

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
SPECIAL PUBLIC MEETING DATE: December 1, 2008**

REGULAR X CONSENT EFFECTIVE DATE _____

DATE: December 1, 2008

TO: Public Utility Commission

FROM: Marc Hellman

THROUGH: Lee Sparling

SUBJECT: PORTLAND GENERAL ELECTRIC: Application for Approval of Long-Term Residential Purchase and Sale Agreement and Long-Term New Resource Block Contract with the Bonneville Power Administration.

STAFF RECOMMENDATION:

I recommend that the Commission direct PGE to execute the Long-term New Resource Block Contract and direct PGE not to execute the Residential Purchase and Sale Agreement with the Bonneville Power Administration.

DISCUSSION:

Bonneville Power Administration (BPA) is a federal agency that markets low-cost federal power to private and public agencies as well as certain large industrial customers. The Regional Power Act, federal legislation passed nearly thirty (30) years ago, authorizes BPA to provide the benefits of the low-cost federal hydroelectric system to residential and small farm customers of Pacific NorthWest (PNW) investor-owned utilities (IOUs). Under the Act, an IOU has two options by which to enter into contracts with BPA for the benefit of the IOU's residential and small farm customers. The first option is to enter into a residential exchange contract pursuant to provision 5(c) of the Regional Power Act. Under this option, the IOU sells power, equal in amount to its residential and small farm load, to BPA at the IOU's average system cost (ASC). BPA in turn sells an equal amount of power back to the IOU at BPA's priority firm (PF) exchange rate. Typically no power is actually transferred between BPA and the IOU. Rather, cash benefits are provided to the IOU equal to the residential and small farm load multiplied by the difference between the IOU's ASC and BPA's PF exchange rate.

The second method to obtain benefits for the residential and small farm customers is to enter into a contract with BPA under the provisions of 5(b) of the Regional Power Act.

Under this provision, an IOU can purchase power from BPA equal to the IOU's net requirements and the power is priced at the new resource (NR) rate. A utility's net requirements are calculated as the difference between the utility's firm loads and its firm resource supply.

BPA is offering two contracts to PGE covering the two options described above. The contracts cover the time period beginning October 1, 2011, and ending on September 30, 2028. Pursuant to ORS 757.663, Commission approval is required before either PGE or PacifiCorp may enter into contracts with BPA for the purpose of obtaining federal system benefits. BPA has set a December 1, 2008, date as the last date for which a utility can execute a contract.

The most recent occasion where the Commission considered utility/BPA contract issues was at the September 23, 2008, Public Meeting. At the time of that public meeting, there was no exchange or requirements contract in force to cover the period beginning October 1, 2008. In compliance to Commission directions, both PGE and PacifiCorp executed their respective agreements to provide benefits beginning with BPA's FY 2008. These contracts, which are effective October 1, 2008 through September 30, 2011, serve as the vehicles by which to provide federal system benefits for the next few years.

In concert with the execution of contracts in force for the next several years, BPA has led the region in a major effort to have new twenty-year contracts in place for all customer groups by the end of 2008. The new contracts cover the period October 1, 2011 through September 30, 2028. This major effort by BPA has been underway for several years. The contracts, while executed in 2008, would not have its terms and conditions in force until October 1, 2011. The purpose of this massive BPA activity is to both establish new methods and procedures to guide BPA in its ratemaking, resource acquisition, as well as secure the benefits of the federal system for the PNW.

Along those lines, BPA has adopted a tiered rates methodology. This methodology charges a lower cost-based rate to public utilities up to a utility-specific maximum average megawatt (AMW) amount. Should the utility's net requirements exceed this cap, and the utility seeks to buy additional power from BPA above the cap, the rate charged for that service would be based on a marginal resource cost concept, not BPA's embedded cost of resources and balancing purchases up to a fixed AMW level.

