# Committee on Resources

## Subcommittee on Water & Power

---

## Witness Statement

---

**Testimony of James Sanders**
**General Manager**
**Benton County Public Utility District**
**Water and Power Subcommittee**
**House Committee on Resources**
**April 6, 2000**

### Introduction

Mr. Chairman, distinguished members of the Subcommittee, my name is James Sanders. I am the General Manager of Public Utility District No. 1 of Benton County, Washington. My utility is a Public Preference Customer of the Bonneville Power Administration (BPA). To put the size of my utility in perspective, our average annual energy purchases are approximately 200 aMW and our peak requirements are approximately 370 MW. I appreciate the opportunity to appear here today at this hearing.

The Pros and Cons of the Slice of System Product

My utility, like all other consumer-owned utilities in the Pacific Northwest, is actively preparing for electric industry restructuring. One of the key benefits of BPA's Slice product is that it provides utilities like mine with an opportunity to independently optimize the flexibility and price of our power portfolios for the benefit of our end-use customers. Public utility districts, municipals, and cooperatives owe it to their customers, some of whom are manufacturers and high-tech firms competing in an international arena (e.g., Boeing, Weyerhaeuser, etc.), to access the most cost-effective, creative and flexible electricity products available. My utility serves a large number of irrigation agricultural load and related firms such as UNOCAL. Our customers, who also happen to be our owners, are telling us that this is the direction that they want us to take with respect to power supply.

Some have asked the question of why smaller utilities like Benton PUD want to purchase Slice. The answer is that all consumer-owned utilities are going to need to respond to the challenges that electric industry restructuring will present. Even if restructuring legislation ultimately provides small utilities with the option of not participating in direct access, few small utilities are actually interested in exercising this option. Many of BPA's customers who have expressed interest in Slice serve primarily rural areas that larger investor-owned utilities have historically elected not to serve. The Slice product, with its operating flexibility, is the only currently available BPA product that enables us meet the changing needs of our end-use consumers.

We recognize that with the benefits of Slice come risks. Before I say anything further about the risks inherent under Slice, let me first say that the risks and rewards of purchasing Slice will be borne solely by my utility and ultimately our customer-owners. Purchasing Slice requires my utility to make a ten-year purchase commitment to BPA. There is not an out, and there is not an ability to shift costs to non-slice utilities. Purchasing the Slice product requires my utility, and all other purchasers of the product, to make a take-or-pay purchase commitment for our proportional share of BPA's revenue requirement for the term of

the power purchase agreement. This take-or-pay commitment includes all of BPA's costs including those directly related to power production, as well as non-power related costs such as fish and wildlife costs. Further, the greatest cost uncertainty a Slice purchaser will face will come from market purchase and sale activity, and changing hydroelectric generating conditions caused by variations in precipitation and future fish decisions. Managing the risks of these items are solely the responsibility of each Slice purchaser and are completely separate from the pool of costs that BPA allocates amongst its different customer groups in the rate setting process. It should be noted, however, that BPA itself, and ultimately each BPA public preference customers, faces all these same risks – with or without Slice. The only difference is who will manage the risk and how.

I recognize that purchasing Slice will expose my utility to market price and weather risks that BPA is currently managing on my behalf. My utility has been performing rigorous economic and financial analysis of the Slice product for over two years as part of our strategic resource planning process. My utility's commissioners, as well as our customer owners, have been actively involved throughout our strategic resource planning process. I believe that we are purchasing Slice with a full understanding of the risks and rewards of operating under Slice, including the volatility it will cause in my utility's purchased power cost and cash flow. In some years, I expect that we will pay more for power under the Slice product than what we would have paid had we simply purchased Preference Power under BPA's Partial Service product. In other years we will pay less. On average, we expect to pay about the same. But our interest in Slice is not about making money. Rather, our interest is in gaining the operational flexibility needed to serve our consumers.

When considering the risks that Slice presents, it is important to keep several items in perspective. First, it is important to note that the risks that a Slice purchaser will face are not new to the electric utility industry. Investor- and consumer-owned utilities (and power marketers) in the Pacific Northwest and throughout the United States, have been managing market price and weather-related risk since the inception of the industry. My utility has already begun discussions with financial advisors and power marketers on products that are available to help us manage the risks inherent under Slice. We also are currently in negotiations with an independent power producer to purchase output from a natural gas-fired combined cycle combustion turbine project (combustion turbine). Purchasing output from a combustion turbine is a good hedge against the risks that Slice will present. Additionally, my utility took the unique step in June 1998 of purchasing a one-third ownership share in a power management firm that has experience in operating electric systems such as Slice, and that is capable of helping my utility manage the risk that we will face under Slice.

