

ADMINISTRATOR'S RECORD OF DECISION

Direct Service Industrial Customer Requirements Power Sales Contract

INTRODUCTION

The Bonneville Power Administration (BPA) has negotiated proposals with its Direct Service Industry (DSI) customers to provide them a 5-year "block" sale of requirements power, consistent with the Administrator's authority under Section 5(d) of the Pacific Northwest Electric Power Planning and Conservation Act. Although the DSIs' current contract (Current Contract) for BPA power supply does not expire until June 30, 2001, BPA has decided to consider this block sale proposal now for three reasons:

- BPA expects that many of the DSIs will give BPA a notice before October 5, 1995, of their intent to terminate the Current Contract or to reduce their loads on the Federal system, effective April 1, 1996;
- even if the DSIs do not notify BPA before October 5, 1995, of their intent to terminate the Current Contract, they have a right to terminate the Current Contract at any time on 1 year's notice; and
- non-BPA suppliers have made competitive offers to the DSIs that will likely be accepted if BPA does not sign the Block Sale Contract.

Execution of the Block Sale Contract would be consistent with BPA's Market-Driven approach (see discussion below) for participation in the increasingly competitive electric power market.

This decision is consistent with BPA's Business Plan, the Business Plan Environmental Impact Statement (EIS) (DOE/EIS-0183, June 1995) and the Business Plan Record of Decision (ROD) (August 15, 1995). In response to a need for sound policy to guide its business direction under changing market conditions, BPA explored six alternative plans of action in its Business Plan EIS. The six alternatives were: Status Quo (No Action), BPA Influence, Market-Driven, Maximize Financial Returns, Minimal BPA, and Short-Term Marketing.

The Business Plan EIS examined each of these six alternatives under two widely differing hydro operating scenarios developed in a parallel environmental process (the Columbia River System Operation Review (SOR)). The SOR will determine the operating requirements necessary to serve the multiple purposes of the Federal hydro facilities in the Columbia River Basin. The decisions about operating requirements will define the power operation for all BPA power transactions, including this 5-year requirements block sale.

In the Business Plan ROD, the BPA Administrator selected the Market-Driven alternative. Although the Status Quo and the BPA Influence alternatives were the

environmentally preferred alternatives, the differences among alternatives in total environmental impacts were relatively small. Other business aspects, including loads and rates, showed greater variation among the alternatives. The Market-Driven alternative strikes a balance between marketing and environmental concerns. It also helps BPA to ensure the financial strength necessary to maintain a high level of support for public service benefits such as energy conservation and the fish and wildlife program.

The Business Plan EIS and ROD were also intended to guide BPA in a series of business decisions on specific issues and actions. The decision to offer a requirements block sales contract is one of these actions, and this ROD is tiered to the Business Plan ROD; that is, the examination of issues and alternatives and the basis for decision within that ROD are incorporated here by reference, and summarized below only as relevant to this decision on the 5-year block sale. Specific information on the block sale contract and the environmental analysis pertaining to this decision are given below.

DESCRIPTION OF THE DIRECT SERVICE INDUSTRIES (DSIs)

The DSIs are a group of industrial firms that operate plants in the Pacific Northwest (PNW) and that purchase power directly from BPA. These plants use primarily electricity-intensive industrial processes to make products such as aluminum and other primary metals, pulp and paper, ferroalloys, and chlor-alkalies. The individual companies, plant locations, and average megawatt (aMW) loads are listed in Table 1, below.

DSI Loads: Size

Currently, DSI operations represent about 2500 aMW of BPA load, producing revenue at an average rate of 25.9 mills per kilowatthour. Starting in 1996, BPA expects that the DSIs will be operating at over 3000 aMW, as commodity prices increase and as a worldwide understanding to limit aluminum metal production for 2 years (1994-1995) expires.

DSI Loads: Service and Revenue Benefits

The DSIs' substantial share of BPA's loads and revenues offers numerous benefits to BPA, through opportunities for distribution benefits, power system reserves, operational benefits, and revenue benefits critical to BPA's Treasury payments.

Table 1: BPA's Direct Service Industry Customers

DSI	Location	Capacity BPA aMW Load
<u>Primary Aluminum</u>		
Alcoa	Wenatchee, WA	198
Columbia Aluminum	Goldendale, WA	290
Columbia Falls Aluminum	Columbia Falls, MT	345
Northwest Aluminum	The Dalles, OR	165
Alumax -- Intalco	Ferndale, WA	455
Kaiser Aluminum	Mead, WA	390
Kaiser Aluminum	Tacoma, WA	150
Reynolds Metals Company	Longview, WA	415
Reynolds Metals Company	Troutdale, OR	250
Vanalco	Vancouver, WA	230
<u>Aluminum Fabrication</u>		
ACPC	Vancouver, WA	3
Kaiser Aluminum	Trentwood, WA	64
<u>Magnesium/Ferrosilicon</u>		
Alcoa -- Northwest Alloys	Addy, WA	83
<u>Titanium</u>		
Oremet	Albany, OR	15
<u>Nickel</u>		
Glenbrook Nickel	Riddle, OR	103
<u>Pulp & Paper</u>		
Port Townsend Paper	Port Townsend, WA	16
<u>Chlor-Alkalies</u>		
Georgia Pacific	Bellingham, WA	34
Elf Atochem	Portland, OR	84
<u>Steel Plate</u>		
Oregon Steel	Portland, OR	No load placed at this time
<u>Total BPA DSI Load</u>		3290 aMW

- **Distribution benefits.** A large aluminum reduction plant can represent a load equivalent to that of a medium-sized city. Service to a single large facility offers

economic benefits, as the very large costs of distributing electric power to multiple points of delivery are avoided.

- **Power system reserves.** DSIs also provide BPA with operating and stability reserves under both the old and new contracts. Stability reserves are those necessary to ensure the stability of the Federal Columbia River Transmission System against losses of transmission facilities. Operating reserves are those necessary to enable BPA to reestablish its load/resource balance after generation or transmission facilities are lost (fail). When the system experiences an outage of major resources/transmission lines or after system disturbances, part of the DSIs' power supply can be interrupted (held back for use elsewhere), thus eliminating the potential for a blackout that could affect a large number of customers. The size and nature of the DSI loads make them especially valuable to BPA as power system reserves. DSIs are compensated under the Block Sale Contracts for providing these reserves by a credit to the rate charged for power deliveries.
- **System operations flexibility.** Matching load and generation is a critical factor in the electric energy business. A shortfall of generation presents one kind of problem; a surplus of generation, another.

A typical large utility serves a diverse load that fluctuates greatly between peak and off-peak periods. To meet the load, it dispatches resources, including power purchased from other utilities. That power may range from the relatively fixed (and usually less expensive) output of baseload type resources to the highly flexible output of peaking resources. During peak hours, the utility must acquire more power. During off-peak hours, the utility must "back off" the resources (reduce its power generation) so that generation balances the lower loads that typically occur at night.

DSIs provide important operating flexibility to the hydro-thermal system. Operation of DSI plants during the night facilitates BPA's participation in valuable power exchange arrangements with Southwest utilities by providing load to use the less expensive night-time energy returns. BPA can then store water in the Federal Columbia River reservoirs for more valuable daytime generation.

Because DSI loads remain relatively constant and high (slightly below their maximum demand) day and night, DSIs' night-time loads offer a particular advantage to the Federal system. During the day, total DSI load might be only 30 percent of BPA's total loads, but at night, that load may exceed 50 percent. Because the DSI loads "absorb" more generation at night, they allow BPA to better match its loads and resources.

DSI night-time load also allows BPA to realize significant revenues from sales of capacity and load shaping services to other utilities. When BPA delivers power to such utilities during peak hours, the utility then "compensates" BPA by

replacing the equivalent amount of energy during off-peak periods. The DSIs enable these exchanges by providing the off-peak load required to absorb the return of energy to BPA.

