate credit program and the conservation accomplished by our Northwest Energy Efficiency Alliance (NEEA) funds. This decision is consistent with the current way we count delivered savings toward our share of the Council's target in the rate period as agreed to by Council staff. Further, BPA invests in regional conservation that is currently counted toward BPA targets, e.g., NEEA market transformation. Counting

conservation funded by IOU rate credits is fully consistent with the methodology we use in this rate period, and should be extended to the FY 2007-2009 rate period. If BPA pays for it, BPA should count it toward our targets. **Draft Conclusion: Count IOU MW's and add to target, but no cost increase.**

5. **Proposal: Increase spending to increase certainty of meeting conservation targets** - BPA acknowledges that the $1.4 M/aMW target is a stretch. Based on recent conservation program performance and given the changes that have been made in the designs of the proposed program portfolio, BPA believes it has a reasonable chance to achieve its share of the Council's new conservation aMW targets with the proposed spending level. It is important to note that while BPA is targeting $1.4 M/aMW, that figure is an average of different program spending levels. BPA has been successful at lowering the cost of savings through the Con Aug Program, and BPA will seek to continue to average program costs in the revised bilateral contracts at the current level ($1.2 M/aMW). Similarly, the NEEA has a demonstrated track record of $1 M/aMW. This leaves the budgets for local initiatives higher ($1.7 M/aMW). Thus, the success to date with driving down program costs and continuing to adapt new marketing strategies leads BPA to believe these forecasted targets are achievable. Just as important, BPA believes that setting and meeting aggressive costs containment goals is important both to keep rates down and to maintain support for steady conservation funding, since higher costs per MW make conservation spending levels less sustainable during periods of even greater financial stress. BPA will assess progress towards our aMW conservation goal and proposes to adjust for underperformance against the target in the next rate period. **Draft Conclusion: Keep funding at current forecast.**

6. **Proposal: Increase spending level for administrative costs -** BPA is proposing to pay up to 10% of administration costs under the new rate credit and bilateral contracts program. The Conservation Workgroup recommended 20% of administrative costs be included. The current C&RD credit allows credit of 20% for administration cost to support infrastructure building. For ongoing conservation programs, however, administration should be lower. A number of utilities and end users that are partners in capturing the regional conservation have told BPA they don't need a full 20% administration for on-going programs. BPA has included a number of activities and tools that should reduce utility administration costs (e.g., standard program design templates and marketing materials, mechanism for utility sharing, etc.). However, BPA received numerous written comments on this topic shortly before issuing this report and will consider them during the comment period. **Draft Conclusion: Keep funding at current forecast.**

7. **Proposal: Increase spending level for conservation infrastructure** - The Conservation Workgroup recommended a 2% infrastructure spending level (i.e., $1.6 M/year). BPA has proposed instead conservation spending levels for FY 2007-2009 that includes $1 M/year for the infrastructure spending that should be sufficient to cover these activities. The 2% infrastructure support forecast was not based upon detailed analysis and budgeting. More detailed analysis developed by BPA leads the Agency to conclude the necessary infrastructure support can be accomplished at the $1 M/year level. The $1 M/year is a component of the $75 M/year proposed conservation acquisition program level. **Draft Conclusion: Keep funding at current forecast.**

Table 1: Proposed Conservation Program Annual aMW Targets and Spending Levels

Program	aMW	Forecast	Cost/aMW
Rate Credit (at 0.5 mills = $42M*/year with IOUs and Pre-Subers included)	21	$36M	$1.7M
Utility & Fed. Agency Bi-Lateral Contracts	15	$21M	$1.4M
3rd Party Bi-lateral Contracts	6	$7M	$1.2M
Market Transformation (via NEEA)	10	$10M	$1.0M
Infrastructure Support and Evaluation	---	$1M	---
Total	52	$75M	$1.4M

* - *assumes $6M/year of the $42M/conservation rate credit will be spent on renewables .*

In total, BPA proposes to reduce the base PFR spending levels (both capital and expense) for achieving the Council's cost-effective conservation target by $5 M/year to $75 M/year (includes the conservation rate credit), which is a portion of the overall Conservation forecast of capital and expense spending. The proposed spending level is an actual increase of $5 M/year over the average annual spending level in the current rate period.