Secondly, when making economic comparisons of Slice to BPA's other subscription products, it is important to make a distinction between the short- and long-terms. In the short-term, there can be significant differences between the cost of Slice and the cost of other Subscription products. BPA has the ability to draw on its financial reserves in the short-term to mitigate negative cost events resulting from unfavorable market prices, hydroelectric conditions and/or changes in river operations for fish. As a Slice purchaser, my utility will be required to build its own reserve account to mitigate these and other negative cost events, which we have already begun to do.

In the long-term, however, Slice does not carry any more risk than BPA's other subscription products. BPA does not pay its costs. BPA's consumer-owned, investor-owned and direct service industrial customers pay BPA's costs. If conditions cause BPA's costs to increase, whatever they may be, BPA will pass-on the higher costs to its customers in the form of higher rates. Conversely, if conditions cause BPA's costs to decrease, BPA will pass-on the lower costs to its customers in the form of lower rates. All of Bonneville's customers ultimately bear all of the benefits and risks inherent in operating the Federal generating system --

whether they purchase Slice or any other subscription product. Evidence of this fact is the Dividend Distribution Clause and Cost Recovery Adjustment Clause that BPA is proposing in the current rate proceeding.

I know that BPA has presented analysis that questions the economic viability of Slice. Because of BPA's ex-parte rules in effect, we have not had the opportunity to review BPA's analysis. However, BPA's analysis is based on a certain set of assumptions. Other reasonable assumptions can be made that remove any doubt about the financial viability of the Slice product. Prior to making a final decision on which subscription product to purchase, we will update our economic analysis of the product alternatives available from BPA one last time.

Again, however, any difference in the cost of the different subscription products will be a short-term phenomenon. There should be no difference between the cost of Slice and the cost of BPA's other subscription product in the long-term. Slice purchasers are getting a proportional share of the same generating system that BPA will use to meet all of its delivery obligations. Slice purchasers are paying a proportional share of the same revenue requirement as BPA's other customers, and Slice purchasers are going to buy and sell electricity in the same wholesale market as BPA to shape generation to load and dispose of surplus energy.

Resale of Federal Power

A number of misconceptions have arisen with respect to the potential for resale of Federal power under Slice. I do not believe that the Slice product will cause any Federal statues governing resale of Federal power to be violated. Most of the misconceptions result from two unique features of the Slice product. First, Slice product output is indexed to Federal generation and not to load. The product by itself does not follow load. Therefore, utility's purchasing Slice will be required to purchase and sell power in the wholesale market to shape generation to load. Second, Slice purchasers will receive a proportional share of all surplus power generated by the Federal system.

Firm Requirements Power. The amount of firm requirements power that may be purchased through Slice is limited to that portion of the customer's firm regional load that is eligible for service under section 5(b) of the Northwest Power Act. This statutory entitlement is known as the customer's "net requirement." A customer's maximum Slice percentage is equal to its net requirement divided by the generating capability of the Federal power system assuming critical water conditions. Since end-use customers demand that their service be maintained even in drought conditions, the Bonneville Project Act and the Northwest Power Act obligate BPA to supply preference customers' net firm requirement load with firm requirements power.

Slice customers will not resell Federal firm requirements power and cannot resell such power by law. The Slice contract contains provisions that ensure compliance with prohibitions on reselling such firm requirements power.

Surplus Power. There are many years when the Northwest is not in critical water conditions and the Federal power system generates energy in excess of firm requirements power. Energy in excess of firm requirements power is known as "surplus power." BPA sells this surplus power, when it is available, at market rates. The revenue that BPA derives from surplus power sales goes toward reducing BPA's power rates for their other power products.

The Slice customer does not receive any credit from BPA's sale of surplus power. (Before considering

resale of surplus power, the unit cost of Slice is approximately $5 per megawatt-hour higher -- approximately 23 percent higher -- than the equivalent cost for BPA's other customers.) Instead, the Slice customer receives its percentage of the generation output produced by the Federal power system, including the surplus power portion, and is responsible for re-marketing surplus energy.

The Slice product will not change the nature of surplus power sales. Surplus power will continue to be sold in its long-standing traditional markets. Surplus sales to California will remain status quo if BPA offers Slice. The total quantity of surplus power on the Federal power system is largely a function of the amount of Northwest precipitation and not a function of Slice or any other BPA subscription power product. Even if the Slice product could increase the amount of surplus power that Northwest utilities would wish to sell into the California market, the amount of surplus power that could be sold to California cannot increase because the California-Oregon Intertie is already filled to capacity at times when Northwest surplus power is available. It is also important to note that significant surplus power sales from California north into the Northwest occur regularly during the Northwest's winter peak period.