- **Revenue benefits.** Even with the recent low commodity prices and limited aluminum production over the past several years, the DSIs accounted for 20 to 25 percent of BPA’s revenues during the past 3 fiscal years, as shown in Table 2, below.

Loss of large portions of these loads could seriously affect BPA’s ability to continue meeting its obligations to repay the U.S. Treasury. This is in part because BPA’s ability to raise revenues from other sources to cover its costs and make its Treasury payments is severely affected by fishery mitigation measures and competitor’s power prices (see New Competitiveness, below).

Table 2: DSI Share of BPA Revenue

Fiscal Year	DSI aMW	DSI Revenue (\$ million)	% Total BPA Revenue
FY 1992	2871	\$448	25%
FY 1993	2377	\$383	21%
FY 1994	2157	\$417	21%

In summary, for BPA to function successfully in the complex environment of power production, purchase, and exchange that enables the various revenue-producing services, the steady loads and the revenue opportunities offered by the DSIs are highly desirable. Given that escalating fish-related constraints on hydro operations are compromising BPA’s ability to reduce its generation during off-peak hours, the DSI’s off-peak loads provide a substantial benefit to BPA marketing, and to its ability to continue to meet its Treasury obligation.

Statutory Guidelines Concerning DSI Service

The Pacific Northwest Electric Power Planning and Conservation Act of 1980 (Northwest Power Act) requires the Administrator to “offer . . . to each existing direct service industrial customer an initial long-term contract that provides such customer an amount of power equivalent to that to which such customer is entitled under its contract dated January or April 1975.” 16 U.S.C. §839c(d)(1)(B). These contracts were intended to replace then-existing DSI power sales contracts with various expiration dates between 1981 and 1991. In addition, section 5(d)(1)(A) of the Northwest Power Act states that the BPA power sales to the DSIs were to “provide a portion of the Administrator’s reserves for firm power loads within the region.”¹ Consistent with these statutory directives, in 1981 the Administrator offered DSIs new 20-year contracts: these

¹ “Reserves” are defined as “the electric power needed to avert particular planning or operating shortages for the benefit of firm power customers.” 16 U.S.C. §839a(17).

specified the same amount of power as in the 1975 contracts, provided reserves protecting the stability of the transmission system, provided reserves backing up the loss of generating and transmission facilities, and allowed for interruption of DSI service for specified purposes. Now, BPA is deciding whether to enter into a new set of agreements that provide its DSI customers with continued requirements service, but under terms competitive with those of other suppliers in the market.

NEW CHALLENGES TO BPA'S COMPETITIVENESS

The electric utility industry is becoming increasingly competitive and dynamic. Four factors are substantially affecting BPA's ability to compete.

Market Change

The electric energy market is in a period of rapid business change that has led to an emerging competition for BPA's customers. The market is increasingly competitive. Natural gas prices have fallen. Combustion turbines (CTs), the technology of choice for new power plants, cost less to install and operate more efficiently than existing CTs. The West Coast has a surplus of generating capacity that is likely to continue for several years. Wholesale marketers are aggressively pursuing sales to BPA's customers: some appear willing to operate with minimal or no profit to gain entrance to the Pacific Northwest market. This competition has led to significantly lower prices for wholesale electric power.

Increased Non-Power Responsibilities

BPA has major public service missions beyond power marketing. These include fish and wildlife enhancement, support of energy efficiency, and environmental stewardship. Costs to carry out these mandated missions have increased significantly over time. In fulfilling these missions, BPA must balance the interests of its ratepayers and its responsibility to the environment. BPA also shares in the Federal government's trust responsibilities to Indian tribes.

As BPA faces increased competition, it is also taking on new costs. Recent measures for salmon mitigation under the Endangered Species Act (ESA) have had dual impacts. Since 1991, BPA's annual investment for fish and wildlife has risen from \$150 million to about \$400 million in 1995, including capital expenditures, replacement power, and lost revenues. As other measures phase in, BPA's annual fish and wildlife investment is expected to increase to \$675 million in 2001. In addition, significant ESA-required changes in the operation of the hydropower system have reduced operating flexibility and further curtailed revenues.

While fish and wildlife costs are still smaller than the fixed debt payments for nuclear investments for which BPA contracted in the 1970s, they are new costs that have been accelerating rapidly and may continue to grow. As a result, they present an increasing

cost pressure at a time when BPA must reduce prices. BPA's customers acknowledge that the prospect of further increases in these costs is one of the major influences motivating them to shift load from BPA to other power suppliers.

Deterioration of BPA's Cost/Price Advantage

BPA must be able to balance its costs and revenues. However, the availability of non-Federal power at competitive prices from alternate suppliers, coupled with the DSIs' ability to terminate their current contracts as early as April 1, 1996, prevents BPA from meeting increased costs simply by raising rates. The BPA firm power rate level above which a rate increase would no longer increase BPA's revenues would produce BPA's maximum sustainable revenue (MSR). Allowing BPA's rates to exceed this level would not be consistent with sound business principles and would reduce BPA's total revenue.

All of BPA's customers are being solicited by other power suppliers. Many DSI customers, in particular, are solicited daily, and several DSIs have already reached agreements with BPA competitors. Most feel that it is important for them to diversify their power purchases, given the new competitive environment. This makes the DSIs more likely to terminate all or part of their existing service from BPA. Recent examples include the following:

- Northwest Aluminum Company will be purchasing 70 MW, or about 40 percent of its current BPA load, from The Washington Water Power Company (WWP). The 5-year contract is for power from August through February (when energy prices are generally higher), at the extremely competitive price of 25.5 mills per kilowatthour (kWh). Northwest Aluminum will make spot market purchases during the March through July period, and BPA may continue to make some sales to the company. Northwest Aluminum has stated that, with the increase in competition, it does not want to rely on any single supplier. Combining the contract with its spot market purchases, Northwest Aluminum expects to pay an annual average of between 19 and 21 mills for power. This arrangement is one of the best examples yet of the intense competition that BPA faces.
- WWP and Kaiser Aluminum have entered into a 5-year agreement for up to 50 MW of power beginning October 1, 1995. WWP has not disclosed the price of the power to be sold under this agreement; however, it is reported to be lower than the rate target in BPA's Block Sale Contract.
- Chelan Public Utility District is purchasing 50 aMW of energy from Enron Power Marketing, for resale to Alcoa; the average price would be 19.0 mills per kWh. In late December 1994, Alcoa issued a request for proposals for up to 216 MW of load (that portion of the plant's load not served directly by Chelan) at its Wenatchee, Washington, aluminum smelter.
- Most recently, on September 12, 1995, Columbia Falls Aluminum announced that it will purchase 245 aMW of its 345 aMW capacity from non-BPA power

suppliers. During the period from April 1996 through December 2000, Columbia Falls will take 145 aMW from PacifiCorp and 100 aMW from Enron.

BPA's competitors are competing directly with BPA's offers. Recent examples of this include the following:

- PacifiCorp is prepared to offer a power rate that varies with the price of aluminum, for service to BPA's DSI customers through preference utility customers. Since 1986, BPA has offered a variable rate to its aluminum DSI customers. Financial hedging transactions, in which a third party assumes the risk of low aluminum prices, now make it easier for BPA's competitors to offer variable rates.
- In addition, PGE and Edmonton Power Authority recently formed a joint marketing effort to offer competitive firm, short-term energy to West Coast markets. The companies said that they would focus initially on BPA's DSI customers, targeting markets seeking at least 10 megawatts for 1 to 5 years. They indicated that they would offer "commodity-based options," in addition to fixed and market-based pricing. It appears the new venture is also prepared to offer a rate tied to the price of aluminum.

To meet this challenge, BPA has been required to negotiate new contracts that will meet the needs of BPA and its DSI customers by giving a new type of service to them. To the extent permitted by statute and consistent with sound business principles, BPA must compete against the market challenge by structuring power products that meet customers' needs, while improving BPA's revenue situation so that it is able to meet its Treasury payment responsibilities. BPA managers have sponsored testimony in the 1996 BPA Rate Case describing in detail the serious competitive challenges facing BPA. (See Moorman and Evans, WP-96-E-BPA-09, and Norman and Oliver, WP-96-E-BPA-10.) One way to meet this challenge is to provide attractive products for DSIs.

