

**ACCESS TO FEDERAL POWER
BY
NEW PUBLIC UTILITY DISTRICTS**

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Biographical Information

Randy Hardy is the principal of Hardy Energy Consulting. In that capacity, he provides strategic advice to electric utilities, power marketers, independent generators and numerous other organizations participating in western power markets.

Mr. Hardy has over 30 years of experience in west coast power markets, including 13 years as CEO of Seattle City Light and the Bonneville Power Administration. He is a 1966 graduate of the U.S. Naval Academy and received his Masters in Public Administration from the University of Washington in 1972. He has also held numerous other leadership positions in the U.S. electric power industry, including Chairman of the Electric Power Research Institute (EPRI) and President of the American Public Power Association (APPA).

New Public Utilities

1. BACKGROUND

Over the past few months, several jurisdictions within Puget Sound Energy's (PSE's) service territory have expressed interest in forming publicly owned utility districts to provide electric service to retail consumers. One motivation for creating these new public utility districts (NPUDs) is the desire to receive low cost wholesale electricity from the Bonneville Power Administration (BPA).

2. DISCUSSION

These NPUD efforts are not new, but have received added impetus from PSE's pending merger with the Macquarie Consortium and the prospect of future power price escalation given PSE's need to acquire new generating resources.

While availability of low cost BPA power provides a significant incentive to form a NPUD, the obstacles to receiving BPA service are substantial, the ultimate result uncertain and timeline for becoming a BPA customer, even if successful, several years. Some of the issues to be addressed include:

(a) BPA Standards of Service

Before a NPUD can even apply to BPA for power it must meet six standards of service. The NPUD must:

- (1) Own its distribution system;
- (2) Demonstrate that it has taken all required steps under federal, state and local laws to authorize its formation as a public body;
- (3) Have obtained authorization to serve loads in its geographic territory (i.e. be constituted to perform its general utility responsibility). BPA standards specifically require that all legal challenges to such service be resolved before BPA begins service;
- (4) Have the ability to bill customers, issue bonds and sue and be sued;
- (5) Have an organizational structure to perform such utility functions as metering, billing and O&M on its distribution system (and related utility equipment); and
- (6) Be able to purchase power in wholesale amounts.

(b) Lead Time for Service

All the above standards must be met before the NPUD can even apply for BPA service. Once BPA determines that all the standards have been met, it requires three year's advance notice before the NPUD can start receiving low cost (Tier 1) BPA power.

While BPA is currently considering a minor change to their three year notice requirement, it would only relax that standard for new tribal utilities (and possibly small NPUDs) whose total load was under 10 average MW. This change would not affect any NPUD over 10 average MW, since the main purpose of the three year notice is to allow BPA to procure the most cost effective augmentation resources (to blend with its Tier 1 hydro) from the current high priced power market. Such advance notice thereby enables BPA to minimize the rate impact (of serving larger NPUDs) on its existing publicly owned utility customers.

These two processes – meeting the standards of service and advance notice for purchasing power from BPA – are sequential. Given the likelihood of disputes, and potential litigation, over issues such as the purchase price for PSE's distribution system, even reaching the point where a NPUD is officially eligible to take service from BPA will likely be several years.

(c) 250/210 MW for NPUDs

In its Regional Dialogue process for post-2011 power contracts, BPA has identified a total amount of 250 average MW by which it would be willing to augment the federal hydro system for NPUDs. However, BPA has already reserved 40 MW (of that 250MW) for tribal utilities until 2021. As a practical matter, this tribal reservation leaves 210 MW for new PUDs (for the first 10 years of the new power contract).

(d) 50 MW Phase In

In addition to an aggregate limit on power for NPUDs, BPA will only allow 50 average MW of NPUD augmentation in any two year rate period. For a large NPUD (e.g. an NPUD with 100 – 150 average MW total load) this restriction would result in a four year phase in period before that NPUD's total load would be served by low cost BPA power. If an NPUD's load was greater than 150 average MW (or grew to over 150 MW before or during the phase in period), the resultant phase in period would last six years.

