

backgrounder

July 2006

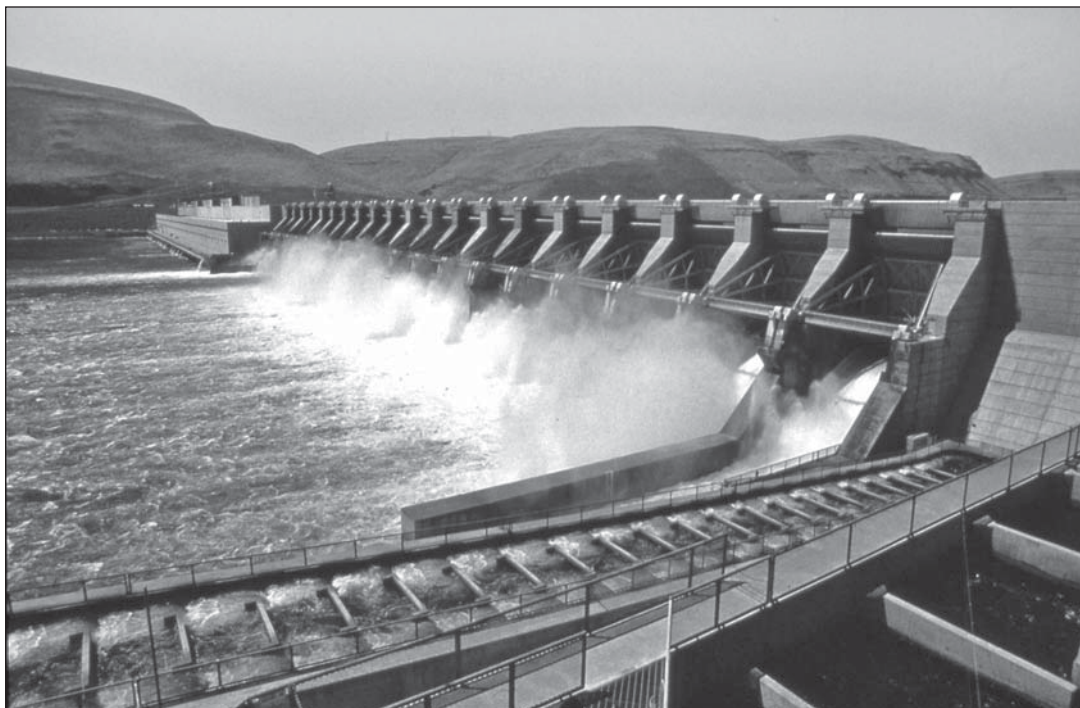
Long-Term Regional Dialogue Policy Proposal: Meeting the region's future energy needs

Note: This backgrounder describes the Long-Term Regional Dialogue Policy Proposal (Policy Proposal), which the Bonneville Power Administration is publishing for continued regional discussion and review. Each time the text describes a position or action, the intent is that it is a proposal. Nothing is final.

The context

Like the collapse of hurricane-ravaged New Orleans, the West Coast energy crisis was one of those events that wasn't supposed to happen in the world's most developed nation. Yet the 2000-2001 energy crisis did occur, and it dramatically spotlighted the consequences of what does happen when there is inadequate energy to meet demand. It was a costly lesson for the entire nation, and it underscored the importance of long-term planning to ensure future energy needs would be met.

It is a lesson the Pacific Northwest is taking to heart. In this region, discussions have been going on since the mid-1990s over the long-term role of the Bonneville Power Administration in the region's future power supply. Pinning down this role is critical to the region because just under half of the electricity consumed in the Northwest is supplied by BPA.



The region's ability to grow its economy will either be facilitated or restricted by the ability of BPA and others to provide adequate power. To do their share, other utilities and power suppliers need to know how much power they can depend on from BPA so they can make informed decisions about how much power they will need to secure elsewhere. This is key to ensuring the region develops adequate infrastructure to meet its future energy needs.