PROCEDURAL HISTORY

The development of a new DSI requirements contract proposal was possible only in the context of an overall decision on the appropriate marketing approach for BPA, made through the Business Plan EIS process. The section below traces the relationship between the development of the requirements Block Sale Contract and the Business Plan EIS.

Since 1937, BPA has marketed large amounts of power under successive 20-year firm power sales contracts with utilities and direct service industries. In 1980, Congress supplemented BPA's marketing responsibilities with (1) resource development obligations designed to meet electrical load growth among its utility customers, and (2) provisions for exchanges of power between BPA and non-preference utilities that would make the benefits of low-cost Federal power available to investor-owned utilities' (IOUs') residential and small farm customers. The Northwest Power Act, which created these additional responsibilities, required BPA to offer new long-term power sales contracts to its utility and DSI customers. BPA responded, and offered new contracts pursuant to the Northwest Power Act in August 1981. Customers were statutorily allowed 1 year to sign the new contracts; most did so before the end of the offer period. The initial contracts will expire on June 30, 2001.

On April 30, 1992, BPA published a Notice of Intent to prepare an EIS for new 20-year power sales contracts. This EIS was entitled the "Long-Term Requirements Power Sales Contracts EIS."

Simultaneously, BPA announced the beginning of a parallel public process for new long-term contract renegotiation. In the summer of 1992, a wide range of parties--including BPA, direct service industry customers, utility customers, conservation interests, environmental interests, consumer groups, and others--began the New Power Sales Contract Renegotiation Process, using interest-based negotiation as its process philosophy. The first important product of this process was the articulation of interests by the participants in September of 1992. By the summer of 1993, this process had developed a set of issues to be addressed in deciding how to meet the interests of the parties, a list of alternative approaches for meeting those interests, and a list of products and services that BPA might offer under new contracts.

On August 9, 1993, BPA published a notice declaring a broadening of the scope of the Long-Term Requirements Power Sales Contracts EIS to include power and transmission rate design and access to the Federal transmission system within the Pacific Northwest. The newly scoped EIS was entitled the "Pacific Northwest Commercial Services and Rates EIS." These topics were combined for the convenience of participants and for efficiency in analysis of issues and alternatives concerning related matters.

On December 3, 1993, in response to public comments and the evolution of issues, BPA yet again expanded the scope of the EIS to encompass all aspects of BPA's

Business Plan. The expanded document was designated the “Business Plan EIS.” A draft of the Business Plan EIS was circulated to the public for comment in June 1994, and BPA/DSI discussions on transmission for DSIs were initiated. Within the Business Plan EIS, BPA specifically stated that the EIS is intended to support, among other things, “[c]ontract terms BPA will offer for power sales to PNW publicly-owned utilities, IOUs and DSIs, for transmission services, and for extraregional sales, including non-PNW IPPs [Independent Power Producers]/brokers/ marketers.” (See, Draft Business Plan EIS at 1-3.)

On September 6, 1994, after a 13-month suspension that allowed preparation of the Business Plan EIS, BPA resumed negotiations with its customers on new long-term power sales contracts. This phase of negotiations was designed to establish tentative BPA/customer relationship agreements that would guide the drafting of preliminary contract language. The tentative agreements and draft contract language were non-binding and revocable. Upon completion, they were to be circulated to the public for comment.

On December 28, 1994, BPA notified interested parties that, given the extensive comments on the Draft EIS and updated information and analysis, it would prepare a Supplemental Draft EIS. The Supplemental Draft Business Plan EIS was distributed to the public on March 7, 1995. Also in March, BPA achieved settlement of the 1995 Rate Case. Additionally, a waiver and release of BPA’s right to serve DSI top quartile and a waiver of notice for the addition of resources by customers to serve certain public agency loads was negotiated. Negotiations on tentative agreements from earlier negotiations, including principles for long-term transmission to the DSIs, were also concluded. A 5-year transmission agreement was offered to the DSIs in April.

In early June 1995, the first preliminary drafts of the new long-term power sales contracts were made available. At about the same time, the comment period for the Supplemental Draft Business Plan EIS closed. BPA then prepared and issued a Final Business Plan EIS (June 13, 1995). Consistent with the original Draft Business Plan EIS, BPA specifically stated that the Final EIS is intended to support, among other things, “[c]ontract terms BPA will offer for power sales to PNW publicly owned utilities, IOUs, DSIs, and independent power producers (IPPs) for transmission services; and for extraregional sales, including non-PNW IPPs/brokers/ marketers.” (See, Final Business Plan EIS at 1-7.)

On June 22, BPA hosted a public meeting to discuss the preliminary drafts of the new long-term requirements power sales contracts, subsequent developments, and issues (such as stranded costs) that needed to be addressed as BPA proceeded in developing contracts. Among the comments received were frequent comments from individual DSI customers that the offers they were receiving from other suppliers were much more straightforward (in terms of the term of the contract, conditions of service, commitment to price, dispute resolution, and other matters) than BPA’s preliminary draft contract. They suggested that, for BPA to compete successfully, the Agency must offer a contract much closer in form and substance to these competing, limited-term, fixed-price offers.

After further discussions with the DSIs, BPA developed a draft template for a 5-year requirements power DSI block sale. That template, along with other BPA requirement contract templates, was circulated for comment on July 13, 1995. This comment period closed on August 11, 1995.

During the comment period, BPA continued to discuss terms and conditions with those DSIs that indicated they would be making major power supply decisions, including termination or reduction of their BPA service, in late August and early September, i.e., decisions on whether to continue with BPA or to accept the offers they had received from others. The Block Sale Contract addressed in this ROD reflects the product of these comments and discussions, as well as other comments received on the block sale template during the public review period.

On August 15, 1995, BPA executed a ROD that declared that the Agency had decided to pursue the basic business direction outlined by the Market-Driven alternative, as described in the Final Business Plan EIS. The decision to select that alternative provides the necessary policy direction to decide a number of specific issues related to products and services, rate designs, energy resources the Agency will acquire, and transmission services the Agency will offer. However, before taking specific action on any of these issues, BPA affirmatively stated that it would review the Business Plan EIS to ensure that a particular action was adequately covered within the scope of that EIS and, if appropriate, issue a tiered ROD. This ROD, which summarizes and incorporates information from the Business Plan ROD, is the result of such a review.

On August 22, BPA sent to the DSIs a final form of unsigned negotiated contract templates with a letter requesting that the DSIs make offers of load placement at a price target that would be communicated to the DSIs on September 13. On September 13, BPA notified the DSIs of the target price. The DSIs were to provide BPA signed offers of load commitment by September 20. BPA received from the DSIs offers to place load commitments on BPA totaling 1606 aMW. Their offers were conditioned on acceptance by BPA by 5 p.m. on September 25, 1995, a deadline subsequently extended to 5 p.m. on September 28, 1995. On September 22, BPA hosted a public meeting to share information on the DSI load commitments and to solicit advice on whether to accept them.

DESCRIPTION OF PROPOSED CONTRACTS

The DSIs are receiving competing firm-power offers for a fixed period, usually 5 years, and at a fixed price. These offers are from utilities, within and outside the Pacific Northwest, and from marketers and brokers. In order for BPA to compete effectively with these entities, it was necessary to offer a comparable product. BPA has been discussing contract terms with representatives of the DSIs since early June, 1995. A draft template was released by Bonneville for public review on July 13, 1995. The DSI offers that BPA received on September 20, 1995, are based on these templates, as modified by subsequent negotiations.

Term

The requirements Block Sale Contract is intended to replace BPA's requirements service to DSIs under the Current Contract. It is designed to meet the needs of the DSIs so that BPA may retain them as customers, while producing for BPA a 5-year revenue stream that is sufficient, when combined with other revenues, to meet BPA's financial and legal obligations. At the same time, the Block Sale Contract does not preclude or require BPA to provide power service to the DSIs after the end (September 30, 2001) of the 5-year term of the contract.