Furthermore, if there were any competing requests for the 50 MW in any particular rate period (from other NPUDs or new tribal entities), BPA

would require that all power beyond the initial 10 MW for each NPUD be spread around (using a complicated formula) to all other qualifying applicants. This requirement could further lengthen the time required for a NPUD to receive BPA power for its entire load.

(e) Higher NPUD Rates for 3 – 7 Years

Given these BPA lead times and phase in requirements for service, it is quite likely that any NPUD would pay higher power rates for some interim period before receiving lower cost BPA power. The sequence of events could unfold as follows:

- The NPUD takes all the necessary steps (legal, financial and otherwise) to meet BPA's Standards of Service.
- Once certified (by BPA) as legitimate, the NPUD must wait a minimum of 3 years for any BPA Tier 1 (low cost) service. A large NPUD would have to wait as long as 7 years (the initial 3 year BPA notice period plus 2 – 2 year rate periods for full phase in) before receiving Tier 1 service for its whole load.
- PSE could probably take the position that, once an NPUD was certified by BPA, PSE no longer had any obligation to provide power, and the NPUD would have to acquire its own power supply (presumably from the market directly or from BPA at a market or near market rate). PSE could logically assume that, in the interest of keeping rates for its remaining retail customers as low as possible, it should use embedded cost generation (e.g. Baker hydro, Coalstrip) formerly used to serve NPUDs, for load growth of its existing customers. This lower cost generation would then be substituted for market purchases from new combustion turbines at \$75+/ MWh.
- On the other hand, the NPUD would have to pay market prices for all of its load for the 3 year notice period (for BPA Tier 1 service) and continue to pay market prices for some of its load throughout the BPA phase in period. Even if the NPUD melded its lower cost BPA purchases with market purchases, its overall rates to retail customers might well be higher (than existing PSE rates) for the duration of the BPA notice/phase in periods. In a large NPUD's case, this would mean higher retail rates for up to 7 years.
- Two factors make the initial 3 year exposure to market prices (for the NPUD's entire load) particularly problematic. First, oil and natural gas prices are increasing world wide at a dramatic rate. Since natural gas fired combustion turbines (CTs) are the only

viable baseload resource to meet future load growth, this trend has increased West Coast market prices from \$60/MWh to \$80/MWh in just the last few months. Second, given the policy positions of all three remaining Presidential candidates on limiting greenhouse gases, it is likely the U. S. will have some form of cap and trade system in place by 2010. Such a system would eliminate new coal plants and rely on natural gas CTs to meet load growth throughout the U.S. The resultant increased demand for natural gas would probably drive forward market prices above \$100/MWh.

- If these events occurred, and an NPUD had to meet its entire load with \$100/MWh power for the three year waiting period, that NPUD would experience a 40 – 50% retail rate increase during that time.
- Therefore, any NPUD could be exposed, not just to higher rates throughout the 3 – 7 year phase in period, but to dramatically higher rates for the first 3 years.

(f) Tribal Utilities

As described above, BPA has already set aside 40 MW for load growth from new tribal utilities. This reservation primarily applies to the Yakama Tribal Utility which formed during the current (2001 – 2011) BPA contract period, has a 7 MW existing BPA served load, but could grow to a 30 – 40 MW total.

However, other new tribal utilities could compete for the remaining 210 MW on an equal basis with NPUDs. Based on information from tribal representatives, only 2 – 3 additional tribal utilities (totaling probably 20 – 25 MW) seem likely to form over the next 5 – 10 years. However, there are 53 tribal entities in BPA's service territory, so their mere existence (and eligibility to compete for the 210 MW) create a significant source of uncertainty for any NPUD.