The tiered rates concept departs significantly from the original basis of the Regional Power Act. In the Act, BPA would acquire resources as public loads grew and BPA would combine the costs of those resources with existing resources forming a melded rate of high cost and low cost resources. Another significant change in policy was the treatment of new publics and public annexation. For many years, the policy for new

publics was to provide service at rates equal to existing public agencies. In the new BPA paradigm of tiered rates, BPA's lowest cost based rate would be available only up to a specified AMW amount of load served by new publics.

In concert with the twenty-year contract objective, and in addition to the tiered rates methodology, BPA also established a new 7(b)(2) rate methodology and an ASC methodology. These methodologies are much improved from previous practices and establish greater equity in the allocation of federal system benefits than would be available under past practices. BPA should be commended for making these changes.

Understandably many BPA customers had concerns about making twenty-year power purchase commitments. To address these concerns, BPA made a number of commitments. Such commitments include revisiting treatment of the public utility sale of the Centralia generating facility. BPA, using the Administrator's discretion, would allow the four public utilities who owned shares of Centralia (who happen to be located in the State of Washington) to no longer count their share of Centralia prior to their sale as a resource reducing the level of load that could be placed and served by BPA at BPA's lowest cost-based rate. This would be a change in current practice and represent a significant benefit, in the millions of dollars each year, to the four public utilities. So that the four utilities knew the treatment of this issue before the December 1, 2008, twenty-year contract date deadline, BPA issued a request for comment on this proposal on November 18, 2008, with close of comment being November 25, 2008.

BPA also made commitments related to the benefits to be available to the residential and small farm customers of investor-owned utilities (residential customers). BPA committed that it would not offer twenty-year contracts until the region reached a resolution of the residential exchange issues. (See Attachment 1, where this BPA commitment is referenced by the executive management of each PNW investor-owned utility.) However, this commitment was not met. Twenty year contracts have been offered and signed by public utilities and yet there is no regional resolution to the residential exchange issue. At this time, public utilities have filed challenges with the Ninth Circuit relating to BPA's recent general rate case. My presumption is that the publics will challenge several of BPA's decisions regarding residential exchange benefits including BPA's treatment of the Load Reduction Agreements executed by BPA with Puget Sound Energy and PacifiCorp.

Even though the investor-owned utilities reached a resolution with some public agencies on the conceptual framework for residential exchange benefits, the concepts contained in that framework were not carried out by BPA. The framework called for an extinguishment of any refund obligation arising from residential exchange benefits paid to investor-owned utilities for the 2001 to 2007 time period. In contrast, in the most

recent BPA rate case, BPA established refund obligations for each investor-owned utility. The total refund obligation amounted to roughly \$750 million in 2009 dollars.

The investor-owned utilities and publicly-owned utilities' framework also called for annual residential exchange benefits in the range of \$200 million to \$220 million. In BPA's rate case, BPA determined the level of residential exchange benefits for 2009 would be roughly \$180 million. Part of the reason for the lower level of benefits was the BPA decision to target the refund obligation to be paid off over a period of seven years albeit with the constraint that no investor-owned utility would have its annual residential exchange benefits reduced by more than 50 percent to meet the refund obligation.

It is true that this Commission has advocated for a higher level of residential exchange benefits more in line with the historic real dollar level of benefits received over time and consistent with a reasonable sharing of the value of the federal hydroelectric system. Absent the refund obligation, the decisions made in BPA's most recent rate case, in concert with BPA's changes in the 7(b)(2) methodology and average system cost methodology go a long ways to restoring equity overall in aggregate for the investor-owned utilities. I should note however that the allocation of benefits among the investor-owned utilities could be viewed as inequitable given the significant reduction in benefits to PacifiCorp and the elimination of any benefits to Idaho Power. While there is no guarantee that future rate cases will produce similar results, at least the most recent rate case produced an amount of residential exchange benefits (excluding the reduction in benefits for purposes of meeting BPA's refund determination) that, in aggregate, is in the ball park of reasonableness. The OPUC continues to advocate on behalf of the customers served by our regulated utilities that there should be no refund obligation.

