

ADMINISTRATOR'S RECORD OF DECISION

Amendatory Agreement to 1981 Power Sales Contracts

INTRODUCTION

The Bonneville Power Administration (BPA) has decided to provide certain of its Federal and public agency Metered Requirements Purchasers¹ with an opportunity to amend their 1981 Power Sales Contracts (1981 PSC). The Amendatory Agreement (Agreement) that BPA is offering will address changes in the electric power marketplace and changing needs of BPA customers, in the context of the Market-Driven approach selected in BPA's Business Plan process. It is the first step in a sequence intended to strengthen BPA's competitive position in the electric power market and to strengthen business relationships with its customers.

In addition to this Agreement, BPA will be working with all of its customers over the coming months to offer opportunities to other customers who do not qualify for, or whose needs may not be adequately addressed by, this Agreement.

BACKGROUND

Issues

In 1981, BPA and its Federal and public agency, cooperative, investor-owned utility, and direct service industrial (DSI) customers signed new 20-year requirements service or direct service contracts. At that time, BPA's electric power prices were far below those of alternative sources. In addition, in 1981 BPA believed it was facing a significant power supply deficit in the Pacific Northwest. As a result, the 1981 PSCs, were more focused on limiting access to cheap Federal power than on restricting purchasers' rights to take load off BPA (to meet their power needs from alternative sources).

In 1991, in response to significant changes that were beginning to occur in the electric utility industry, BPA began a contract negotiation process that resulted in the identification of a number of issues and concerns. One product of this process was the development of a set of contract templates for replacement contracts that were made available for public review and comment on July 13, 1995. The comment period on these templates closed on August 11, 1995.

¹ Metered Requirements Purchasers are those customers that purchase all of their power supply for their firm regional the power loads required for their consumers, exclusive of small resources dedicated to serve load or resources under a service and exchange agreement with BPA. These customers generally do not participate in the wholesale market and are not permitted to sell their firm requirements power at wholesale to another utility. BPA supplies the normal load growth of these customers, including service to new large loads.

One of the resulting templates formed the basis for the Block Sale contracts under which BPA has achieved a commitment of 1761 average megawatts (aMW) of DSI load. A separate Record of Decision (ROD) on the Block Sale contracts is available from BPA's Public Involvement Office (see section titled "Public Availability" near the end of this ROD). BPA intends to use the other templates in bilateral negotiations between BPA Account Executives and customers to develop individually negotiated and tailored contracts that will better address the needs of BPA and its non-DSI customers in the context of current market circumstances. This will be the subject of a future ROD.

Notwithstanding the efforts of BPA and its customers to create a framework for negotiating new requirements service contracts, it has become evident that some customers neither desire nor require the degree of change in their contractual relationship that would be afforded by new contracts. The Amendatory Agreement BPA is offering is designed to address a number of issues and concerns important to these customers and to BPA.

Action

During the next 5 years, BPA's potential public agency market is estimated to be about 5260 aMW. The BPA Administrator has decided that BPA can maximize both load and revenue and achieve increased customer satisfaction over the next 5 years, by offering to amend the 1981 PSCs of BPA's requirements service customers or to negotiate new requirements service contracts. As a first step in this process, the Administrator is offering the Amendatory Agreement to those BPA Federal and public agency Metered Requirements customers that agree to place 100 percent of their firm load on BPA, excepting load served by resources obtained through the Columbia Storage Power Exchange (CSPE)² or approved, as of February 15, 1995, in a customer's 1981 PSC Firm Resource Exhibit (FRE).

In developing the Agreement, BPA has been guided by the following parameters:

- Amended contracts should yield at least as much revenue over the 1997-2001 period as could be realized by holding customers to their existing contracts.
- Amended contracts should not release public agency customers from any existing exposure to pay stranded costs beyond the term of the contract.

Context

² The Columbia Storage Power Exchange is a nonprofit organization formed by five public utility districts, three municipalities, and three private utilities to purchase the Canadian share (by virtue of the Columbia River Treaty) of downstream power generated at U.S. hydroelectric plants and resulting from storage dams built upstream in Canada. The Treaty with Canada for joint development of the Columbia River for flood control and increased hydroelectric power generation became effective on September 16, 1964. Under the Treaty, Canada was required to build three large storage dams on the upper reaches of the Columbia River in Canada: Duncan Dam, Keenleyside Dam, and Mica Dam. The United States was allowed to build Libby Dam in Montana. The storage provided by these dams permits production of additional firm power at downstream U.S. plants. This additional power is shared equally by Canada and the United States. Canada has sold its share of this power to the CSPE for 30-year periods, coinciding with the scheduled completion dates of each of the three Canadian dams.