The Block Sale Contract will become effective on the date that it is executed by BPA. Deliveries of firm power will commence on the later of October 1, 1996, or the date that the Federal Energy Regulatory Commission (FERC) provides interim approval of a power rate schedule that satisfies the rate test in the Block Sale Contract.

5-Year Sale Only

The Block Sale Contract obligates BPA to sell and deliver to the DSIs, for service to their plant load, annual amounts of heavy- and light-load-hour firm energy for 5 years. The DSIs are obligated to buy the energy on a take-or-pay basis at a fixed price. The take-or-pay condition completely shifts the risk of decreases in the price of aluminum from BPA to the DSIs.

The DSIs rejected negotiations based on the options of either the full requirements template or the partial requirements template. These templates contain terms for the offer of ancillary power products supporting non-Federal resources, as well as for the sale of Federal power. The DSIs requested contract terms to match the offers they were receiving from other suppliers. BPA was able to offer a contract without the terms covering ancillary services to the DSIs, since it had an agreement in the DSI Integration of Resources (IR) Transmission Agreement (April 1995) that the DSIs would purchase these services from BPA or arrange for them to be provided by another supplier.

Remarketing of Excess Power

Under the Block Sale Contract, a DSI has a one-time option either to curtail take-or-pay energy (for a fixed fee), or to have BPA remarket take-or-pay energy in excess of the DSI's actual demand. If a DSI elects the curtailment option, it will be charged a fixed fee specified in BPA's Industrial Firm Power (IP) Rate Schedule. A DSI selecting the remarketing option will be billed for its full take-or-pay obligation, but will receive a credit on its power bill for revenue BPA receives as a consequence of remarketing excess energy, net of any cost incurred by BPA to remarket the power. Such one-time options must be exercised by February 1, 1996, the time of the DSIs' first submittal of monthly amounts of Firm Power.

Reserves

The Block Sale Contract provides BPA with both stability and operating reserves, as does the Current Contract. New provisions on reserves were necessary in the Block Sale Contract to reflect the fact that the DSIs are no longer full requirements customers of BPA. BPA can restrict only those power deliveries made pursuant to the Block Sale Contract.

Termination Rights: Rate Test and Dispute Resolution

DSIs have certain rights to terminate the Block Sale Contract. The conditions under which the DSIs may exercise termination rights fall into two categories: conditions over which BPA either (1) does or (2) does not have control. If the contract expires, or is terminated for conditions over which BPA has control (as set forth in subsection 5(a)(1)), then BPA shall not assess any stranded cost recovery against the signing DSIs (or any third party doing business with such DSIs) that is based on purchases under the Block Sale Contract or any prior BPA contract, or that is based on the termination or reduction of those purchases. BPA believes that the Block Sale Contract does not preclude the use of a general cost recovery surcharge (on any rate other than the Block Sale rate), that is not based on prior BPA purchases. The parties to the Block Sale contract preserved arguments regarding BPA's ability to assess stranded cost recovery based on prior purchases when the contract terminates for any condition over which BPA has no control. The stranded cost recovery release described above does not apply to any unrecoverable costs represented by unamortized investment in BPA substation or transmission facilities for which the primary purpose is to serve the DSI load during the life of the contract. The conditions over which BPA has control that could entitle the DSIs to terminate the Block Sale Contract involve a rate test and BPA's response to conditions of dispute resolution.

The DSIs are eager to take advantage of current offers by alternative suppliers to serve their loads at prices below BPA's current Industrial Firm Power Rate. BPA is presently engaged in establishing new power rates that are expected to be lower than its existing rates. Section 7 of the Northwest Power Act defines the legally required procedures BPA must follow in establishing rates; BPA will be unable to complete that rate process for several more months. In recognition of the need to respond to competitive offers available to the DSIs and to preserve BPA's ability to serve their loads, and also of the prohibition on negotiating final rates outside the rate case, the Block Sale Contract contains a rate *target*, rather than an actual rate. Under the terms of the contract, the DSIs have the option to terminate the contract if BPA (1) proposes in the 1996 rate case a DSI rate schedule greater than the rate target in the Block Sale Contract; (2) by September 1, 1996, fails to file with FERC a rate schedule equal to or less than the rate target; or (3) fails to propose a revised rate schedule to FERC that is equal to or less than the rate target if BPA's initial submission to FERC is remanded.

Offers available to the DSIs from other suppliers typically contain dispute resolution procedures providing for compliance with awards or decisions rendered by an independent arbiter. Currently BPA, as an entity of the Federal government, is limited in

its ability to be bound by such determinations in all situations. The Block Sale Contract defines conditions under which the DSIs may terminate the contract if BPA chooses not to accept or abide by the finding of such an arbiter.

Unrecoverable Delivery Facility Costs

The Block Sale Contract requires that a DSI terminating service under that contract must reimburse BPA for the book value, less mitigation, for delivery facilities that were acquired for the primary use of the DSI. The Block Sale Contract acknowledges that a DSI may buy power from others and that continued use of delivery facilities at applicable transmission charges is acceptable mitigation against the remaining book value of facilities.

Other Stranded Costs

The Current Contract is a requirements contract: that is, BPA is obligated to meet each DSI's contractual requirement for electric power, up to its maximum Contract Demand. The Current Contract contains a provision [Subsection 2(b)] that allows the DSIs to terminate service (in whole or in part) "for any reason" upon 12 months' notice.² Section 2(b) states:

2. Term of Contract

(b) the Purchaser may for any reason terminate service hereunder, in part or in whole, by giving Bonneville a one-year prior written notice. If all or a portion of service to the Purchaser is so terminated, (1) the purchaser shall reimburse Bonneville for any otherwise unrecoverable costs incurred by Bonneville through June 30, 2001, by reason of such termination; provided however, that Bonneville shall use its best efforts to mitigate such costs; and (2) the Purchaser shall not subsequently purchase during the term hereof the electric power and energy associated with the amount of service so terminated from a utility served by Bonneville unless Bonneville at its sole discretion determines that there is no material adverse impact on the Federal System. Termination shall not be considered curtailment for purposes of this contract. (*Emphasis added.*)

While the DSIs' contractual right to terminate service with 12 months' written notice is made clear in section 2(b), there has been considerable disagreement and discussion about what the reimbursement of "unrecoverable costs" means, as well as about the requirement that subsequent service to a DSI by a utility served by BPA not cause a

² In addition, the DSIs may terminate service pursuant to the DSI contract waiver and release, granted in March 1995 as part of an overall rate settlement. Under this option, the DSIs are allowed eventually to purchase up to their entire first quartile from third parties without reducing contract demand, and without regard to the termination provision in the current contract. This waiver and release goes into effect on October 1, 1995, and continues until the current contracts terminate.

“material adverse impact on the Federal System.” BPA has previously interpreted the former provision as limited to recovery of costs of substation and transmission facilities built to serve DSI load.

BPA has recently reiterated its view that the only stranded costs BPA may recover on an individual basis from a DSI providing BPA written notice of early termination pursuant to section 2(b) of the Current Contract are as follows:

The unamortized investment, if any, in BPA substation or transmission facilities whose primary purpose is to serve the DSIs’ load during the life of the contract, less any mitigation by BPA. If the DSI is served by transfer over third party facilities, “unrecoverable costs” shall include any amount the Administrator is obligated to pay the third party because of termination of the transfer arrangement.³

Given this interpretation, a terminating DSI is protected by section 2(b) of the Current Contract from the imposition of any additional form of cost recovery charge or exit fee related to BPA’s earlier power supply investments and individually targeted at it by reason of full or partial termination of its contract. BPA does not, however, interpret the Current Contract as precluding BPA from setting uniform power or transmission rates of general applicability at a level sufficient to recover BPA’s overall cost, including costs of power that would otherwise have been sold to the DSIs.