At this time, it appears that future residential exchange benefits will be determined on a BPA rate case by rate case basis. Given the vagaries of the 7(b)(2) rate test, the huge unknowns concerning wholesale electric markets, national policies regarding greenhouse emissions, and treatments of renewable energy certificates, there is no assurance that future rate cases will conclude with similar results regarding residential exchange benefits.

For FY 2009, PGE's level of residential exchange benefits will be less than the company was receiving prior to an adverse Ninth Circuit ruling on residential settlement agreements between the investor-owned utilities and BPA. My most recent information on projected residential exchange benefits for FY 2009 is shown in the table below.

| | Resx Benefits Prior to Ninth Circuit Decision and Suspension of Benefits | Total Resx Benefits Projected Prior to Any Refund Obligation | Projected Benefits beginning October 12, 2008 | Projected Benefits Refunded to Public Agencies |
|-------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------|-----------------------------------------------|------------------------------------------------|
| Residential Exchange Benefits | \$76.5 million | \$59.2 million | \$42.4 million | \$16.8 million |

The level of benefits continues to change as BPA receives ASC information from the region's exchanging utilities. BPA has dockets under way to establish each investor-owned utility's ASC. One could observe that absent any refund obligation, the level of residential exchange benefits available to PGE's residential customers is less than previous benefits under settlements, but not drastically lower.

Returning to the topic at hand, there are two contracts being offered by BPA to PGE. One contract is a net requirements contract (5(b) Contract). The other is the Residential Purchase and Sale Agreement (RPSA). While PGE has a net requirements contract in force through September 30, 2011, it is in the interests of customers that the 5(b) Contract for the term beginning October 1, 2011, be executed. In BPA rate cases, BPA will be making determinations that are influenced by whether or not a utility has rights in place to place net requirement loads on BPA. The determinations are based on a multi-year future period and so the contracts in effect post 2011 can affect residential exchange benefits prior to 2011.

In the 5(b) Contract, PGE will need to notify BPA prior to November 1, 2009, as to what amount, if any, PGE will purchase from BPA pursuant to the contract. Absent any notice from PGE, BPA will assume that PGE will purchase zero requirements power from BPA for the time period, 2012 through 2019. Also under the contract, if BPA determines that it has insufficient power to supply PGE's request, BPA will provide PGE no less than five years notice of such a curtailment. These are reasonable notice provisions. Given all these considerations, with regards to the 5(b) Contract, I recommend the Commission direct PGE to execute that contract today, December 1, 2008.

The second contract is the RPSA. PGE currently has a RPSA contract in force through September 30, 2011. The proposed agreement has an effective term of October 1, 2011 through September 30, 2028. While I received these contracts on Tuesday, November 25, 2008, and have not had an extensive time to review the terms and

conditions of the contracts, there are a few observations to offer. First, the contracts entail the framework for providing residential exchange benefits as set forth in the Regional Power Act. As PGE notes in its transmittal letter, the terms of the contract do not prescribe a certain level of benefits, but rather lay out the formulaic foundation, which given BPA's then applicable rate case decisions, would prescribe the benefits available to PGE's customers.

Second, the contract includes provisions for BPA to purchase power from the market "in lieu" of buying power from PGE at PGE's ASC. The "in lieu" provisions have their basis in the Regional Power Act. The contract also provides that BPA will develop an "in lieu" policy prior to implementing any "in lieu" action. A concern in the RPSA contract is that there are no specified notice provisions given and that the notice provisions are stated to be developed in BPA's "in lieu" policy determination. The notice provisions are extremely important. Executing the contracts prior to knowing the "in lieu" notice provisions raises risks. For example, in workshops held by BPA, OPUC staff has recommended "in lieu" notice provisions be sufficiently long that they allow for the prospect of "in lieu" power be known and considered in developing utility integrated resource plans.