Table 2: PBL Total Proposed Conservation Forecast FY 2007-2009

Program	Proposed Forecast	Annual MW Target Spending
Generation Conservation Expenses	**$34.0 M**	
EE Development (Reimbursable)	$12.9 M	
Energy Web/Non-Wires Solutions	$1.0 M	
Technology Leadership	$1.3 M	
Legacy (Contract closeout after FY 2000)	$2.8 M	
Low-Income Weatherization	$5.0 M	
Market Transformation	$10.0 M	YES
Infrastructure Support and Evaluation	$1.0 M	YES
Conservation Rate Credit	**$36.0 M**	**YES**
Expense Total	**$70.0 M**	
Generation Conservation Capital Total	**$28.0 M**	
Utility & Fed Agency Bi-Lateral Contracts	$21.0 M	YES
3rd Party Bi-lateral Contracts	$7.0 M	YES

BPA Proposals Proposed PFR Base
FY 2007-2009
(Reductions)/Increases

Reduce Conservation Expense Spending Level ($1 M/year)
Reduce Conservation Capital Spending Level ($4 M/year)

Melinda S. Eden
Chair
Oregon

Joan M. Dukes
Oregon

Frank L. Cassidy Jr.
"Larry"
Washington

Tom Karier
Washington

Northwest Power and Conservation Council

Jim Kempton
Vice-Chair
Idaho

Judi Danielson
Idaho

Bruce A. Measure
Montana

Rhonda Whiting
Montana

April 29, 2005

Becky Clark
Clark-PND
P.O. Box 3621
Portland, OR 97208-3621

RE: Council Staff Comments on Implementation Elements of Bonneville's Post-2006 Conservation Program Proposal.

Dear Ms. Clark:

Thank you for the opportunity to comment on Bonneville's March 28, 2005 Post-2006 Conservation Program Proposal. The Northwest Power and Conservation Council sent a letter to Administrator Steve Wright on April 26, 2005. That letter expressed the Council's concerns about the overall level of conservation funding and the need for a contingency plan to reach conservation targets by 2009 should acquisitions fall short.

In addition to the overarching concerns expressed by the Council, the Council staff submits these comments on specific implementation elements of Bonneville's Post-2006 Conservation Program Proposal. Because these comments and suggestions focus on implementation details, they have not been reviewed or approved by the Council. However, the comments will be discussed at the Council's May 10 meeting. The Council may choose at that time to amend the staff comments.

Sincerely,

Dick Watson
Power Division Director
Northwest Power and Conservation Council

851 S.W. Sixth Avenue, Suite 1100
Portland, Oregon 97204-1348
www.nwcouncil.org

Steve Crow
Executive Director

503-222-5161
800-452-5161
Fax: 503-820-2370

Council Staff Comments on
Implementation Elements of BPA's March 28, 2005 Conservation Proposal

1. Proposal Element: Use a portfolio approach of rate credits, bilateral contracts and direct funding to achieve targets.

Council Staff Comment: The Council staff generally agrees with Bonneville's multi-mechanism approach to conservation acquisition. We support efforts to acquire the targeted conservation at low cost, to Bonneville, its customers and the ratepayers provided cost control mechanisms do not jeopardize reaching the targets and actually reduce total electricity system costs.

However, The Council staff does not agree with Bonneville's proposal to base its willingness to pay for conservation acquired primarily on cost to Bonneville. The Council staff believes this unnecessarily limits the agency's ability to establish incentives for utilities to do cost control. It has the unfortunate effect of establishing a "market clearing price" for measures based on specific estimates of costs, which, in practice, are constantly changing. It reduces Bonneville's flexibility to reflect utility or geographic cost differences. Finally it reduces the ability to do trading among utilities because it allows for little economic arbitrage value. Staff believes that trading could enhance the ability of Bonneville and the utilities to meet the conservation targets.