The Current Contract entitles the DSIs to terminate service on 12 months’ notice and protects them from the imposition of any individually assessed additional form of cost recovery charge or exit fee by reason of full or partial termination of those contracts; BPA also believes that the Current Contract does not preclude BPA from setting uniform power or transmission rates of general applicability at a level sufficient to recover BPA’s overall cost. BPA might determine that generation costs that would otherwise have been recovered over the next 5 years could be fully recovered *only* by reallocating part of those costs to the transmission function for recovery consistent with law. Given that possibility, BPA cannot now rule out options, including a cost recovery surcharge, that would permit the Agency to recover those reallocated costs based in whole or in part on past benefit or power purchases from BPA’s power system.

The DSIs do not agree that BPA has any authority to recover, as part of a transmission rate, any costs that have traditionally been recovered through generation-related charges.

With the competitive changes in the electric utility industry, many are debating whether utilities like BPA will be burdened with unrecoverable costs because customers decide to change power suppliers. Although the Current Contract is not due to expire until 2001, BPA has decided to negotiate a new DSI power sales contract (the Block Sale Contract) in order to keep as much of the DSIs’ load as possible and avoid significant

³ Letter to DSI customers from Steven G. Hickok dated June 14, 1995, Letter to John Carr, Direct Service Industries, Inc. from Randall Hardy dated September 1, 1995.

revenue loss, given the DSI's right to terminate their Current Contract with 12 months' notice and their receipt of competitive offers (see "New Competitiveness in the Electric Industry," above). The associated issue of how BPA will recover certain costs without charging a special fee to DSIs that terminate service before the end of the 20-year term of the Current Contract ("stranded cost charge") has been addressed through negotiations associated with the block sale proposal, with a goal of continued BPA service to sufficient DSI loads to avoid the need for such a charge.

The Block Sale Contract, like the Current Contract, is a requirements contract, but one under which the DSI may place less than its full load on BPA. The Block Sale Contract and the process for offering it are designed to eliminate the issue of BPA's recovery of unrecovered cost. BPA's execution of the Block Sale Contracts depends upon a determination that sufficient DSI load has been placed on BPA to provide a reasonable likelihood of overall recovery of costs and payment to the Treasury. The contract provides that a DSI or third party doing business with the DSI will not be charged any amount, charge, or fee of any nature whatever based on the purchases made by the DSI under the Block Sale Contract or any prior power purchase agreements between the DSI and BPA. This limited protection from stranded cost was offered to the DSIs in return for their taking the risk of placing load on BPA without knowing the outcome of BPA's rate case and the rate test contained in the Block Sale Contract. This required that they forego placement of such load with alternate suppliers at the low rates currently being offered, recognizing that such rates may well increase by next April.

ANALYSIS OF DSI LOAD COMMITMENTS

The DSIs have offered to BPA signed take-or-pay purchase agreements consistent with the terms of the Block Sale Contract for 1606 aMW of firm load if BPA can meet or beat a target price of 22.6 mills/kWh (delivered, based on 100-percent load factor). These offers were open only until the close of business (5:00 p.m. PDT) on September 28, 1995, so that the companies could execute contracts with alternative suppliers by September 30, 1995, should BPA decline their offers. Several of the companies advised BPA that they were unwilling to extend their deadline because the bids they solicited from competing suppliers expired on September 30, 1995.

Some companies also indicated a willingness to purchase a combined total of approximately 325 aMW of a different product, and to increase the first year or two of the 5-year take-or-pay block by a significant amount, if BPA would offer an idle-capacity start-up rate in FY 1996 based on short-term energy prices. BPA has offered such start-up incentives in the past, and has developed a set of monthly rates for such energy in FY 1996 and a contract offer can be made available to the companies.

BPA established the target price for the Block Sale based on its Initial Rate Proposal, the direct testimony of parties to the rate case, a survey of the DSIs' demand/price elasticity in the market environment that existed just prior to the time of the Initial Rate Proposal, and its planned Supplemental Rate Proposal. Analysis supporting the target

price used half-mill price increments and found the expected net BPA revenue (net income) to be maximized at 22.5 mills/kWh. The expected firm loads at that price ranged from 960 to 1671 aMW, with an expected value of 1382 aMW.

If BPA were to sign Block Sale Contracts totaling 1200 aMW, the annual net revenues from (1) a block sale of 1200 aMW, (2) 325 aMW of other likely long-term business with the DSIs outside of the block sale, (3) revenues from re-marketing the surplus power not sold to the other DSIs, and (4) avoiding operational purchases, are \$29 million short of the analogous figure from BPA's Initial Rate Proposal, which assumed 2550 aMW of DSI sales under their existing contracts (3/4 firm, not take-or-pay). However, comparison to the Initial Rate Proposal, while reassuring from the standpoint of being able to adhere to BPA's rate directives and show full cost recovery, is not the only test.

BPA expects its sales to the DSIs under the "don't sign" assumption to average about 500 aMW per year over the 5-year rate period. Under this scenario, the net revenues from these sales and the other categories of sales or avoided purchases listed in the previous paragraph are \$118 million less than the revenues from the 2550 aMW of sales listed in the Initial Proposal, and \$ 89 million less than if BPA signed Block Sale Contracts for 1200 aMW.

BPA tested the sensitivities of these results to secondary market price assumptions. BPA's mid-range assumption about the secondary market, under the 1200-aMW block sale case, was 17 mills/kWh (average across 12 months) with BPA selling about 375 aMW into it; for the "don't sign" case, it was 14.5 mills/kWh, with BPA selling about 1700 aMW into it. Each mill above or below these secondary market price assumptions adds or subtracts \$18 million per year to or from the "don't sign" case.

BPA examined the implications of signing or not signing these contracts from the perspective of the more fundamental issues of the restructuring of the Northwest power industry, of BPA, and of BPA responsibilities and legal mandates. The only matter residually affected by these contracts appeared to be BPA's opportunity to recover stranded costs from the DSIs. In weighing this matter, BPA took into account the existing DSI contracts which, it believes, make legally questionable an approach that individually targets exiting customers. Much more feasible are general rate surcharges to assure overall BPA cost recovery.

Two matters frequently cited as negatively affected by a "sign" decision--the benefits of the residential exchange to the investor-owned utilities, and the benefits of BPA's fish and wildlife funding--are not negatively affected. BPA studies showed that a worse outcome for the exchange beneficiaries, than was already obtained from the influence of the market price of power in the 7(b)(2) test, was one that combined the market price influence with the much lower DSI loads and revenues of the "don't sign" case and an assumption that BPA would make up the revenue shortfall with a broad surcharge. The exchange virtually disappeared in the mid-range "don't sign" scenario. Fish and wildlife funding did not appear to be affected by anything short of changing existing laws.

Finally, having examined the direct testimony of the parties to the rate case, BPA was reasonably assured that, with at least 1200 aMW of firm take-or-pay load commitment that could bear a price of up to 22.6 mills/kWh, it had sufficient flexibility in the case to resolve all allocation and formula issues.

ENVIRONMENTAL ANALYSIS

Consistent with the Business Plan ROD, the Business Plan EIS was reviewed to determine whether a 5-year block sale of power to the DSIs was adequately covered within the scope of the Business Plan EIS. The Business Plan EIS alternatives analyzed a range of DSI service options. The Market-Driven alternative included sales to DSI loads, based on declining firm service.

The Business Plan EIS showed that environmental impacts are determined by the responses to BPA's marketing actions, rather than by the actions themselves. These market responses include resource development, resource operation, transmission development and operation, and consumer behavior.

Environmental Impacts

The Business Plan EIS assumed that all of the DSIs would operate at a similar capacity, whether served by BPA or non-BPA suppliers. Therefore, the analysis of impacts focuses on the effects on BPA loads (and the resulting impacts of resource development and operations), and not on the impacts of DSI plant operation. Selling power to the DSIs under the Block Sale Contract would help BPA retain DSI firm loads in the short term. Therefore, it could reduce the incentive for brokers, marketers, or other utilities to develop new CTs and incur associated environmental effects (air, land, and water). Fewer new CTs could mean continued operation of older, less efficient thermal resources that would have higher air emission than newer CTs. If market conditions change substantially, DSI operations could change. In that case, there could be increases or decreases in the environmental impacts--primarily air quality impacts--of the DSIs' operations (Business Plan Final EIS, Table 4.3-1). However, these changes would be a function of the market--not of the Block Sale Contract.