The RPSA contract also contains provisions by which BPA may reduce the otherwise eligible residential exchange benefit for PGE refund obligations. The RPSA terms specifies that the refund obligation and recovery period shall be determined by BPA through wholesale power rate adjustment proceedings. The RPSA also includes paragraph 20, which reads as follows:

The monetary benefits provided to PGE under this agreement shall be subject to adjustment by BPA to account for the overpayment of benefits, if any, for the period October 1, 2001, through September 30, 2008. Any such adjustments shall be limited to those formally established by BPA in its wholesale power rate adjustment proceedings or other forums established by BPA for the determination of the amount of overpayment to be recovered and the associated recovery period; provided however, that any such adjustment is subject to the resolution of all administrative or judicial review thereof.

Notwithstanding anything in this Agreement to the contrary, it is hereby agreed that neither Party has waived or is waiving, either by virtue of entering into this Agreement, by making or accepting payments under this Agreement, or otherwise, any arguments or claims it has made or may make, or any rights or obligations it has or may have, regarding: (1) the above referenced payments, if any, to PGE, (2) the calculation, implementation, or settlement of Residential Exchange Program benefits for any period of time, and each Party hereby expressly reserves all such

arguments and rights. This section 20 shall survive the termination or the expiration of this Agreement and shall survive even if any other provision of this Agreement is held to be not consistent with law, or void, or otherwise unenforceable.

It is unclear to me why the provisions of reducing benefits as the BPA's determined refund obligation is the key provision that survives even if other provisions of the agreement are found to be unenforceable. For example, why should benefits paid under the contract not also be immune from the threat of challenges so as to remove the prospect of retroactive ratemaking and creation of a refund obligation? It is unfortunate that the Commission is provided such a short amount of time to review and consider the terms and conditions of the RPSA.

Given the above discussion in totality, as well as the understanding that PGE has a RPSA contract in force through September 30, 2011, I recommend the Commission direct PGE to not execute the RPSA. I recommend that in addition to discussions with BPA regarding contract terms and conditions, we search for alternative means by which to secure a stable and meaningful share of federal system benefits. By itself, relying on rate case by rate case decisions to determine residential exchange benefits does not provide a stable and necessarily equitable sharing of federal system benefits with residential customers of investor-owned utilities. Perhaps the BPA pursuit of 20-year contracts meet the goal of preserving the benefits of the PNW hydroelectric system for PNW customers; however the goal of equitably sharing the benefits of the federal system among all PNW customers and citizens has not been secured.

There are several relevant considerations that could be considered in deciding whether or not it is prudent to direct PGE to not execute this RPSA. First, as we get closer to October 2, 2011, PGE has the statutory right to request a RPSA from BPA and BPA is obligated to provide such a contract. The relevant Regional Power Act provision is:

839c(c)(1). Whenever a Pacific Northwest electric utility offers to sell electric power to the Administrator at the average system cost of that utility's resources in each year, the Administrator shall acquire by purchase such power and shall offer, in exchange, to sell an equivalent amount of electric power to such utility for resale to that utility's residential users within the region. [Northwest Power Act, §5(c)(1), 94 Stat. 2713.]

However, there are risks to directing PGE to not execute the contract. For example, we do not know the terms and conditions of any future RPSA. Presumably they would be

similar to those in effect for other companies; however there is no assurance that would be the case. Further, BPA could revise decisions it made in the most recent rate case that were beneficial to Oregon such as to include the conservation and renewables portion of the public purposes charge in average system costs.

PROPOSED COMMISSION MOTION:

The Commission require PGE to execute the Long-term New Resource Block Contract and direct PGE not to execute the Residential Purchase and Sale Agreement with the Bonneville Power Administration.