In discussion with its customers over the past four months, BPA has received requests with two divergent concepts. Some customers are asking for additional ability to “diversify” or take less service from BPA; others are asking for certainty in being able to continue to purchase their full service from BPA. Because there are numerous contract issues involved with the first request, customers who want to purchase their full requirements from BPA are requesting that BPA provide some certainty as to their purchases from BPA. In response, BPA is offering this Amendatory Agreement to provide that certainty in its contract relationship for those customers and to better meet BPA's and its customers' needs to be competitive and improve the long-term attractiveness of BPA as a power supplier. In offering this opportunity, BPA is continuing its choice, under the Market-Driven approach discussed in the BP EIS, of responding to its customers' need for participation in the increasingly competitive electric power market, as discussed below.

The decision to offer the Amendatory Agreement is consistent with BPA's Business Plan, the Business Plan Environmental Impact Statement (BP EIS) (DOE/EIS-0183, June 1995) and the BP ROD (August 15, 1995). In response to a need for a sound policy to guide its business direction under changing market conditions, BPA explored six alternative plans of action in its BP EIS. The six alternatives were: Status Quo (no action), BPA Influence, Market-Driven, Maximize Financial Returns, Minimal BPA, and Short-Term Marketing. In the subsequent 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 in total environmental impacts among alternatives 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 fish and wildlife mitigation activities.

The BP EIS and ROD were also intended to guide BPA in a series of related decisions on specific issues and actions. Decisions on providing requirements services are some of these subsequent actions, and the subject of this tiered ROD. Tiering subsequent RODs to the Business Plan ROD helps delineate BPA decisions clearly and provides a logical framework for connecting broad programmatic decisions to more specific actions.

Before taking specific action on any of these issues, BPA affirmatively stated that it would review the BP EIS to ensure that a particular action was adequately covered within the scope of that EIS and, if appropriate, issue a tiered record of decision. This ROD, which summarizes and incorporates information from the Business Plan ROD, is a result of such a review. It describes specific information on the decision to offer to amend the 1981 PSCs, and summarizes the environmental impacts associated with this decision, as described in the BP EIS.

NEW COMPETITIVENESS IN THE ELECTRIC INDUSTRY

The electric utility industry is becoming increasingly competitive and dynamic. Four factors are substantially affecting BPA's ability to compete: market change, increased non-power obligations, deterioration of BPA's cost/price advantage, and decreased capacity for hydroelectric power production. The emergence of competition has led to significantly lower prices for wholesale electric power. At the same time, BPA's costs for providing major public benefits (including fish and wildlife enhancement and support of energy efficiency) have increased significantly. A series of dry years and changes in hydro system operations have also affected BPA's ability to produce power and generate revenues.

The current West Coast power surplus, decline in costs of competing generating resources, low market prices, and difficulty in siting and developing new generating facilities continue to lead electric utilities and other parties to emphasize shorter-term commitments to buy and sell. In addition, the recent market deregulation has fostered the emergence of marketers and brokers. These parties by their nature concentrate on shorter-term commitments than utilities serving the public that have extended obligations to serve load.

However, BPA must be able to balance its costs and revenues. The availability of power at competitive prices from other suppliers precludes BPA from meeting costs simply by raising rates for its customers. That BPA firm power rate level above which a rate increase would no longer increase BPA's revenue (due to a price-induced reduction in demand) would produce BPA's maximum sustainable revenue (MSR). Allowing BPA's rates to exceed this level would not be consistent with sound business principles. It would reduce BPA's total revenue and its ability to repay borrowings from the U. S. Treasury and fund public benefits.

METERED REQUIREMENTS PURCHASERS AND CURRENT CONTRACTS

Potential Metered Requirements Purchasers

Both BPA's preference customers and Federal agencies are eligible to purchase power from BPA on a Metered Requirements or a Computed Requirements basis. Those purchasing their full requirements on a Metered Requirements basis from BPA may be affected by this offer to amend the 1981 PSCs.

- **Preference Customers** -- These customers include publicly owned utilities, municipalities, and cooperatives to which, consistent with its statutes, BPA must give preference to public bodies and cooperatives in purchasing power available from the Federal power system. This category includes non-generators that rely on BPA for almost all of their wholesale power needs and generators that meet some of their load with their own resources.
- **Federal Agencies** -- Existing Federal agency customers may purchase power directly from BPA. New Federal agency customers may request service from

BPA. Examples of current customers include Fairchild Air Force Base and the United States Department of Energy's Richland Operations Office.

