RESIDENTIAL EXCHANGE TERMINATION AGREEMENT

FOR PNGC MEMBER UTILITIES

RECORD OF DECISION

BONNEVILLE POWER ADMINISTRATION

US. DEPARTMENT OF ENERGY

JULY 31, 1996

TABLE OF CONTENTS

Record of Decision

Termination of Residential Purchase and Sale Agreements
With Pacific Northwest Generating Cooperative Utilities

I. BACKGROUND

Bonneville Power Administration (Bonneville) was established by the Bonneville Project Act of 1937 (Project Act), 16 U.S.C. 832 *et seq*. After enactment of the Project Act, Bonneville marketed the low cost hydropower generated by Federal dams in the Pacific Northwest. While Federal appropriations were used in the construction of the Federal hydrosystem, Federal taxpayers did not ultimately pay these costs. The costs of the hydrosystem are repaid with interest over time by Bonneville's ratepayers through Bonneville's wholesale power revenues. Thus, Bonneville's ratepayers have paid the costs of the Federal hydrosystem.

Section 4(a) of the Project Act requires Bonneville to "give preference and priority to public bodies and cooperatives" when selling power. 16 U.S.C. 832c(a) This preference had little significance in Bonneville's early years, however, because Bonneville had sufficient power for to serve the needs of all customers in the region. These customers include public bodies and cooperatives, known as "preference customers" because of their statutory first right to Federal power under the preference clause noted above. *Id.* These customers also include investor-owned utilities (IOUs) and direct service industrial customers (DSIs). In 1948, the increasing demand for power caused Bonneville to require that contracts with the DSIs must include provisions to allow the interruption of service when necessary to meet the needs of Bonneville's preference customers. In the 1970's, forecasts showed that preference customers would soon require all of Bonneville's power. Therefore, in 1973, Bonneville gave notice that new contracts for firm power for IOUs would not be offered and that as DSI contracts expired between 1981-1991, the contracts were not likely to be renewed. *Aluminum Co. of America v. Central Lincoln Peoples' Utility Dist.*, 467 U.S. 380, 383-385 (1984). In 1976, Bonneville advised preference customers that Bonneville would not be able to satisfy preference customer load growth after 1983 and that Bonneville would have to determine how to allocate power among preference customers.

The high cost of alternative sources of power caused Bonneville's non-preference customers to attempt to regain access to cheap Federal power. Many areas served by IOUs moved to establish public entities designed to qualify as preference customers and be eligible for administrative allocations of power. Because the Project Act provided no clear way of allocating power among preference customers, and because the stakes involved in buying cheap federal power had become very high, the competition for administrative allocations threatened to produce contentious litigation. The uncertainty inherent in the situation greatly complicated the efforts by all Bonneville customers to plan for their future power needs. In order to avoid the prospect of unproductive and endless litigation regarding access to the Federal power marketed by Bonneville, Congress enacted the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act), 16 U.S.C. 839 *et seq.*, in 1980. *Central Lincoln Peoples' Utility Dist. v. Johnson*, 735 F.2d 1101, 1107 (9th Cir. 1984).

The Northwest Power Act expressly reaffirmed the right of Bonneville's preference customers to first call on Federal power before such power could be offered to Bonneville's IOU or DSI customers. 16 U.S.C. 839g(c). The Act also established the residential exchange program. 16 U.S.C. 839c(c). As noted above, when Bonneville had insufficient Federal power to meet the needs of investor-owned utilities in the 1970s, such utilities developed their own resources which were generally more costly than Federal hydropower. The residential exchange program provides Pacific Northwest utilities a monetary form of access to low-cost Federal power. *See California Energy Resources Conservation and Dev. Comm'n v. Johnson*, 807 F.2d 1456, 1459-60 (9th Cir. 1986). Under the program, Pacific Northwest utilities may sell power to Bonneville at a rate based on the utility's average system cost (ASC) of its resources. Bonneville is required to purchase that power and sell, in exchange, an equivalent amount of power to the utility at Bonneville's Priority Firm Power (PF) rate. This is the same rate that applies to Bonneville's sales of power to its preference customers, although the Act expressly provides that the PF rate for the residential exchange program may be higher than the PF rate for preference customers due to a rate ceiling for preference customers established in section 7(b)(2) of the Act. 16 U.S.C. 839e(b)(2); 16 U.S.C. 839e(b)(3). The residential exchange is simply "a mechanism for calculating a subsidy, not for establishing a traditional cost of purchased power." Federal Energy Regulatory Commission Order No. 400-A, 30 F.E.R.C. 61,108, 61,195-96 (1985*); see Central Elec. Cooperative v. Bonneville Power Admin.*, 835 F.2d 199-1, 200-01 (9th Cir. 1987). No power is actually transferred to or from Bonneville since the "exchange" is simply an accounting transaction: "in practice, only dollars are exchanged, not electric power." *Public Util. Comm'r of Oregon v. Bonneville Power Admin.*, 583 F. Supp. 752, 754 (D. Or. 1984), *aff'd*, 767 F.2d 622 (9th Cir. 1985).