June 6, 2007

Stephen J. Wright
Administrator and Chief Executive Officer
Bonneville Power Administration
P.O. Box 3621
Portland, OR 97208

Dear Steve,

As the leaders of Northwest investor-owned utilities, we thank you for your responsiveness and the collaborative approach you and your staff have demonstrated as we begin to work our way through the federal power benefit issues arising from the May 3 rulings by the U.S. Ninth Circuit Court of Appeals. We understand the difficult position in which the Court's ruling has placed the Bonneville Power Administration (BPA) and we pledge to work cooperatively to reach consensus on a solution that works for all the region's stakeholders.

We particularly appreciate your efforts to encourage discussions between the region's investor-owned utilities (IOUs) and public utilities. As we have expressed to you and your staff in recent weeks, we believe a collaborative regional approach is the best path to a swift, equitable and durable solution.

We are encouraged that the representatives of public power have pledged to constructively engage in this regional process and that they share our goal of ensuring that all electricity consumers in the Northwest are treated fairly. We too commit to work in good faith to find an equitable and legally sustainable solution.

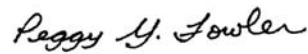
Time is of the essence for our residential and small farm customers, who face significant bill increases beginning this month. We recognize that time is of the essence for the rest of the region's utilities as well. We all – BPA, public utilities and IOUs alike – have invested years in developing and refining the Regional Dialogue Proposal for equitably allocating the Northwest's federal power benefits. The recent court decisions have undermined those collective efforts to determine the future role of BPA federal power benefits in the region. The Residential Exchange is a key component of these collaborative efforts and we agree with your analysis that a regional solution is not possible unless all issues, including the Residential Exchange, are resolved. We appreciate your commitment to not offer contracts pursuant to the Regional Dialogue until the region arrives at a solution to the Residential Exchange issues confronting us today. We are

hopeful, however, that the regional Residential Exchange discussions will be fruitful and that we will soon be able to finalize and implement a fair and equitable long-term solution.

Sincerely,



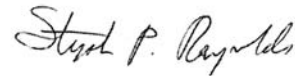
Scott Morris
President and COO
Avista



Peggy Fowler
President and CEO
Portland General Electric



Mike Hanson
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NorthWestern Energy



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Chief Executive Officer
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Department of Energy

Bonneville Power Administration
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POWER SERVICES

November 24, 2008

In reply refer to: PSW-6/Portland

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Dear Gentlemen:

Re Statement of Official Representations

It is the Bonneville Power Administration's (BPA) official position that execution of the proposed Residential Purchase and Sale Agreement (the "Proposed Contract") on or before December 1, 2008, shall not adversely affect or in any manner or respect waive PacifiCorp or Portland General Electric Company (the "Companies") rights to contest before the Ninth Circuit Court of Appeals or other court of competent jurisdiction the lawfulness of any provision of the Proposed Contract, including but not limited to claims that it deprives the Companies of their statutory or contractual rights, nor shall execution of the Proposed Contract constitute an admission or agreement by the Companies as to the legality of any provision in the Proposed Contract, and BPA shall not argue or assert anything to the contrary in the Ninth Circuit Court of Appeals or any other court of competent jurisdiction in the event the Companies timely challenge the lawfulness of any provision of the Proposed Contract.

In the event of any conflict between this Statement of Official Representation and Section 17.2 (Entire Agreement and Order of Precedence) in the Proposed Contract, then this Statement of Official Representation supersedes and takes precedence over Section 17.2 to the extent necessary to resolve the conflict.

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The Senior Vice President, Power Services, has delegated authority pursuant to 16 USC § 832a and BPA Manual Ch. 20 to make the representation contained herein. The Senior Vice President, Power Services, is aware of the relevant facts and makes this Statement of Official Representation with the intent that the Companies rely upon it.

Sincerely,

A handwritten signature in black ink, appearing to read "P E Norman", written in a cursive style.

Paul E. Norman
Senior Vice President, Power Services