The Regional Dialogue

For several years, BPA has engaged the region in discussions known most recently as "The Regional Dialogue."



The intent of this dialogue has been to define BPA's power supply and marketing role for the long term and to do so in a way that meets key regional and national energy goals. The timing is important because current power sales contracts expire in 2011, and utilities will need to determine what power they will purchase from BPA now so that they will have sufficient lead time to develop or otherwise secure additional resources needed for 2011 and beyond.

Much of this overall Policy Proposal benefited from input from regional stakeholders, and BPA is grateful for these contributions. The Public Power Council, which represents BPA's public utility customers, put forth a power allocation proposal, and the Northwest Power and Conservation Council, which represents Northwest states, included a chapter on the "Future Role of BPA in Power Supply" in its 5th Northwest Power Plan. These and other sources are reflected in BPA's Policy Proposal.

A new paradigm

Regional Dialogue discussions reached a significant milestone in February 2005 when BPA made a policy decision to ensure that the benefits of the low-cost federal system are not diluted by melding higher cost power purchases or additional resources into the system.

Under this policy, after 2011, BPA would limit the firm power it sells to preference customers at its lowest cost-based rates to an amount approximately equal to the firm capability of the existing Federal Columbia River Power System (FCRPS). This would be known as Tier 1 power. The Northwest Power Act defines preference customers as public bodies such as public utilities, cooperatives and municipalities.

Preference customers may turn to BPA for additional power to serve their load growth, and, while BPA would make every effort to meet their needs cost-effectively, the agency would charge a higher rate, called Tier 2, for such power to cover the costs of securing the additional power.

This policy will reduce augmentation costs, which historically have been the greatest source of BPA's cost and rate increases. At the same time, tiered rates will give BPA customers stronger economic incentives to invest in new resources, including conservation and renewable resources.

While the Regional Dialogue Policy Proposal describes a tiered rates construct, decisions on the rate construct and prices will be determined in a formal rate proceeding as defined in Section 7(i) of the Northwest Power Act.

Greater certainty

Implementing these policies requires a new set of long-term power sales contracts and rates. While the new contracts and rates would be completed by the end of the next year, power deliveries would begin only after the current contracts expire in September 2011. BPA is proposing 20-year contracts. Such contracts will create the certainty to support development of the infrastructure needed to sustain the Northwest economy and to avoid price volatility.

The Policy Proposal also provides certainty about BPA's goals for conservation and renewable resource development and generally how the agency will pursue them. It also will bring much greater certainty to BPA's ability to fund its obligations, such as fish and wildlife mitigation. Historically, this funding has been most at risk when BPA rates have approached or exceeded market prices and customers have reduced their purchases from BPA. This Policy Proposal largely removes that source of risk.

Forging consensus

In September 2005, as part of the Regional Dialogue discussions, BPA released a Long-Term Regional Dialogue Concept Paper. The intent of the paper was to focus discussion on key issues with the aim of forging regional consensus.

While the concept paper and subsequent discussions generated progress and broad areas of agreement, some significant issues remain to be resolved. For example,

the region has not yet agreed on treatment of the residential exchange (benefits BPA provides for investor-owned utilities' small farm and residential consumers). This Policy Proposal captures the agreements that have been reached and also proposes treatment of unresolved issues.

Consensus is important because it will allow the region to move forward on infrastructure development and other challenges without the distraction of ongoing disputes. Such consensus will require tough compromise by all sides, but without it the region will have a hard time meeting its key goals.

Also, to provide the greatest possible assurance of contract enforceability, BPA is proposing a dispute resolution approach designed to provide a high degree of assurance to customers signing long-term contracts.

A sense of urgency

Although BPA will continue to work toward consensus, it intends to move forward even if all issues cannot be perfectly resolved. If the region is to have a reliable energy future, new long-term contracts and rates need to be in place to facilitate customer resource planning several years before current contracts expire.

The Policy Proposal provides a fallback proposal if regional consensus cannot be reached on key issues. The fallback proposal would move forward a substantial but narrower policy package for adoption.