Where a utility's ASC is higher than Bonneville's PF rate, the difference between the rates is multiplied by the utility's jurisdictional residential load to determine an amount of money that is paid to the utility as residential exchange benefits. These benefits must be passed through directly to the utility's residential consumers, generally through lower retail rates. 16 U.S.C. § 839c(c)(3). The cost of providing these benefits to exchanging utilities is borne primarily by Bonneville's publicly owned utility and DSI customers, subject to the rate ceiling established in section 7(b)(2) of the Northwest Power Act, which protects Bonneville's preference customers from excessive costs of the residential exchange program. 16 U.S.C. 839e(b)(2).

The residential exchange program is implemented through contracts called Residential Purchase and Sale Agreements (Residential Exchange Agreements). These agreements have been executed with all Pacific Northwest utilities interested in participating in the residential exchange program, including the utility members of Pacific Northwest Generating Cooperative (PNGC). Bonneville and the PNGC member utilities previously executed Residential Exchange Agreements as follows: Blachly-Lane County Cooperative Electric Association, Contract No. DE-MS79-81BP90683; Central Electric Cooperative, Inc., Contract No. DE-MS79-81BP90684; Consumers Power, Inc., Contract No. DE-MS79-81BP90689; Coos-Curry Electric Cooperative, Inc., Contract No. DE-MS79-81BP90690; Douglas Electric Cooperative, Inc., Contract DE-MS79-81BP90691;

Lost River Electric Cooperative, Inc., Contract No. DE-MS79-81BP90719; Oregon Trail Electric Cooperative, Contract No. DE-MS79-81BP90707; Raft River Rural Electric Cooperative, Inc., Contract No. DE-MS79-81BP90599; and Umatilla Electric Cooperative Association, Contract No. DE-MS79-81BP90728 (hereafter referred to as Utilities). These Utilities have been participating in the residential exchange program since the execution of these agreements.

II. PROCEDURAL HISTORY

In late spring of 1996, PNGC expressed interest to Bonneville regarding the possible buyout of the current Residential Exchange Agreements for PNGC's member utilities. As noted above, these Agreements establish the terms governing a utility's participation in the residential exchange program. The Agreements currently run through June 30, 2001. Subsequent to PNGC's request, Bonneville and PNGC conducted negotiations regarding the proposed buyouts. Bonneville, PNGC and the Utilities desire to settle the disputes between them regarding their rights and obligations for the period from and including August 1, 1996, through and including June 30, 2011, under the Residential Exchange Agreements or subsequent Agreements and section 5(c) of the Northwest Power Act, by terminating the Residential Exchange Agreements and receiving the payment of liquidated amounts from Bonneville. As a result of the negotiations, Bonneville, PNGC, and the Utilities developed a proposed agreement to terminate the Utilities' participation in the residential exchange program, as described in greater detail below.

On June 24, 1996, Bonneville sent a notice to all interested parties announcing a 30-calendar day comment period regarding a proposal by Bonneville, PNGC and the Utilities to terminate the Utilities' participation in the residential exchange program through June 30, 2011. Interested parties were encouraged to express their views. Bonneville's notice also described the proposed agreements. In summary, Bonneville proposed to pay the Utilities specified sums of money to buy out the Utilities' current Residential Exchange Agreements through June 30, 2001. The Utilities would also agree not to participate in the residential exchange program through June 30, 2011. The specific proposed provisions of the buyout agreements and the reasons for those provisions are summarized below.

III. SUMMARY OF AGREEMENT

A. Section 1. Definitions. This section defines a number of terms used in the Agreement, including "Residential Exchange," Residential Exchange Benefits," and "Residential Load."

B. Section 2. Termination of Prior Agreements. This section provides that the Residential Exchange Agreements and all amendments thereto of the Utilities executing the Agreement would be terminated effective at 2400 hours on August 1, 1996.