Statutory Guidelines Concerning Customer Contract Service

BPA's 1981 PSCs were offered in accordance with the Bonneville Project Act of 1937 and section 5(g) of the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (Northwest Power Act). Section 5(b)(1) of the Northwest Power Act directs the BPA Administrator, "whenever requested," to offer long-term power sales contracts to public bodies and cooperatives entitled to preference and priority under the Bonneville Project Act of 1937 in order to meet the firm power load of each such entity in the region. Sections 5(b)(3) and 5(g)(1) authorize BPA to offer requirements power sales contracts to its existing Federal agency customers. The BPA Administrator also has broad discretion to offer power sales contracts to DSIs or new Federal agencies.

Current Contract

Long-term power sales contracts between BPA and its public utility and Federal agency customers were offered and executed in 1981 and 1982. The term of these contracts expires on June 30, 2001. The contracts include four previous amendments. The Amendatory Agreement addressed in this ROD would be the fifth amendment to the contracts of those customers choosing to adopt the Agreement, and would extend the term of the contract through September 30, 2001. Consistent with section 20(b) and (c) of the PSC, this Amendatory Agreement is being offered to all BPA's customers who are purchasing their full load from BPA as a metered requirements customer. This Amendatory Agreement does not affect or apply to the terms and conditions of service for any customer purchasing from BPA on a Computed Requirements basis. If eligible customers choose not to adopt the Amendatory Agreement, their existing contracts would remain in effect through June 30, 2001.

KEY ISSUES AND CONCERNS

Issues and concerns that are addressed in the Amendatory Agreement include the following: customer load commitment, conservation issues, price level, price stability, and BPA cost recovery (stranded investment/exit fees).

Customer Load Commitment

The ability to have certainty over its customer load is a fundamental aspect of BPA's strategy for meeting its financial commitments during the FY 1997-2001 period. Assured commitment of load by customers will enable BPA to address its customers' needs concerning price level and stability.

Under the current PSC's, both preference and DSI customers have certain rights to reduce purchases from BPA. The DSI's remaining on their 1981 PSCs have the right to reduce the level of their contract demand on BPA or, with 12 months' notice, to terminate their contracts. Preference customers must give a 7-year notice before contract termination; however, they, too, may reduce purchases from BPA under several circumstances. These customers may reduce BPA purchases on short notice if one of their retail customers (such as a large industry) chooses to develop its own generation facilities. Under section 12(b)7, customers may reduce their purchases from BPA on 6 months' notice if BPA has a resource deficit. Under section 12(b)4 of the 1981 PSCs, customers may replace BPA service with cogeneration and renewable resources up to 50 aMW, on 30 months' notice.

Conservation

Historically, the Northwest Power Planning Council, BPA, private utilities, public agency and cooperative customers and a variety of public interest groups have worked to identify and acquire the right mix of developable low-cost resources to reduce the regional consumption of electricity, given alternative costs and load/resource balance conditions. Conservation has often been a cost-effective way to delay the addition of costly new generating resources.

Today there are many ideas and (disagreements) about how to address energy conservation in a rapidly changing electric power industry. BPA addressed conservation in the Competitiveness Project, including a reinvention of the regional conservation effort that BPA and its customers have been funding since 1981. The vast amounts of surplus power currently available (some at prices below the PF-96 rate in BPA's December 1995 Supplemental Rate Proposal) add an important dimension to this issue. In response to customer requests, BPA aimed to move away from incentive-based, centralized conservation programs to an approach that supports utilities in establishing and implementing their own customized, locally controlled and funded conservation programs.

Under this new approach, BPA will retain its statutory obligation to purchase cost-effective conservation when acquiring new resources. However, BPA anticipates that the conservation accomplishments of its customers, combined with the agency's continuing conservation efforts, will achieve conservation savings sufficient to meet BPA's conservation goals. Essentially, BPA is seeking to unbundle demand-side management from the power products, charging separately for any future programs and

services offered to customers, and leaving the targeting, funding, and attainment energy efficiency to these customers.

Price

Under the terms of the 1981 PSC and consistent with its statutes, BPA has the right to change rates, as necessary, to assure full recovery of the costs of providing service to its customers. Given the recent relative volatility of electricity prices, customers are seeking to ensure price stability. If BPA can achieve an assured commitment to place firm load on BPA from customers, it can, in turn, offer price stability for the service that the customers desire. The Amendatory Agreement addresses this mutual goal of price stability and firm load certainty.

Customers are also concerned that BPA provide services at prices competitive with those of alternative suppliers. Accordingly, the Amendatory Agreement contains a rate test designed to address this customer concern, while preserving BPA's ability to achieve sufficient revenue to meet costs.