Overall, the Policy Proposal aims to give the region both greater certainty and greater stability. Provisions in this Policy Proposal for service to publics, the residential exchange settlement and other issues have been tailored to "work" even if future market conditions and customers loads differ significantly from today's "best guesses."

Other highlights

The following highlights provide a very broad overview of key subjects addressed in the Policy Proposal. An expanded summary of issues is available that provides greater detail, but readers are cautioned that neither this

backgrounder nor the issues summary is a substitute for the complete Policy Proposal. The intent of the backgrounder and issues summary is to provide context and capture key highlights, not to explain the proposals in detail.

Tiered rates: The fundamental concept of tiering rates has been described above. The amount of Tier 1 power (lowest cost-based rate) available to public utilities would be determined by the power produced by the existing Federal Columbia River Power System, which BPA currently estimates will be 7,100 average megawatts in fiscal year 2012, net of all pre-existing firm system obligations. Costs for power beyond what the federal system produces that are included in Tier 1 prices would be strictly limited to very specific exceptions, for example limited augmentation for new public utilities.

Preference customers would be assigned a high water mark (HWM) that defines their access to Tier 1 power. The HWM approach would be established in new 20-year contracts. Because BPA has an obligation to serve, its public customers could secure additional power from BPA, but BPA would charge Tier 2 rates to cover the higher cost of augmenting the federal system. The Tiered-Rates Methodology would be established through a section 7(i) rate-making process. BPA will not subsidize Tier 2 rates to create a financial advantage over the market.

Conservation and renewables: BPA proposes to continue its commitment to developing all cost-effective conservation in the load it serves. BPA also proposes to support renewable resource development consistent with the Northwest Power and Conservation Council's Northwest Power Plan at the least possible cost. To the extent necessary, BPA would spend up to a net of \$21 million each year on a range of facilitation activities with its public power customers. The tiered rates proposal should make it easier and more economical for BPA to meet both of these commitments by giving BPA's customers a strong market-based incentive to invest in conservation and renewable resources.

Slice product: The Slice Product Review allowed Slice customers, Northwest Requirements Utilities/non-Slice customers and BPA to reach partial alignment on a number of operational and financial issues. However, a number of issues remain, and the Policy Proposal does not represent overall alignment. BPA is proposing to continue to sell the Slice product at roughly the current amount if ongoing legal disputes over the Slice contract can be resolved successfully. The Policy Proposal also calls for a limited scaling back of Slice operating flexibilities.

Residential Exchange benefits: BPA proposes a long-term financial settlement of the Residential Exchange Program that includes annual payments of \$250 million to investor-owned utilities, who pass on the benefits to their residential and small farm consumers. These would be adjusted up or down annually based on trends in BPA's rates and the investor-owned utilities' average system costs. This proposal is based on an estimate of the reasonable range of future benefits to investor-owned utility customers under the North-west Power Act. It is also near the center of the range of actual residential exchange benefits over the last 30 years.

Public utilities also have rights to claim exchange benefits. If they were to do so, it would in effect shift part of the cost of their new resource acquisitions to BPA, creating another source of significant financial uncertainty. BPA's Regional Dialogue contracts would require that existing public customers agree to settle their rights to the exchange during the term of the contract. Settlement of both investor-owned and public utility rights to exchange benefits will bring greater long-term certainty to an area that has historically been a large driver of BPA costs and rates.

Benefits to direct-service industries: Alternatives under consideration include extending monetary benefits similar to those offered in 2007-2010 contracts, ending benefits or providing limited physical power to the direct-service industries. BPA believes more public discussion of post-2011 service to DSIs is needed and intends to conduct at least one public meeting that centers on post-2011 DSI benefits.

BPA will weigh the sustainability of important family-wage jobs against its other goals, especially the imperative of keeping power rates as low as possible. BPA has commissioned a study to explore both the economic benefits of regional support for DSI jobs through BPA service and the economic impact of rate increases that result from that support.