C. Section 3. Residential Exchange Benefits for the Period August 1, 1996, through September 30, 1996. This section provides that no further changes to the Utilities' average system costs (ASC) would be required or submitted under the Residential Exchange Agreements for the period prior to October 1, 1996, and that

Bonneville would pay the Utilities at their currently effective ASC for all Residential Load served by the Utilities from the Effective Date through September 30, 1996. In the unlikely event that any utility's ASC is less than Bonneville's applicable PF rate during the two-month period, the utility would pay Bonneville's based upon the utility's currently effective ASC.

D. Section 4. Payment by Bonneville. This section provides that Bonneville would, in full and complete satisfaction of all of its obligations for payments to the Utilities for the residential exchange program under Section 5(c) of P.L. 96-501 for the period ending July 1, 2001, pay to PNGC the sum of $18,330,359 in two payments. Bonneville would pay PNGC the sum of $8,905,843 on or before the last business day of October 1999. Bonneville would pay PNGC the sum of $9,424,516 on or before the last business day of October 2000. Bonneville determined the amount of the payments based upon the future value of residential exchange benefits to the Utilities for the period ending July 1, 2001, using Bonneville's final proposed 1996 wholesale power rates and an interest rate of 7.65 percent.

E. Section 5. Payment by Utilities to Residential Loads. This section provides that the payments specified in section 4 would be distributed among the Utilities by PNGC and the Utilities in a manner determined by such Parties. Exhibit A to the Agreement provides an illustrative example of the yearly distribution of such payments among the Utilities. The payments provided in section 4, as distributed by PNGC and the Utilities, would be passed through directly to the Utilities' Residential Loads pursuant to section 10 as described below.

F. Section 6. Interest. This section provides that if Utilities elect to make payments, or credits to retail rates, for Residential Loads prior to October 1999, any interest charges incurred to make such payments may be deducted from the pass-through of benefits specified in section 10. Interest charges would be limited to an annual rate of 7.65 percent.

G. Section 7. Advocacy of Legislative Action. In this section, the Parties recognize that the payments provided by Bonneville to the Utilities under the Agreement would be for the purpose of buying out the Residential Exchange through June 30, 2001. The Parties also recognize that Bonneville's financial flexibility is significantly constrained by, among other things, the fact that it has established 5-year rates which cannot be revisited for many customers during the period prior to October 1, 2001. It would be unfair for Bonneville to pay residential exchange benefits for the period ending July 1, 2001, which were calculated based on Bonneville's proposed 1996 rates, and then be forced to pay additional amounts for residential exchange benefits for that same period. Indeed, because Bonneville's rates reflect a forecast of residential exchange benefits for the period ending July 1, 2001, and because those rates determine Bonneville's revenues, Bonneville would have no funds available to pay any additional residential exchange benefits that might be required by subsequent legislation. Therefore, the Parties intend that the payments under the Agreement would constitute a full and complete settlement of all amounts to be paid by Bonneville under the Residential Exchange program and any appropriations or other legislation that may, as did the Energy and Water Development

Appropriations Act, Public Law 104-46, provide for an allocation, increase, or decrease of Residential Exchange benefits through June 30, 2001.

In this section the Parties also agree that additional consideration has been exchanged to support their mutual promises with respect to the Residential Exchange program for the period through June 30, 2011. The Parties would agree not to request or advocate, directly or indirectly, any legislative action, including appropriations legislation, to provide greater or lesser monetary payments (or equivalent in benefits) under the Residential Exchange program than are provided for under the Agreement for the period through June 30, 2011. Notwithstanding the foregoing, the Parties may participate in the development of legislation, other than as described in the preceding sentence, regarding the Residential Exchange or a program other than the Residential Exchange. The Parties would not be precluded from responding to requests for information from Congress regarding any legislation being considered by Congress, provided the response is not inconsistent with the Parties' obligation under the second sentence of section 7(b) of the Agreement. In the event that it was determined by a court of competent jurisdiction that a Party had breached its obligations set forth in section 7(b) of the Agreement, the other Parties would be free to request or advocate any legislative action. In the event any Party successfully advocated legislation in breach of its obligation under the second sentence of this section 7(b), that Party would agree to forego any increase or decrease in the benefits, relative to those benefits provided in the Agreement, that would otherwise occur under the new legislation.