Marketing Impacts

The DSIs can reduce their power purchases from BPA under their current power sales contract upon 1 year's notice. If the DSI terminates its requirements contract with BPA, it has the right to receive service from a local utility and it will be considered a retail load of the local serving utility. To the extent that BPA can demonstrate to the DSIs that it is taking a Market-Driven approach to its business activities, and that this approach under the Block Sale Contract includes competitive BPA power rates, the DSIs would be less likely to reduce their power purchases from BPA.

The DSI load provides some important benefits to the Federal hydroelectric system. The DSIs provide power system reserves, operational flexibility, and stability reserves. There are distribution benefits from serving large, discrete loads, and the DSIs loads help reduce the economic impacts of flow augmentation for fish. In addition, to the extent that the Market-Driven BPA retains DSI loads, BPA's ability to meet its financial obligations is enhanced. Maintaining revenues from sales to DSIs would also help keep electricity rates lower for public and private utility customers. BPA would more easily be able to keep its rates below the maximum sustainable revenue level.

Public Service Benefits

Consistent with the Market-Driven approach, the offer of the new 5-year Block Sale Contract to the DSIs strikes a balance between marketing and environmental concerns. BPA will be a more active participant in the competitive market for power, and will use its success in the market to ensure the financial strength necessary to better produce the public benefits that BPA affords to the region.

Mitigation

In offering the DSIs the Block Sale Contract under the Market-Driven approach, BPA understands that conditions that permit the agency to function successfully may change over time. Therefore, the Market-Driven approach contains preparatory mitigation measures (response strategies) to respond to change and to allow the agency to balance costs and revenues. Such mitigation will enhance BPA's ability to adapt to changing market conditions.

These response strategies--which include means to decrease spending, increase revenues, and transfer costs from BPA to other entities--could be implemented if BPA's costs and revenues did not balance. BPA has already decided (in the Business Plan ROD) to apply as many mitigation response strategies as necessary whenever BPA's costs and revenues do not balance. These mitigation strategies, or equivalents, will be implemented to enable BPA to best meet its public service and environmental obligations, while remaining competitive in the wholesale electric power market.

PUBLIC AVAILABILITY

This ROD will be distributed to all interested and affected persons and agencies. Copies of the Business Plan, Business Plan EIS, the Business Plan ROD and this ROD are available from BPA's Public Involvement Office, P.O. Box 12999, Portland, Oregon 97212. Copies of these documents may also be obtained by using BPA's nationwide toll-free document request line, 1-800-622-4520.

CONSIDERATION OF COMMENTS

July 13-August 11, 1995, Public Comment Period

Issue: Should BPA eliminate the rate test provision from the Block Sale Contract?

Comment Summary: The inclusion of a rate test provision in the Block Sale Contract is inconsistent with the negotiated contract principles developed between September 1994 and March 1995. (Portland General Electric, pp. 1 & 2)

Response: The inclusion of a rate test in the Block Sale Contract is intended to enable BPA to preserve its opportunity to compete for DSI loads. BPA is required by statute to undertake formal procedures, as defined in Section 7(i) of the Regional Power Act, in setting power and transmission rates. BPA is currently engaged in such a process. However, the actual rate that would apply to the DSIs is yet unknown, because it will require several more months to complete the rate case. The DSIs wish to take advantage of the current highly competitive market for electric power to acquire economic power supplies. They are now prepared to do so, and can not justify continuing to defer exercising options to obtain such power from alternate suppliers without any assurance regarding BPA's rate level. The rate test permits BPA to provide the DSIs with sufficient assurance of competitiveness to allow them to place load on BPA, contingent on BPA's ability to meet the rate test.

Comment Summary: The rate test provision in the Block Sale Contract allows the DSIs to terminate their contract on 7 days' notice. This short notice period subjects BPA and its other customers to the risk of significant economic impact without time for mitigation. (Puget Power, pp. 3 & 4; Portland General Electric, p. 2)

Response: The DSIs have the right to terminate the Current Contract with BPA, effective April 1, 1996, provided they indicate their intent to terminate before October 5, 1995. Under the terms of the Block Sale Contract, the DSIs could terminate the contract with 7 days' notice, were BPA to fail to meet the rate test. The time difference is not sufficient to enable a significantly different response by BPA. However, BPA believes that the terms of the Block Sale Contract substantially decrease the probability of any need to mitigate for loss of DSI revenues. BPA's goal is to avoid the need to undertake such mitigation, rather than to obtain 6 months' notice of the need to mitigate.

Comment Summary: The rate test provision of the Block Sale Contract creates an incentive for BPA to meet the rate test without regard for its statutory duties and its other customers. (Portland General Electric, p. 2)

Response: BPA has every incentive to remain competitive in supplying the DSIs: BPA wishes to continue to derive significant revenue from this customer segment and to spread as large a portion of its costs across this group as the competitive market and BPA statutory provisions allow. BPA will not and cannot violate the requirements of the 7(i) process in order to meet the rate test.

Comment Summary: The rate test provision in the Block Sale Contract allows the DSIs to terminate the contract on 7 days' notice. Loss of this amount of load would have extraordinary environmental consequences that BPA would be unable to mitigate in 7 days. BPA must comply with the requirement of the National Environmental Policy Act before taking such actions. (Puget Power, pp. 3, 4 & 5)

Response: From a practical standpoint, the referenced provision (allowing the DSIs to terminate the contract if BPA is unable to meet the rate test) has no potential for environmental effect. The DSIs' Current Contract contains a termination right that, if exercised prior to October 5, 1995, would allow them to remove their loads from BPA effective April 1, 1996. Since BPA's rate case is not expected to be complete until April 1996, BPA's ability to meet the rate test in the Block Sale Contract would not be demonstrated any sooner. BPA's response to termination by the DSIs under conditions of either contract would be the same. That is, BPA would seek to market that power it would otherwise have used to serve the DSI loads to a market that would be identical regardless of which contract had been in effect (i.e., the Current Contract or the Block Sale Contract).

Comment Summary: It is important for BPA to include the same provisions for a rate cap in the utility power sales contracts as are contained in the Block Sale Contract in order for BPA to remain competitive and retain the utility customers. (PUD No. 2 of Pacific County, p. 2; Western Public Agencies Group, p. 8)

Response: The rate test in the Block Sale Contract responds to the provision in the current DSI contract that enables the DSIs to terminate their contracts on relatively short notice, compared with the 7-year termination notice requirement in the utility contracts. The rate test enables BPA to make a competitive offer to the DSIs that would ensure a 5-year load commitment on BPA. That outcome is in the best interest of all of BPA's customers. The rate test does not guarantee a rate equal to or less than the rate target. Since the utilities have no right to terminate their current contracts before BPA's current rate case is concluded, no purpose comparable to that underlying the DSI rate test would be served by including a rate test in the utility contracts.

Issue: Should BPA include provisions in the Block Sale Contract that may enable the DSIs to escape responsibility for stranded costs?

Comment Summary: Including in the Block Sale Contract a provision allowing the DSIs to escape stranded cost responsibilities makes the contract inconsistent with the negotiated contract principles developed between September 1994 and March 1995. (Portland General Electric, pp. 1 & 2)

Response: The contract reflects negotiations and BPA's efforts to keep DSI loads in order to avoid the need for stranded cost recovery.

Comment Summary: The Block Sale Contract may allow the DSIs to escape responsibility for stranded costs arising under the Current Contract. No other proposed contract templates provide this opportunity to other customers. (Portland General

Electric, p.2) BPA is proposing to eliminate the need to recover stranded costs from the DSIs and other customers by shifting costs to residential exchange customers. BPA should not eliminate this long-standing obligation of the DSIs. (Puget Power, pp. 1, 2 & 4).