The Council staff believes both cost and value to the power system are important factors to consider in determining Bonneville's willingness to pay. The absolute upper limit of Bonneville's willingness to pay should be the value of the energy savings to Bonneville. For conservation measures that have large non-energy benefits, this upper limit may be well below estimated costs. In cases where measure cost is low, measure value to the power system is relatively high and the barrier to market adoption is unrelated to the cost of the measure, it may make sense to provide rate credits based on cost plus some portion of value. This could provide more flexibility than Bonneville's proposal. We urge Bonneville to consider retaining the flexibility to differentiate payment by measure or program in order to be able to send appropriate signals regarding the importance of specific conservation activities. This will allow Bonneville to target initiatives towards a portfolio of conservation activities that will provide value to the region over the long run. For example, certain programs and initiatives focused on lost opportunities may need to be accelerated soon in order to reach the penetration rates identified in the Council's plan.

As is the practice in the present rate discount, the value of savings to Bonneville should include the value of avoided wholesale energy and the value of offsetting or deferring transmission capacity expansion. We note that Bonneville's transmission business line customers should pay for transmission system benefits of conservation. We do not believe this is currently the case.

If all of the tools Bonneville employs are strictly cost-based, the agency will not likely have enough flexibility to reach the conservation targets. Too much emphasis on cost control at the expense of achieving the target would be an undesirable outcome for the region's ratepayers over the long run.

2. Proposal Element: Decrement loads of customers for conservation achieved under bilateral contracts only. Do not decrement for rate credit savings of partial requirements customers, IOU exchange customers or the Northwest Energy Efficiency Alliance. Consider decrements for third-party bi-lateral contracts of slice/block customers on a case-by-case basis.

Council Staff Comment: The conservation decrement appears to be a significant barrier to utility participation in Bonneville conservation programs. We support Bonneville's proposal to not decrement rate credit savings. However, we believe the proposal to decrement conservation achieved under bilateral contracts will continue to be an unnecessary hindrance to achieving conservation targets. To our knowledge, conservation decrements have not historically been implemented outside of net requirements. To initiate conservation decrements now, for what is in practice a very small short-term adjustment between net requirements calculations, will further encumber Bonneville and the utilities from reaching conservation targets. The Council staff believes that Bonneville's net requirements calculations and process are sufficient and timely to account for utility conservation implemented.

3. Proposal Element: Rate impacts are 0.04 mills per kWh for not decrementing conservation.

Council Staff Comment: This is a short-run issue. The Bonneville system will see the reduction in load due to conservation as its net requirements are recalculated. Forgoing the long-run benefits of cost-effective conservation for a small short-term rate relief is shortsighted and unnecessarily increases long-run system costs and risk.

4. Proposal Element: Count rate credit payments for investor-owned utility conservation towards Bonneville's share of the Council's regional conservation target.

Council Staff Comment: The Council staff believes Bonneville's proposal is inconsistent in the manner it treats Bonneville's share of the regional conservation target, its accounting of IOU conservation attributed to the rate discount, and its budget available to reach its conservation targets. This should be corrected in the final proposal. If BPA includes IOU rate credit payments of the exchange settlement as part of its conservation budget, Bonneville should increase its share of the regional target to include savings expected from IOU rate credit conservation claims.

5. Proposal Element: Rate credit can be used to augment Alliance funding for projects above and beyond that agreed to by the Alliance board and included in its base budget.

Council Staff Comment: Council staff strongly endorses Bonneville's position on this issue. The Council staff believes there are additional and expanded market transformation opportunities identified in the Council's power plan that cannot be covered in the current Alliance budget.

6. Proposal Element: Partial-requirements customers cannot claim the rate discount for contributions to the Alliance base budget not covered by Bonneville.