Stranded Cost

Stranded costs are costs that BPA has incurred to serve customers during the term of the 1981 PSCs, but that BPA might not, for various reasons, be able to recover fully during the term of the contracts. Under the terms of the 1981 PSCs, customers agreed to place their firm power load, less their firm resources (if any) dedicated to serve their load, on BPA and to pay for BPA products and services at rates established according to the procedures set forth in the Pacific Northwest Power Act. Many metered requirements customers have no resources and place their full load on BPA. BPA, in turn, was required to obtain the resources to provide these services and to recover the incurred costs. More recently, sharp declines in the cost of natural gas, coupled with moves to deregulate the electric utility industry, have caused the market value of BPA's products to fall. BPA has reacted by taking steps to reduce its costs substantially and market its products so as to derive maximum revenue, given the nature of the current market. BPA's goal is to use cost management and competitive marketing to recover fully (by September 30, 2001) those costs incurred for service through that date. However, if this proves impossible, BPA may need to rely on some form of rate surcharge to recover these otherwise unrecoverable costs.

THE AMENDATORY AGREEMENT

BPA's offer to amend certain of its metered requirements contracts with Federal and public agency customers would be effective upon execution and terminate at midnight on September 30, 2001. The Amendatory Agreement establishes the customer's commitment to purchase all firm power and other products necessary to serve all of its

Actual Firm Load³ from BPA throughout the term of the contract, except for the following: any resources the customer plans to receive under the CSPE Agreement; resources that were approved, as of February 15, 1995, in the customer's Firm Resource Exhibit; and resources the customer is required to acquire under the Public Utilities Regulatory Policies Act of 1978, or any other Federal law. In addition, the customer must agree to plan for and acquire the local cost-effective energy conservation available in its service territory.

BPA agrees to meet a price test for its final PF-96 rates based on an average cost per kilowatthour (when applied to the customer's load, and based on a variety of assumptions concerning various characteristics of the customer's service requirements) of no more than 0.5 mill above the price resulting from the application of the proposed PF-96 rates contained in BPA's December 1995 Supplemental Rate Proposal. The actual price ceiling will vary from customer to customer, depending on the unique characteristics of each customer's load and the services it chooses to obtain from BPA. Furthermore, BPA agrees that its final 1996 rates, once finally approved by the Federal Energy Regulatory Commission, will apply unchanged to the customer's committed load throughout the term of the Agreement for signatory customers.

BPA also agrees not to seek recovery of any stranded costs from customers signing the Amendatory Agreement during the term of the Amendatory Agreement. However, the Amendatory Agreement specifies that it is not intended to diminish the rights of BPA or the customer regarding treatment of stranded costs by BPA after the Amendatory Agreement has terminated.

Finally, BPA agrees to provide signatory customers with customized guidance and technical assistance regarding conservation measures. Charges for this service, if any, would be negotiated between BPA and the customer. BPA will also offer financial assistance to customers in support of conservation projects, provided BPA funds are available. Terms for repayment to BPA for this assistance would be similarly negotiated. If a customer were unable to achieve targeted conservation levels, BPA might incur reasonable costs to assist the achievement of the targets; the customer would then reimburse BPA for such reasonable costs.

ENVIRONMENTAL ANALYSIS

Consistent with the BP ROD, the Administrator reviewed the BP EIS to determine whether the actions embodied by offering the Amendatory Agreement were adequately covered within the scope of the BP EIS. The BP EIS was intended to support a number of decisions including the development of flexible contractual arrangements specifically tailored to customer needs. "Bundling or Unbundling of BPA Power Products and Services" was one of the 19 key policy issues addressed in the BP EIS; a range of bundling/unbundling options was analyzed. The Market-Driven Alternative included

³ Actual Firm Load is the actual maximum integrated 1-hour monthly peak and average monthly energy loads of the customer's system in the Pacific Northwest, excluding any load that the customer has a unilateral right to interrupt during any month, even if such load was not actually interrupted.

unbundling and rebundling consistent with the products that BPA will offer under the Amendatory Agreement.

Environmental Impacts

According to BPA analyses, public agency customers will place somewhat higher loads on BPA under the Amendatory Agreement than without such an offer. The BP EIS alternatives addressed a range of customer loads and the effect of offering such unbundled/ rebundled services. A more detailed discussion of these effects is provided in section 4.2.1.1, and a summary of such effects in Table 4.2-1, of the BP EIS. Additional information on the environmental consequences of these effects is presented in sections 4.3 and 4.4 of the EIS.