(g) Average System Cost (ASC) Effects

PSE receives rate equalization payments (under BPA's Residential Exchange Program) for its residential and small farm customers. The purpose of such payments is to share benefits of BPA's federal hydro system with all Northwest residents. They are designed to minimize cost differences between federal hydro generation and higher cost IOU thermal generation. Since BPA does not own any distribution, the payments do not include any distribution component (even though distribution costs typically make up roughly 30 - 50 percent of any retail utility's residential rate).

Due to the absence of any ASC distribution component, these payments alone would not likely equalize retail rates between PSE rates in those areas considering forming NPUDs and nearby existing PUDs. However, once you: (1) reduce PSE residential rates with BPA ASC payments; (2) add the cost of any NPUD hiring staff and purchasing PSE's distribution system; and (3) factor in the extended period during which the NPUD will have to carry those overhead/facilities costs before receiving BPA power for its entire load, it is at best unclear whether the power related rate benefits (even if the NPUD ultimately receives BPA power) will result in lower residential rates.

In theory, the NPUD's feasibility study should objectively evaluate these cost/rate tradeoffs. But several of the key variables for any such feasibility study (e.g. the purchase value of PSE's distribution system; the effect of competing requests for the 210 MW) will be at best only educated guesses. The result will be sufficiently wide margins of error as to severely limit the usefulness of any feasibility study for NPUD decision makers.

(h) Other NPUD Cost Exposures

Once formed, a NPUD would be subject to other cost exposures (previously applicable to PSE). Principal among these would be I-937 requirements to meet 15 percent of its load from renewable resources (probably wind) by 2020. Although this mandate only applies to utilities with more than 25,000 retail meters, most potential NPUDs would be large enough to require their compliance. Since delivered wind costs are currently in the \$90+/MWh range, and could go higher, this requirement would likely create significant upward rate pressure on NPUDs.

(i) Existing PUD Rate Impacts

Augmenting the federal power system by 250 MW for NPUDs will raise existing BPA rates by 8 – 10 percent (depending on whether BPA must purchase augmentation resources at current market prices, or likely higher prices in a greenhouse gas constrained environment).

While this impact is probably of little consequence to NPUDs, it leaves existing PNW publicly owned utilities distinctly ambivalent about NPUD formation. BPA's 50 MW per rate period phase in requirement exists, in large part, to minimize this rate impact. Although existing PUDs are unlikely to formally oppose creation of NPUDs, it is unlikely (with a few notable exceptions) that they will actively support NPUDs with the PNW Congressional delegation or in public forums.

3. CONCLUSION

Although the above description is not an exhaustive list of issues associated with formation of NPUDs, it is sufficient to draw four tentative conclusions:

- (a) Even if successful, it will probably take 5 – 10 years for any large NPUD to receive BPA service for its entire load. Such a timeline would involve 2 – 3 years upfront to form a retail utility, purchase PSE's distribution system and take the other steps necessary to qualify for BPA service. Added to this initial formation/qualification period would be 3 – 7 years, (depending on the NPUD's size and length of the resultant BPA phase in period), for the NPUD to actually receive BPA power.
- (b) Given that timeline, the likelihood of competing requests and the formation of new tribal entities, it is highly uncertain whether a NPUD would ever receive a sufficient BPA allocation to cover its whole load.
- (c) If PSE decided that, once a NPUD qualified for BPA service it had to acquire its own power supply, the NPUD would need to purchase power from the wholesale market for all of its retail load for 3 years and for some of its retail load (in a large NPUD's case) for another 4 years. As a result, NPUD retail rates would be dramatically higher (than PSE rates) for 3 years and significantly higher for the entire 7 year phase in period.
- (d) Any NPUD must carefully weigh the costs of hiring staff, purchasing PSE's distribution system and similar requirements for meeting BPA's Standards of Service against PSE residential rates being substantially reduced by BPA ASC benefits. If this evaluation is objectively made, it is by no means certain that the NPUDs final residential rates will be less than if they continue to buy power from PSE.