M E M O R A N D U M
EUGENE WATER & ELECTRIC BOARD

Rely on us.

TO: Commissioners Simpson, Brown, Helgeson, Manning and Mital

FROM: Erin Erben, Resources & Strategic Planning Manager;
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DATE: September 24, 2013

SUBJECT: Regional Power and Transmission Policy Update

OBJECTIVE: Information Only

Issue

Management provides the Board an update on regional policy, legislative, and market affairs three times a year, in order to provide context for the business environment EWEB operates within as a way to aid the Board in its decision making. This update series rotates through these three topics each year so as to cover one in detail each time. In January, Management briefed the Board on the status of the Northwest power markets and in May we provided you with a legislative update on matters pending in Salem and Washington DC. We now want to provide you with a regional policy status on current issues that primarily involve BPA and FERC and a look ahead to what key topics we expect to focus on for Fiscal Year 2014.

Background

EWEB engages in regional policy work with other public, and sometimes investor-owned utilities, in the Pacific Northwest as a way to extend our political leverage. While we are the largest public utility in Oregon, we are not large compared to many other voices that impact our industry and it would be imprudent to incur the necessary cost to stand alone in addressing our interests with Legislative and Regulatory affairs. It would further be careless to ignore them entirely.

EWEB has recently begun to characterize our future risks as part of the preparation for the upcoming 2015 Strategic Plan, where we would like to reassess all aspects of our current plan to ensure it is guiding us to the future we choose for ourselves. The external risks that staff has identified as part of this process to date, include environmental, economic, technology-driven, and regulatory forces. Our regional policy work falls into the regulatory arena is dedicated to helping us identify external risks in time to respond to them and, where possible, help shape the outcome of the discussion that will result in new laws and regulations impacting our industry and our business.

Discussion

The following items reflect the current status on key topics that EWEB has been actively engaged in with counterparties across the region. Each of them has either direct or indirect financial implications to EWEB.

BPA Power and Transmission Rates for FY14-FY15

BPA's final Record of Decision (ROD), submitted to FERC in July, proposed a 9.6% average increase in power rates and 11% average increase in transmission rates for FY 2014/2015. The actual impact to each BPA customer is dependent on many factors including product selection, load profile, and non-federal resources. The majority of the 9.6% power rate increase is allocated to the flat "block" purchase as a result of the low market forecast for secondary revenue. The "slice" portion of our BPA purchases did not see a significant rate increase.

In this rate case, BPA changed the cost allocation methodology between its two transmission products - Point-to-Point (PTP) and Network Transmission (NT). The PTP rate increased 15.66% and the NT rate increased 9.5%. As an NT customer, EWEB will see a 7.6% increase to our transmission bill. Overall, the new BPA power and transmission rates combined will increase EWEB's customer's bill by about 1.75%.

Northwest Power and Conservation Council's (Council) 7th Power Plan

The Northwest Power Act (NWPA) requires the Council to develop a region-wide resource plan to ensure an adequate, efficient, economical, and reliable power supply for the region. Working with regional partners and the public, the Council evaluates energy resources, their costs, consumer demand, and emerging technologies to help determine an optimized resource strategy for the region.

The Council has begun development of the 7th NW Power Plan. This process is anticipated to take about two years tom complete and relies upon broad public participation to inform the plan and build consensus on its recommendations. EWEB is actively participating in the technical and strategic groups both as a way to inform and to learn. Internally, staff has developed the following principles and objectives to guide our input:

Principles:

- **Transparency** and access to materials and models
- **Consistency** in modeling assumptions and reconciling seams issues across models
- Use of Plan as **guideline** and not a prescriptive 'implementation manual' for each utility

Objectives:

At the highest level, EWEB's objectives from participating in the 7th Power Plan discussions can be boiled down to three major categories. Each has several sub-points that will undoubtedly be refined as the work continues.

1) EWEB would like to see **broad support** for the Council's plan, including both the models and underlying assumptions, as well as the resulting targets, and a firm understanding of the decisions and assumptions that went into it by those involved in the process.

2) Inclusion of an **adaptive strategy**, to accommodate both changes to key assumptions over time and to recognize key differences across utilities. This means that the plan itself has the flexibility built into it to remain robust through unexpected events – this could take the shape of triggers to reduce or increase targets or even a reopener if warranted. Risk assessment and scenario planning/ uncertainty analysis would be key components of this type of approach. In addition, targets should reflect the fact that different utilities have different resource portfolio and load growth positions and that the average probably doesn't well reflect any of them.

3) Address **capacity needs** and associated valuation regionally. We have heard a great deal of discussion about both peak and ancillary service/ flexibility shortages (for renewable integration, or "ramping") pending as a growing concern. Should reserve margins reflect flexibility needs in addition to capacity needs going forward? Should the 7th Plan set targets for DR? Should energy efficiency avoided cost be determined based on coincidence of end use load shapes with regional loads and/or wholesale prices. These topics should be thoroughly discussed and guidelines provided.

Columbia River Treaty

The Columbia River Treaty is an international agreement between Canada and the United States, ratified in 1964 for the cooperative development and operation of Columbia River Basin water resources to reduce the effect of floods and optimize hydropower generation. After September 15, 2024, the earliest the treaty could be terminated, Canada and the United States each have the option to terminate most Treaty provisions by providing a 10-year advance written notice. The U.S. Army Corps of Engineers (Corps) and BPA represent the United States as the "U.S. Entity" and work in concert with the State Department and National Security Council in official Treaty discussions with Canada.