Response: The DSIs Current Contract termination rights differ from those of BPA's utility customers and establish a potential for stranded costs that does not exist for the utilities. The contract provision relieving the DSIs of stranded cost was based on the assumption that the DSIs would place sufficient load on BPA (through the mechanism of the block sale) to avoid stranded costs. BPA believes that the amount of committed DSI load, in combination with the take-or-pay provision of the contract, will achieve this goal. BPA also expects to be able to meet the rate test provisions of the contract template successfully. (See also earlier section titled "Analysis of DSI Load Commitments.")

Comment Summary: Pending decisions by FERC make it untimely for BPA to lock into stranded cost decisions at this time. BPA should (1) postpone the offer of contracts to the DSIs until after there is a clear indication of FERC intent, (2) leave placeholders in the contracts, or (3) have reopeners in the contracts concerning the issues of stranded cost and retail/wholesale transmission access rights, since these are likely to be affected by FERC actions. (Northwest Conservation Act Coalition, p. 2)

Response: BPA's preferred course of action is to avoid a stranded cost situation by securing contracts for DSI load sufficient to provide a reasonable likelihood that BPA will fully recover its costs. Given current market circumstances, BPA must act promptly to secure these loads or accept the alternative of an uncertain struggle to recover stranded costs through litigation. Delay will foreclose the option of avoiding probable stranded costs because the DSIs could otherwise commit to purchasing power from non-BPA sources.

Comment Summary: The lack of explicit stranded cost recovery language in the Block Sale Contract threatens equitable allocation of stranded costs and BPA's ability to employ a comprehensive, flexible approach which ensures the funding of BPA's public purposes. (Northwest Conservation Act Coalition, p. 7)

Response: Section 5(b)(2) of the Block Sale Contract does explicitly address stranded cost recovery by indicating certain terms under which the DSIs would be relieved of this responsibility. However, the whole purpose of the contract is to avoid the issue of stranded cost by recovering sufficient revenue from the DSIs to compensate fully for the costs of serving them.

Comment Summary: It is important for BPA to include the same provisions for stranded cost in the utility power sales contracts as are contained in the Block Sale Contract, in order for BPA to remain competitive and retain the utility customers. (PUD No. 2 of Pacific County, p. 2; Western Public Agencies Group, p. 8)

Response: Unlike the DSIs, BPA's utility customers do not possess in their current contracts any termination rights that would allow them to remove their loads from BPA

before the end of the term of their existing contracts. It would be imprudent for BPA to create the potential for additional stranded cost by relieving the utilities of their Current Contract responsibilities regarding load placement.

Comment Summary: It is unacceptable to impose a stranded cost fee on one group of customers while simultaneously absolving another customer group [DSIs] from any liability for such costs. Neither contracting terms in the Current Contract or different market circumstances justify such differing treatment. (Western Public Agencies Group, p. 8)

Response: BPA's intent is not to absolve any customer group from responsibility for stranded costs, but to avoid such costs.

Issue: Do the reserves the DSIs are required to provide under the Block Sale Contract satisfy the requirements of the Regional Power Act?

Comment Summary: The reserves required to be provided by the DSIs under the Block Sale Contract are inadequate and do not comport with the types and levels of reserves required by the Regional Power Act. (Puget Power, pp. 4 & 5)

Response: The Northwest Power Act does not specify the exact type of reserves that the DSIs are required to provide. Sec. 5(d)(1)(A) and Sec. 3(17). Both stability and operating reserves continue to be provided under the Block Sale Contract. Under the Current Contract, the first quartile is not a reserve because it is served with nonfirm power. The second quartile "planning" reserve is not needed, simply because BPA is not planning new resource acquisitions that, if delayed, would require BPA to depend on the DSI second quartile.

Comment Summary: The Block Sale Contract should provide for more interruptibility, such as the current top quartile service, in order to increase the flexibility BPA needs to address fish and wildlife responsibilities. (Northwest Conservation Act Coalition, p. 7)

Response: At the time the Current Contract was negotiated, BPA was able to use a number of mechanisms to achieve flexibility in serving the DSI top quartile. These included Shifted Firm Energy Load Carrying Capability (FELCC), Advance Energy, and Borrowed FELCC. These permitted BPA to continue to serve the top quartile on a conditional basis (thus increasing load and revenues), while maintaining the right to enhanced restriction rights (to the third quartile) if the energy were subsequently needed. However, current changes in river operations designed to mitigate effects on fish and wildlife have precluded BPA from using the mechanisms above, and the DSIs are not willing to accept the resulting degree of uncertainty in top quartile service.

Issue: Does the Block Sale Contract honor the principle of public preference to Federal power?

Comment Summary: BPA should make it clear in the Block Sale Contract that the DSIs have no rights to 7(c) priced power after 2001. (Northwest Conservation Act Coalition, p. 5)

Response: The Block Sale Contract does not address DSI purchases of 7(c) priced power after 2001.

Issue: Should BPA's other customers be able to obtain service under the same terms and conditions as the DSIs?

Comment Summary: The Block Sale Contract is understandable and straightforward and comes much closer to outlining the basis for a sound business relationship than do the other templates, an example being the provision potentially to provide liquidated damages to the DSIs in the event of non-performance by BPA. (Public Power Council, pp. 3 & 5; McMinnville Water and Light, p. 2)

Response: BPA will take this evaluation into account in considering possible modifications to the other templates.

Comment Summary: The Block Sale Contract contains customer termination rights, whereas the utility power sales contracts do not. Termination rights should be added to the latter. (Western Public Agencies Group, p. 3)

Response: BPA will evaluate the differing circumstances of the DSIs and other customer groups in considering the appropriateness of adding termination rights to the contract templates pertaining to other customer groups.

Comment Summary: As provided for in the Block Sale Contract, the utility templates should provide that BPA be subject to a penalty if it fails to fulfill its delivery obligation under the contract for reasons other than a force majeure. (Western Public Agencies Group, p. 4)

Response: BPA will address this issue as it further considers the utility templates.

September 22, 1995, Public Meeting

On September 22, 1995, BPA held a public meeting to address the question of whether, over the next 5 years, the DSI customer commitment for power from BPA would be enough to remove the need for stranded cost recovery and, if not, what mechanisms should be used to recover these costs. The benefits and risks of these options were also to be addressed.

Issue: Stranded Costs--Limiting Exemption to the DSIs

Comment Summary: Several participants indicated that the DSIs should not be exclusively exempt from stranded cost responsibility, particularly given their support for

the development of nuclear power plants in the Northwest. It was suggested that if DSIs were exempted from stranded costs, the same provisions should be afforded to public agency customers. However, concern was also expressed that exempting BPA's customers from stranded costs could result in a loss to taxpayers.

Response: BPA shares these concerns and believes that it is more important to avoid stranded costs than to increase the risk of such costs by focusing on how best to recover them should they occur. BPA has offered to relieve DSIs of stranded costs only in return for load commitments that would avoid creation of DSI-related stranded costs. The public agency customer contracts have different termination rights than those contained in the DSI contracts. In the case of the public agencies, BPA does not face the same risk of early termination as for the DSIs. It would not be prudent for BPA to introduce a new stranded cost risk by offering relief from stranded cost in new public agency contracts.

Issue: Stranded Cost Relief--Effect on Environmental Purposes

Comment Summary: BPA should not offer the DSIs a corporate bailout in the form of stranded cost relief at the expense of salmon. It is unconscionable for BPA simultaneously to provide "sweetheart" deals to the DSIs, including stranded cost relief, and to request exemption from environmental laws. BPA must not lose sight of its public agency responsibilities in its quest to be competitive.