The BP EIS shows 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. The Amendatory Agreement addressed in this ROD is an integral part of BPA's decision to pursue a Market-Driven strategy. The anticipated effects of this strategy are thoroughly discussed in the EIS and were considered in arriving at the decision to offer the Amendatory Agreement to BPA's Metered Requirements customers.

Socioeconomic Impacts

Power comparable to BPA's power is currently available from alternate suppliers at competitive prices. If BPA were to try to recover its costs simply by holding customers to their existing contracts and simultaneously raising rates, it would run the risk of losing customers over time and reducing its revenues. BPA must generate enough revenue to pay all of its costs. If costs exceed revenues, BPA may not be able to meet its financial obligations to repay the Federal Treasury.

BPA understands from the BP EIS that the Amendatory Agreement it is offering as a part of adopting a Market-Driven policy could result in different socioeconomic outcomes than if BPA were to hold customers to their existing contracts (as would occur under the Status Quo Alternative). The increased sales and revenues BPA anticipates by offering the Amendatory Agreement would help keep electricity rates lower for public and private utility customers and DSIs by enhancing revenues from sales to customers signing the Amendatory Agreement. This action would also make it easier for BPA to maintain a higher level of support for public benefits such as energy conservation and the fish and wildlife program than under a scenario based on holding customers to their existing contracts.

Public Benefits

Consistent with the Market-Driven approach, the decision to offer the Amendatory Agreement will enable BPA to participate actively and successfully in the competitive market for power. BPA will use its success in the market to ensure the financial strength necessary to produce the public benefits that BPA affords to the region.

Mitigation

In deciding to enter into the Amendatory Agreement as a feature of implementing the Market-Driven approach, BPA understands that the conditions that permit the agency to function successfully may change over time. Therefore, the Market-Driven Alternative contains preparatory mitigation measures (response strategies) to respond to change and allow the agency to balance cost 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--could be implemented if BPA's costs and revenues do not balance. BPA has already decided (in the BP ROD) to apply as many mitigation response strategies as necessary whenever BPA's costs and revenues do not balance. Preservation of BPA's rights regarding recovery of stranded costs is also a potentially important means for insuring BPA's financial obligations will be met. These mitigation strategies, or equivalents, will be implemented to enable BPA to best meet its financial, public service and environmental obligations, while remaining competitive in the wholesale electric power market.

PUBLIC AVAILABILITY

Copies of the Business Plan EIS and the Business Plan ROD, as well as additional copies of this ROD and the form of Amendatory Agreement, are available to all interested and affected persons and agencies 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.

CONCLUSION

I have decided to offer the Amendatory Agreement to the 1981 PSC, as previously described, to BPA's Federal and public agency and cooperative Metered Requirements customers. In order to ensure that this action results in a satisfactory outcome for BPA, I have limited the assurances of rate stability and stranded cost protection to the term, as amended to run through September 30, 2001, of the existing PSC's of customers signing the Amendatory Agreement. Any termination of the Amendatory Agreement by a customer for any reason, including BPA's failure to meet the rate test contained in the Amendatory Agreement for its PF-96 rate schedules, will eliminate any BPA obligations

under the Amendatory Agreement, including those obligations concerning rate stability and stranded cost protection. Furthermore, BPA will maintain prices at or above the PF rate levels as reviewed and approved by FERC for those firm power loads that public agency customers must place on BPA under their existing PSCs.

I have concluded that the Amendatory Agreement will meet the mutual goals of this class of customer and BPA. The offer of this Amendatory Agreement is an important step in the process of achieving the load commitments that BPA must have in order to assure adequate revenue recovery through rates that will provide all of its customers with products that can be competitively marketed during the term of the Amendatory Agreement. I believe this Agreement will also help to effectively position BPA for financial success after 2001, and will foster development of a healthy, durable, and mutually beneficial business relationship with its customers. BPA must strive to support the competitive capacity of its customers in order to best assure its own long-term competitive success.

This decision is a final action under section 9(e)(1)(B) of the Northwest Power Act regarding the sale of power to this class of customer under section 5(b)(1) of the Northwest Power Act when executed by me. I believe this decision to be fully consistent with BPA's Market-Driven approach for participation in the electric power market, since it will increase net revenues and enhance the business relationships required for BPA's long-term competitive success. Additionally, this decision will preserve the financial strength BPA must have in order to deliver the public benefits, such as fish and wildlife mitigation and energy conservation, for which it is responsible. The decision represents a reasonable balance between the environmental effects associated with continuing to provide power to BPA's customers, as addressed in the BP EIS, and the benefits this service enables.

Issued in Portland, Oregon, on February 16, 1996.

/S/ Randall W. Hardy

Administrator and
Chief Executive Officer