The current Treaty flood control operations, which provide significant benefits to the United States, will expire in September 2024. Terms and conditions for ongoing flood control will need to be renegotiated, regardless of whether the treaty is terminated or not. In addition, U.S. operations of the Columbia River system for fisheries management have significantly reduced the original downstream power benefits of the Treaty. If the Treaty continues without modification post-2024, U.S. power utilities would remain obligated to deliver the current level of the Canadian Entitlement. The Entitlement represents a continuous power and energy delivery to the Canadian government paid for by Northwest electricity customers as compensation for the construction of the Canadian storage projects that improved flood control and increased hydropower generation in both countries. This compensation took the form of an initial lump sum payment ($64 million for 60 years of assured flood control) and Canada's share of the ongoing difference in hydroelectric power capable of being generated in the U.S. with and without the use of Canadian storage.

Based upon an extensive analysis of downstream power benefits by BPA, the remaining benefit of coordinated operations is minimal, while the costs imposed under the existing Treaty protocols is high. BPA has forecast the Canadian Entitlement payment in 2025 using existing methodologies to be 450 aMW with about 1,300 MW of capacity. Yet, BPA estimates the actual benefits to be only 90 aMW and 0 (zero) MW of capacity. If the Entitlement was based on the actual benefit, this would equate to a payment of 45 aMW or a ten-fold decrease in actual value from what is currently paid to Canada. By 2025 the U.S. would be returning to Canada approximately $250 to $350 million in value annually, despite the U.S. Entity's own estimate that the actual annual value of power benefit to the U.S. is only in the range of $50 to $60 million, of which Canada's share should be $25 to $30 million.

EWEB has joined the efforts of utilities that purchase federal hydropower, operators of non-federal hydropower facilities directly affected by the Treaty, or other river users in the "Columbia River Treaty Power Group", formed to ensure that Northwest electricity customers would have their interests represented in the Treaty review process. The central focus of this group has been to advocate for an adjustment in the Canadian Entitlement to be exactly one half of the actual annual power benefit.

However, in the recently formulated Draft Recommendation from the U.S. Entity to the State Department, it was suggested that the Treaty could be adjusted "to meet ecosystem-based function requirements." This is a great concern to EWEB and other power interests as it seems to ignore the significant investment made by NW electric ratepayers, over $700 million annually, to fund ecosystem improvements. EWEB has made comments to the U.S. Entity that these investments need to be properly recognized, and decisions of whether or not to create new ecosystem requirements should be considered outside the scope of treaty negotiations.

BPA's Debt Management:

BPA is scheduling a kickoff for its Debt Management and Access to Capital process in late October. The agency sees little hope Congress will approve more borrowing authority in the future and is said to be planning to push for significant revenue financing of projects through a public process. The outcome of these public discussions will feed into BPA's Integrated Program Review (IPR) next spring. The IPR occurs every two years, or just prior to each rate case, and provides participants with an opportunity to review and comment on BPA's program level estimates prior to spending levels being set for inclusion in rate cases. EWEB's objectives are to ensure that BPA is making prudent capital investments, the focus of the IPR, but can also improve relationships with BPA and help ensure the appropriate regional investments are made in the FCRPS by participating in this effort.

BPA's Generation Inputs (and Ancillary Services)

The uses of the Federal Columbia River Power System (FCRPS) to support the transmission system and maintain reliability are generally referred to as "Generation Inputs". Generation Inputs are required to provide Ancillary Service products. Rates for these products have been litigated in BPA's past rate cases; however, in this rate case the customers settled some of the rates. BPA forecasts show the demand for balancing services will exceed the ability of the FCRPS to provide the necessary capacity and energy required during the next rate period. Given BPA had never faced this situation, customers agreed to take the time to answer the question of whether loads or variable generation (or both) must pay for the costs of acquiring balancing capacity and energy from the market. These discussions are occurring and will likely continue into the new year. This is important to us because it will establish the formal value of capacity in the region and set the terms by which future capacity costs used for ancillary service provision are allocated to generation resources, such as new wind additions to the system, and existing load.

BPA's Oversupply Rate Case

BPA announced the Administrator will issue a draft Record of Decision in the OS-14 Oversupply Rate Case on November 16, 2013 and publish a final decision on January 21, 2014. While BPA has produced three separate proposals, in its last proposal consumer owned utilities would pay about 70% of the costs.

BPA has refined its processes over that past two year to ensure transmission system reliability and fish protection when there is too much power for the region to consume. As a result, they have significantly

reduced their projected annual oversupply costs. In 2011, BPA displaced approximately 97,500 MWhs of generation with energy from the hydro system. BPA's policy at that time, then called Environmental Redispatch, did not include a mechanism to reimburse generators for the cost of displacement. The magnitude of the impact to BPA customers depends on the water year. In 2012, the Oversupply Management Protocol (OMP) replaced Environmental Redispatch, and BPA displaced approximately 47,000 MWhs of generation with energy from the hydro system at a cost of $2.7 million. This year the costs were negligible.

Areas of Focus for 2014

Generation Inputs, BPA Debt Management and the IPR, the Columbia River Treaty, and the Seventh Power plan will continue to be areas of focus in 2014. In addition, EWEB will be working on the development and support of its Carbon Tax position, will continue to work to influence BPA's pricing and rules surrounding access to short-term transmission products, and will undoubtedly take-on new issues as they arise.

TBL Assessment

A TBL assessment was not conducted to provide this update. However, as management develops and articulates EWEB's position throughout the region, EWEB staff takes into consideration the impacts to us and to the region from all three perspectives - impacts to society, to the environment and to utility economics.

Recommendation

This information is provided for informational purposes only.

Requested Board Action

No board action is being requested at this time.