Response: BPA is making every effort to fully recover all of its costs, including those needed to fulfill its fish and wildlife responsibilities. The market for power is currently defining limits to BPA's ability to generate revenue. The Block Sale Contract will facilitate BPA's efforts to maximize the revenues available to fulfill BPA's fish and wildlife responsibilities. In order to achieve a balance between revenue and cost, BPA has been making every reasonable effort to reduce or control its costs in all areas. The agency's primary concern in the fish and wildlife area is that BPA assets invested achieve the greatest possible value for those assets. BPA recognizes and supports the fact that, as a Federal agency, it has a clear duty to pursue public agency responsibilities and foster the goals of environmental legislation.

Issue: Stranded Costs--Need to Devote Time to a Regional Solution

Comment Summary: The stranded cost issue is complex and deserves thoughtful and careful consideration from a regional perspective. Further open debate is needed to evaluate the risks of relieving the DSIs of this responsibility. This decision should not be made unilaterally by BPA. The Northwest Power Act needs to be revisited.

Response: BPA believes that substantial opportunity for public review and comment has been offered regarding the terms and conditions of the Block Sale Contract and its stranded cost provisions. Delay of the stranded cost decision would likely destroy BPA's opportunity to secure sufficient DSI load to avoid the issue. Although BPA agrees there are many other issues that need to be addressed by the region during the transition from a controlled to a deregulated electric power market, the opportunity to

eliminate stranded cost as an issue depends on prompt action at this time. BPA recognizes and supports the need to revisit the Northwest Power Act.

Issue: Effects on the Residential and Small Farm Exchange

Comment Summary: Signing the DSI contracts would result in a shift of costs from the DSIs to the exchange customers, and would undermine the Exchange.

Response: The terms under which the Exchange operates are defined by the Northwest Power Act. BPA is simply following the directives of the Act in applying the exchange. Choosing *not* to sign the DSI contracts would decrease the amount of revenue derived from the DSIs, and would require a corollary increase in the rate to BPA's public agency customers. This change would, in turn, cause the exchange benefit received by qualifying IOUs to be lower than if BPA were to sign the Block Sale Contracts.

Issue: Retail Wheeling

Comment Summary: Does BPA consider as “retail wheeling” the use of its transmission system by another power supplier to serve a DSI? Why is BPA so concerned about retaining DSI loads when open access retail wheeling will provide it with access to a wide variety of alternate industrial loads?

Response: BPA does not consider use of the Integration of Resources (IR) Transmission Agreement by another power supplier to serve a DSI to be retail wheeling. BPA believes the alternative for DSIs to BPA service under a power sales contract or the IR Transmission Agreement is service from their local utility. BPA cannot assume at this time that it will have open access to alternate retail industrial loads.

Issue: BPA’s Incremental Power Costs

Comment Summary: BPA cannot afford to purchase power at costs greater than the revenues it receives from the sale of that power. How can BPA justify continued operation of WNP-2, given its current operating costs? It would appear BPA would be better off to reduce DSI loads and eliminate the need for power from such high-cost resources.

Response: BPA is working with the Supply System to reduce the costs of plant operation at WNP-2. The Supply System has and is continuing to make progress in this regard. Further improvements will be needed in order to avoid shutdown of the plant. If these cannot be achieved, BPA will support plant closure. In the short term, however, it is less costly to operate the plant during this transition phase (to lower operational cost) than to terminate the facility.

Issue: Balancing the Ability to Compete with Public Agency Responsibilities

Comment Summary: BPA’s recent actions concerning efforts to obtain a fish cap and exemption from environmental laws are destroying its credibility among environmental advocates. BPA must continue to honor its public agency responsibilities and recognize that it is not possible for BPA, as a Federal agency, to be fully competitive. Nevertheless, BPA’s ability to continue to fund fish and wildlife measures depends on its continued success in generating revenue from sale of its products and services.

Response: BPA is attempting to address its environmental responsibilities as effectively as possible in the face of very challenging market circumstances. It is seeking to achieve the most effective application of the resources available to it, and will continue to do so. BPA is also attempting to bring predictability to its fish and wildlife expenses in order to provide the rate assurance demanded by its customers in order for it to remain a competitive source of power supply. In addition, BPA is seeking appropriate relief from certain cost responsibilities that can appropriately be recovered from other sources. A reasonable balance must be struck between assuring the continued competitiveness of BPA in the marketplace and committing its resources to

environmental ends. If such a balance cannot be achieved, BPA will cease to have a meaningful role.

Issue: Timing of BPA's Decision

Comment Summary: BPA should delay its decision to sign the DSI contracts in order to enable a wider regional debate that can integrate the actions BPA takes regarding the DSIs with a broader strategy for completing the transition to a competitive, deregulated marketplace. Furthermore, BPA's action at this time pre-determines and forecloses other issues in the rate case. BPA should hold off 45-60 days to allow discussion of shifting costs and accounting periods. On the other hand, in order to be competitive, the DSIs must be able to make power supply decisions now. There is a fragile relationship between the DSIs and BPA which could fall apart if the signing is delayed.

Response: BPA does not believe that signing the DSI contracts would pre-determine the rate case. In fact, signing the DSI contracts would remove a major uncertainty from BPA's revenue projections and would enable greater flexibility on other issues. It is important for BPA to act promptly on this matter in order to compete effectively for the DSI loads. Loss of these loads through inaction by BPA at this time would have substantial adverse rate consequences for BPA other customers. Signing the DSI contracts does not preclude BPA from further consideration of how to treat rate case issues, and does not foreclose future regional debate on how to accomplish transition to a deregulated power market.

CONCLUSION

The development of the DSI Block Sale Contract has involved many parties over a period of years in a process that has afforded substantial and repeated opportunities for participation, evaluation, and contribution. Together, they raised and considered numerous issues; many, though not all, were entirely resolved. The environmental analysis contained in the Business Plan Final EIS, the concerns and suggestions of BPA's customers and other participants in the contract development and review processes, the legal directives under which BPA must operate, BPA's public agency responsibilities, and the facts of the marketplace have all been considered in making the decision below.

BPA originally indicated that it would provide protection from a cost recovery surcharge if the DSIs, as a class, placed sufficient load (in the range of 2150 to 2400 aMW) on BPA. The cumulative offers that have been received from the DSIs do not provide that amount of load. Ten of BPA's 15 DSI customers returned to BPA offers to place load on BPA consistent with the terms of the Block Sale Contract. BPA could not execute a new contract with all its DSI customers, three of which did not return an offer. Two customers returned offers that were inconsistent with the take-or-pay provisions of the

Block Sale. These offers substantially changed the basic contract terms we had negotiated. The total load commitment of the 10 customers submitting offers to BPA consistent with our negotiated terms was 1606 aMW.

Given the strong concerns that have been recently expressed by numerous parties regarding stranded cost relief for the DSIs, and the fact that the present DSI load commitment does not meet BPA's criterion for acceptance of the contracts offered by the DSIs, I have decided offer to execute the contracts only with DSI customers placing a minimum of 80 percent of their firm load on BPA, provided that at least 1200 aMW of load commitment results from this counteroffer.

I have decided it is in the best interests of BPA's customers and the electric ratepayers of the Pacific Northwest to offer the DSIs Block Sale Contracts under the preceding conditions. To forego this opportunity would result in substantial loss of DSI load and a serious deterioration in BPA's ability to meet its costs. If this were to occur, BPA would need to consider whether to seek a recovery mechanism for stranded costs. There are clearly significant differences of opinion in the region concerning the feasibility and equity of such an approach. The analysis of the potential revenue consequences demonstrates that execution of at least 1200 aMW of DSI load under the Block Sale will enable BPA to continue financing its public agency responsibilities, including restoration of the region's fish and wildlife resources. Accordingly, I have decided to offer the subject contracts to the DSIs as conditioned above.

Issued in Portland, Oregon, on 9/28/95.

/s/ Sue F. Hickey
Acting Administrator

bcc:

Adm. Chron. File – A-7

Official File – KEC (EQ-14 – Business Plan EIS – 1995)

KPierce:ljc:3962

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DSI Customer Requirements (Block) ROD 9-28-95.doc