Council Staff Comment: Staff believes that excluding any Alliance funding above and beyond that made by Bonneville on behalf of the utilities from qualifying for the rate discount will put Alliance funding by partial-requirements customers at risk. Staff proposes that instead of excluding the use of the rate discount for partial-requirements customer contributions to the

Alliance base budget, such contributions should be allowed but the savings should count toward satisfying Bonneville's conservation targets.

7. <u>Proposal Element: Bonneville programs should pay only for cost-effective measures as defined by the Council staff's plan.</u>

Council Staff Comment: Council staff strongly endorses Bonneville's position on this issue. Funding programs and measures that pass a Total Resource Cost (TRC) test is consistent with the way the Council developed conservation targets and it ensures that programs and measures benefit the entire region as well as the utility system and its ratepayers. This treatment is consistent with the treatment of conservation investment by state regulatory commissions throughout the region.

However, the staff notes that the Council plan does not provide an exhaustive list of cost-effective measures. Nor does the plan identify the cost-effectiveness of all applications of all measures. Furthermore the plan identifies that there is considerable uncertainty on both costs and benefits that should be taken into consideration in program implementation. So in implementing a TRC cost-effectiveness screen, Bonneville will have to tailor its mechanisms to allow funding of measures, or particular application of measures, that are not be specifically identified in the plan. The cost-effectiveness methodology used in the plan should be used in making TRC cost-effectiveness determinations. The Council staff will assist Bonneville with refining mechanisms to implement the goal of paying for measures that pass a TRC cost-effectiveness screen.

8. <u>Proposal Element: Infrastructure Support at $1 million per year.</u>

Council Staff Comment: The Council staff agrees that Bonneville should support the infrastructure activities listed. However, the Council staff is concerned that the proposed budget is insufficient to accomplish the long list of infrastructure support activities on page 11 of the full proposal. Bonneville should work with the Council staff and utilities to develop a zero-based budget estimate of the funding needed for these activities. Bonneville's budget for infrastructure support should reflect the agency's appropriate share of those estimated costs.

9. <u>Proposal Element: The rate credit program will contain expanded reporting, more frequent review and earlier response to under performance.</u>

Council Staff Comment: The Council staff generally concurs with these changes. However, the Council staff recommends quarterly reporting instead of semi-annual reporting proposed by Bonneville. First, quarterly reporting would provide earlier feedback on progress. Second, quarterly reporting will reduce the training and re-training costs for use of the tracking and reporting software. The proposed expanded scope of software will require additional training. Quarterly reporting will facilitate familiarity and reduce retraining costs.

Furthermore, program specifications and/or contracts should include a requirement that utilities report their expenditures for conservation measures and programs. The current C&RD software tracking system already provides this option. Cost reporting will not only aid in tracking overall performance of the conservation acquired, it will assist Bonneville, the Council and utilities identify cost-efficient programs that could be replicated as well as areas where cost-efficiency or program effectiveness could be refined and improved. In addition, if utilities report all of their conservation program expenditures (including those not compensated by Bonneville) and all of their program savings through the tracking system, they will no longer need to dedicate time and effort to respond to the Regional Technical Forum's separate annual survey of utility conservation performance.

10. <u>Proposal Element: Eligibility excludes the Direct Service Industries.</u>

Council Staff Comment: Council staff concurs with this proposal.

11. <u>Proposal Element: Small utilities will be required to pursue conservation if they chose to participate. Up to 20% of the rate credit will be available for administrative costs.</u>

Council Staff Comment: Council staff concurs with this element of the proposal.

12. <u>Proposal Element: Provide a Renewables Alternative under the rate credit.</u>

Council Staff Comment: Council staff supports Bonneville's proposal to allow use of the rate credit for a limited amount of renewables development along with the provisions to keep the rate credit budget for conservation whole by replenishing any funding used for renewables from Bonneville's generation fund. However, the next phase of post-2006 program development should review of the renewable credit schedule in view of the six years that have passed since the rate credit schedule for non-direct application renewables was devised, and changes in the cost-effectiveness of renewables since that time.