H. <u>Section 8</u>. <u>Challenges to Final Actions</u>. This section provides that the payments by Bonneville under this Agreement would be in full satisfaction of amounts to be paid to the Utilities under the Residential Exchange Agreements and for the Residential Exchange program for the period prior to July 1, 2001. Because the Agreement establishes total exchange benefits for the period prior to July 1, 2001, PNGC and the Utilities would agree not to challenge issues within any final actions taken by Bonneville which are rendered moot as to PNGC and the Utilities by this Agreement. For example, PNGC and the Utilities would not be able to challenge issues related to the determination of the PF Exchange rate in Bonneville's 1996 rate case, which is used in determining residential exchange benefits. Such issues include, but are not limited to, recovery of stranded costs, the DSI margin, the DSI value of reserves, the section 7(c)(2) adjustment, the DSI floor rate calculation, allegations of closed mind or bias, the resources included in the Federal base system, in-lieu resource assumptions, the resources included in or omitted from the section 7(b)(2) rate test resource stacks, the inclusion of Mid-Columbia resources in the 7(b)(2) Case resource stack, the determination that there were no costs of uncontrollable events to be excluded from the Program Case, the treatment of Energy Services business revenues, or the quantification of DSI reserve benefits. <u>See</u> 1996 Final Rate Proposal, Administrator's Record of Decision, WP-96-A-02. The payments by Bonneville under the Agreement also are the full amounts to be paid to PNGC and the Utilities for the Residential Exchange program for the period prior to July 1, 2011. Nothing in the Agreement, however, would preclude any Party from pursuing remedies for breaches of the Agreement.

I. Section 9. Termination of Filings. This section provides that, subject to section 11 below, by terminating their Residential Exchange Agreements and participation in the Residential Exchange program through June 30, 2011, the Utilities would not be required (a) to file, calculate or track ASC, (b) to submit invoices, or to perform other duties formerly required by the Residential Exchange Agreements. Bonneville's corresponding rights and obligations would be similarly satisfied through the implementation of the Agreement. Bonneville projects that no Utility will have any debit balance under section 10 of its Residential Exchange Agreement upon termination of such agreement. If and to the extent any Utility had, as of August 1, 1996, a debit balance under its Residential Exchange Agreement, such balance would carry over to any subsequent agreement.

J. Section 10. Passthrough of Benefits. This section provides that amounts received by PNGC and the Utilities from Bonneville under this Agreement would be passed through directly to the Utilities' Residential Loads (as defined in the Utilities' Residential Exchange Agreements). Such amounts would be identified on PNGC's and the Utilities' books of account and paid by the Utilities exclusively to, or credited exclusively against the retail rates of, the Utilities' Residential Load by October 1, 2002. Notwithstanding the termination of the Utilities' Residential Exchange Agreements, Bonneville would retain the right to audit PNGC and each Utility at Bonneville's expense to determine whether the Residential Exchange Benefits paid to PNGC and the Utilities under this Agreement were provided only to the Utilities' eligible residential and small farm customers as required by section 5(c)(3) of the Northwest Power Act. The first audit would occur at the time prescribed by the current review cycle. A second audit may occur after the last disbursement of monies under the Agreement. Bonneville may conduct an additional audit after the second audit only if PNGC and the Utilities have not demonstrated the passthrough of such benefits as specified. Bonneville would retain the right to take action consistent with the results of such audits to require the passthrough of such benefits to eligible customers. Bonneville's right to conduct such audits of PNGC and the Utilities would expire October 1, 2003 (except for Bonneville's continuing right to assure compliance with such audits). As long as Bonneville has the right to audit PNGC and the Utilities pursuant to the Agreement, PNGC and the Utilities would agree to maintain records and documents dating back to the Effective Date of the Agreement showing all transactions and other activities pertaining to the terms of the Agreement and the Utilities' payments of Residential Exchange Benefits to residential and small farm customers.

K. Section 11. Settlement of Disputes. This section provides that the Parties would agree to terminate all pending, and to commence no new, litigation, contract disputes, and regulatory or administrative disputes, including ASC determinations, load determinations, billing disputes, and other issues regarding the Residential Exchange program, with respect to Residential Exchange benefits for the period prior to July 1, 2011, except for claims of breach of this Agreement. Bonneville and the Utilities, however, would still be required to pay any amounts owed for the period prior to August 1, 1996, as provided in section 13.

