

July 6, 2010

Mark Gendron
Vice President, Requirements Marketing
Bonneville Power Administration
PO Box 3621
Portland, OR 97208

Sent via email

Re: Implementation of the Demand Rate under the TRM

Dear Mark,

The 90 preference utilities that comprise the Northwest Requirements Utilities (“NRU”), the Pacific Northwest Generating Cooperative (“PNGC”), Western Montana Electric Generation and Transmission Cooperative (“WMTG&T”) and the Western Public Agencies Group (“WPAG”) have joined in this letter to express concerns regarding the potential rate impacts that could result from the demand rate to be implemented under the Tiered Rate Methodology (“TRM”) in the WP-12 rate proceeding. These concerns are exacerbated by the substantial rate increase all preference customers could be facing due to increases to the revenue requirement and risk mitigation funding being considered by Bonneville in the WP-12 rate case.

When the Tiered Rate Methodology (“TRM”) was being formulated, Bonneville was concerned that the absence of a demand price signal could cause inefficient use of Bonneville’s finite Tier 1 capacity resources by preference customers receiving Tier 1 requirements service. To address this concern, Bonneville took three separate steps. First, it incorporated a factor into the determination of each preference utility’s capacity amounts that ensured that each preference customer would face a marginal price signal for at least some portion of their demand (targeted at 10%) served by Bonneville under the Tier 1 rate from day one under the TRM. Second, Bonneville included in the TRM specific directions regarding the calculation of the marginal demand rate, stating that it would be based on “. . . the annual fixed costs (capital and O&M) of the marginal capacity resource as determined in each 7(i) Process. BPA will identify the marginal capacity resource and annual fixed costs associated with that resource for each Rate Period.” (TRM § 5.3.6)

Third, and perhaps most important, Bonneville made considerable efforts to compare the TRM rate design with Bonneville’s then current rate design, in order to ensure that the shift from the current to the TRM rate design, and in particular the imposition of a demand price signal, did not cause inordinate rate impacts to any of Bonneville’s preference customers. Bonneville sought to ensure that the initial rate impact from the shift to the TRM rate design (without regard to revenue requirement increases) would not exceed five percent (5%) to any preference customer. Given the potential magnitude of the WP-12 rate increase due to revenue requirement and risk mitigation funding, it is important that the demand price signal not compound for some preference customers what could turn out to be a substantial WP-12 rate increase.

The TRM provides Bonneville with some latitude in selecting the marginal resource for purposes of establishing the demand rate for Tier 1 service to preference customers. Further, it should be noted that this demand rate was not established for the purpose of covering any costs of acquiring capacity to provide Tier 1 service, but rather for the sole purpose sending an appropriate price signal to encourage efficient use of this resource by preference customers. With these thoughts in mind, we urge Bonneville to set a Tier 1 demand rate that is sufficient to send a price signal to preference customers regarding their Tier 1 capacity use, but not so high as to make what may already be a substantial WP-12 rate increase worse.


Preliminary analysis indicates that as the Tier 1 demand rate exceeds the originally tested \$8.50 per kW/month level, an increasing number of the medium and small preference customers will face a rate increase of five percent (5%) or more merely from the shift to the TRM rate design. Given that the WP-12 rate case involves a major shift in the rate design for the Priority Firm rate, and that Bonneville is not forecast to actually acquire any capacity resources to provide Tier 1 service during the rate period, it is appropriate that Bonneville consider adopting the following approaches when formulating the Tier 1 demand rate price signal for its Initial Rate Proposal for the WP-12 rate proceeding:


1. The TRM calls out the components that are permitted to be used to determine the marginal capacity rate, which are fixed capital and O&M. While some level of gas transportation procured to provide fuel to the peaking resource are considered fixed costs, a peaking resource does not require gas transportation in all hours of all months due to its limited operation. As a consequence, the fixed gas transportation costs should be reduced by the revenues that would be obtained from selling such gas transportation on the capacity release market when it is not needed to provide fuel for the peaking resource.
2. Setting the marginal capacity cost is not an exercise in retrieving costs actually incurred by Bonneville to provide Tier 1 requirements service, but to send a price signal to preference customers to encourage efficient use of a potentially scarce resource to serve their requirements loads. Consequently, reflecting the costs that a preference customer would incur to acquire a capacity resource is an appropriate basis for establishing a price signal for preference utilities receiving Tier 1 requirements service. In the absence of a viable capacity market (which is the current situation), this marginal capacity resource should be assumed to be one financed and built by a preference customer of Bonneville, and funded using tax exempt bonds since this would be the least cost approach. For purposes of establishing a demand rate to send a price signal to preference customers receiving Tier 1 requirements service, Bonneville should assume that the marginal capacity resource will be built by a preference customer and funded with tax exempt bonds.

The foregoing approaches are recommended for the WP-12 rate case, and are not intended to set a precedent for subsequent rate cases under the TRM. They will result in a strong demand price signal to preference customers of Bonneville, while at the same time mitigating the rate impacts associated with the implementation of the TRM rate design in a manner consistent with the TRM. It will also mitigate the rate impacts to medium and small preference customers from this initial shift to the TRM rate design in the WP-12 rate case. We strongly urge Bonneville to

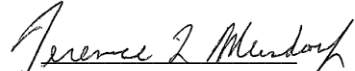
seriously consider including the two approaches suggested in its Initial Rate Proposal in the WP-12 rate case. By doing so, Bonneville will help ensure a successful implementation of the TRM.

Respectfully,


John Saven


William Drummond


John Prescott


Terry Mundorf

Cc: Greg Delwiche, Bonneville Power Administration
Scott Corwin, Public Power Council