Resource adequacy: BPA's proposal reflects the direction taken by the Regional Resource Adequacy Forum sponsored jointly by BPA and the Northwest Power and Conservation Council. A key proposal is that customers would contractually agree to provide data on a confidential basis to a neutral third party who would assess regional adequacy.

Long-term cost control: The 20-year contracts will obligate BPA customers to pay BPA's costs even if those costs go above market. Cost-control features in the Policy Proposal would put unprecedented mechanisms into place to increase the level of customer and stakeholder input into, and transparency of, BPA's cost decisions. The Policy Proposal would create a regional cost review process that would be a significant enhancement of BPA's current review process for both power and transmission.

President's budget proposal: Consistent with sound business practices required under BPA's statutes, the President's fiscal year 2007 budget provides that BPA will use any surplus power sales (net secondary) revenues it earns in any given year above \$500 million to make early payments to the U.S. Treasury to provide BPA with financial flexibility to invest back into energy infrastructure, conservation, and fish and wildlife protection programs. Given the importance of this action for the post-2011 period, BPA seeks public comment on this action in conjunction with the discussion about BPA's Long-Term Regional Dialogue Policy Proposal.

Schedule

The BPA administrator intends to make final policy decisions and sign a record of decision in January.

Updated information will continue to be posted at www.bpa.gov/power/regionaldialogue.

- Formal BPA Policy Proposal released – July 2006
- Public comment on Policy Proposal and discussions seeking consensus – July to September 2006.
- Publish BPA Regional Dialogue Policy and record of decision on long-term issues – January 2007
- Negotiate and develop new contract prototypes based on policy and ROD – February to December 2007
- Limited bilateral negotiations – January to April 2008
- BPA and customers sign new long-term contracts – April 2008
- Service and rates under new contracts begin – October 2011

How to comment

BPA believes, taken as a package, the Long-Term Regional Dialogue Policy Proposal strikes an equitable balance among the affected regional parties. BPA is also open to changing the Policy Proposal to achieve consensus and will work further with regional interests toward that end during the comment period. The complete Policy Proposal is available at www.bpa.gov/power/pl/regionaldialogue/07-2006_policy_proposal.pdf. A summary of issues in the Policy Proposal is available at www.bpa.gov/power/pl/regionaldialogue/07-2006_issue_summary.pdf.

The comment period is open through Sept. 29, 2006. Comments can be submitted online at www.bpa.gov/comment, via e-mail to comment@bpa.gov, via mail to Bonneville Power Administration, Public Affairs – DKC-7, P.O. Box 14428, Portland, OR, 97293-4428, or faxed to (503) 230-3285. You can call us with your comment toll free at (800) 622-4519. Comments also can be submitted

at any one of the five public meetings. Please reference the Regional Dialogue with your comments. Also note that all comment letters will be posted on BPA's Web site at www.bpa.gov/corporate/public_affairs/Comment_Listings.

The schedule of public meetings is below.

Seattle, Wash.

Aug. 1, 2006
Registration: 3 – 3:30 p.m.
Meeting: 3:30 – 7 p.m.
Mountaineers Building
300 3rd Ave. W.

Pasco, Wash.

Aug. 7, 2006
Registration: 1 – 1:30 p.m.
Meeting: 1:30 – 5 p.m.
Franklin PUD Auditorium
1411 W. Clark St.

Portland, Ore.

Aug. 9, 2006
Registration: 3 – 3:30 p.m.
Meeting: 3:30 – 7 p.m.
BPA Rates Hearing Room
911 N.E. 11th Ave.

Idaho Falls, Idaho

Aug. 23, 2006
Registration: 3 – 3:30 p.m.
Meeting: 3:30 – 7 p.m.
Shilo Inns Suites Hotel
780 Lindsay Blvd.

Pablo, Mont.

Aug. 31, 2006
Registration: 2 – 2:30 p.m.
Meeting: 2:30 – 6 p.m.
Mission Valley Power
65 W. Pablo Road