L. Section 12. Survival of Obligations. This section provides that the Agreement, read in conjunction with the Residential Exchange provisions of the Utilities' new partial requirements contracts for the period from August 1, 1996, through August 1, 2001, sets forth the entire agreement of the Parties with respect to the subject matter of this Agreement and may be amended only by writing signed by each Party. The Agreement would inure to the benefit of, and be binding upon, the respective successors and assigns of the Parties. The Agreement would not be intended to confer any right or remedy upon any person or entity other than the Parties and their respective successors and assigns.

M. Section 13. Previously Accrued Benefits. This section provides that any Residential Exchange Benefits due any Utility, or owed by any Utility, for the period ending at 2400 hours on August 1, 1996, would not be affected by the Agreement. Such amounts would be accounted for and paid separately from the sums payable under section 4. All obligations arising under the Residential Exchange Agreements for the period prior to August 1, 1996, would be preserved until satisfied.

N. Section 14. Status as Preference Customers. This section provides that the rights and obligations of the Utilities as wholesale preference customers of Bonneville would not be affected by the Agreement. The Utilities would continue to have the right to purchase electric power as wholesale preference customers of Bonneville under rates established pursuant to section 7(b) of the Northwest Power Act. Nothing in section 14 of the Agreement would be construed as an admission, agreement, or evidence with respect to whether PNGC is entitled to become a wholesale preference customer of Bonneville. The Parties each would reserve their rights in that regard.

O. Section 15. Final Action. This section provides that Bonneville, PNGC and the Utilities would agree that the Agreement implements the Residential Exchange Program pursuant to section 5(c) of the Northwest Power Act and that the Agreement constitutes a final action pursuant to section 9(e)(1)(B) of that Act. Bonneville, PNGC and the Utilities further would agree that any action challenging the Agreement must be filed within 90 days of the final action, pursuant to section 9(e)(5) of the Northwest Power Act.

P. Section 16. Enforceability. This section provides that Bonneville, PNGC and the Utilities would warrant and certify that the Agreement is binding and enforceable on the Parties and within the Parties' legal authority. Further, Bonneville, PNGC and the Utilities would agree to defend any and all challenges to the validity and enforceability of this Agreement or to the rights and duties contained herein. Bonneville would defend lawsuits filed against Bonneville. PNGC would defend lawsuits filed against PNGC. The Utilities would defend lawsuits filed against the Utilities. Bonneville, PNGC and the Utilities would agree to cooperate in defending any and all challenges to this Agreement.

Q. Section 17. Invalidity. This section provides that in the event it was determined by a court of competent jurisdiction that any Party's duties or obligations under the Agreement were invalid, illegal or unenforceable, and in the further event that such determination were not reversed on appeal, then the Party to whom such duty or obligation is owed would have the right, if exercised within 60 days of the final determination on appeal, to rescind the Agreement, which then would be invalid and void ab initio, and of no force or effect.

R. Section 18. Counterpart Signature. This section provides that the Agreement may be executed by counterparts. Upon execution by the PNGC, the Utilities and Bonneville, each executed counterpart would have the same force and effect as an original instrument and as if Bonneville, PNGC and the Utilities had signed the same instrument.

IV. REVIEW OF COMMENTS

Bonneville's June 24, 1996, notice requested written comments by July 25, 1996. Bonneville received one written comment. The response to the comment follows. While not raising any issues directly related to the instant proceeding, the comment raised a fear that Bonneville wishes to have the residential exchange program terminated or not have it extended beyond 2001 in order to reduce rates to Bonneville's utility customers and remain competitive in the new electric power market. It was argued that this might increase retail rates for consumers of investor-owned utilities. The residential exchange program, however, is established by law. Bonneville must implement the residential exchange program as long as the statute exists. Bonneville cannot unilaterally eliminate the residential exchange program. In the Conference Report accompanying the Energy and Water Development Appropriations Act, P.L. 104-46, the conferees encouraged Bonneville, consistent with the regional review, to work with Bonneville's customers to gradually phase out the residential exchange program by October 1, 2001. The issue of

Bonneville, consistent with the regional review, to work with Bonneville's customers to gradually phase out the residential exchange program by October 1, 2001. The issue of the future of the residential exchange program will be addressed in the regional review and will not be decided in the instant proceeding.

CONCLUSION

Based upon the foregoing discussion, the record compiled in this proceeding and all requirements of law, I hereby determine that Bonneville should execute the Residential Exchange Termination Agreement with PNGC and its member utilities.

Issued at Portland, Oregon, on this 2nd day of August, 1996.

UNITED STATES OF AMERICA
Department of Energy
Bonneville Power Administration

By Jack Robertson

Name Jack Robertson

Title Deputy Chief Executive Officer