My utility does not own any of the transmission capacity that connects the Pacific Northwest with California. However, open access provides us with the same access to the California-Oregon Intertie as other non-intertie owning entities. We strongly believe in retaining the benefits of Northwest power for Northwest ratepayers and will actively look for opportunities to dispose of surplus energy in the Northwest. The fact that we do not own intertie capacity increases the need for my utility to pursue a strategy of selling surplus power in the Pacific Northwest to the maximum extent possible.

Finally, let me say that we intend to meet the same statutory requirements that BPA abides by when disposing of surplus energy.

Limitations on the Availability of the Slice Product

BPA should not arbitrarily limit the amount of power that it is willing to make available under any subscription product. Such limitations run counter to Federal and state legislative efforts to increase competition in the electric utility industry.

The amount of firm power that may be purchased through Slice, individually or collectively, is already statutorily capped by section 5(b) of the Northwest Power Act. The total amount of firm requirements power sold by BPA to all of its preference customers, including the Slice product, can be no greater than BPA's statutory obligations to furnish firm power. Unlike other BPA requirement products, the Slice product is further limited to a customer's firm net requirement in the first year of the contract and will not increase during the contract term, even while the customer's requirement load increases. This feature is unique to the Slice product.

A lot of BPA's customers have expressed interest in Slice. However, Slice does not fit every customer's needs and not all those who have shown interest will sign a Slice contract. Even if large amounts of Slice were purchased, such a development would provide great benefits to the Federal government by spreading risks and securing long-term agreements. Slice allows BPA to better manage its risks by increasing its overall diversification. Slice passes risk from BPA – and ultimately the Treasury -- to its customers.

It is also important to note that while Slice is new to BPA, it is not new to the Federal government. The Western Area Power Administration has been successfully selling a "Slice-like" product for a number of years. Additionally, my utility, along with other consumer-owned utilities, have been successfully

participating in mock Slice scheduling exercises with BPA for several months. The goal of these "dry runs" is to work through all the processes and details of operating under Slice well in advance of actual Slice implementation. The Slice dry runs have uncovered no insurmountable hurdles to making Slice a successful product for BPA and BPA's customers.

One of BPA's reasons for wanting to limit Slice sales is concern about the creditworthiness of Slice purchasers. We support a reasonable creditworthiness test so long as it does not require the waiver of our section 5(b) rights to purchase power from BPA. We recognize that Slice is a new product that will directly expose purchasers of the product to market price volatility and weather-related risks. Therefore, we believe it is appropriate for BPA to implement a reasonable creditworthiness test on Slice purchasers. Towards this end, we have been in negotiations with BPA for the past few months on such a test. However, we believe that a creditworthiness test should be applied to all of BPA's counterparties, including the agency's direct service industrial and investor-owned utility customers. As events during the past two summers have shown, electricity commodity prices are extremely volatile. Such volatility can very quickly deplete the financial resources of any entity participating in the electricity market. Such adverse financial results can occur for reasons totally unrelated to an entity's purchase from BPA, and BPA needs to be vigilant in monitoring the creditworthiness of all its customers.

No other requirements power product offered by BPA to Northwest preference customers has an arbitrary cap on sales, and the Slice product should not be treated any differently.

**Term of Slice Contract**

A ten-year contract is critical to my utility's ability to successfully purchase Slice. The primary reason is that a longer-term contract is necessary to average out financial outcomes through time. As I stated earlier, Slice exposes its purchasers directly to the market price and hydroelectric generating risks that BPA currently manages on behalf of my utility. The cost of Slice will be highly volatile, but on average is expected to be close to what my utility would have paid had it purchased Preference Power under BPA's Partial Service Product. A contract of less than ten-years increases the risk of my utility paying more for Slice than what we would have paid under other BPA products available to us.

A second reason for needing a ten-year contract is that my utility, along with several other consumer-owned and direct service industrial customers, are currently in negotiations with a merchant plant developer to build two, 250 MW combined cycle combustion turbines in the Pacific Northwest. Participating in a new generating project is a long-term commitment. My utility is looking at a 15-year commitment under a purchase from a combined cycle combustion turbine. In order to make a long-term purchase commitment from a generating asset, my utility needs the assurance that the Slice product will be available during most, if not all, of the term of the purchase commitment. Therefore, we support a 10-year term with a right to renew.

When considering the term of the Slice contract, an important issue to consider is that Slice is the only BPA subscription product that offers the flexibility necessary to cost-effectively integrate a generating resource to load. BPA's other subscription products do not offer similar flexibility. While it is technically possible to purchase output from a generating resource under BPA's other subscription products, the economic viability of such a strategy is diminished.

The Pacific Northwest is already resource deficit under certain extreme winter peak scenarios. BPA's own studies indicate that the magnitude of the potential deficit could exceed the Pacific Northwest's ability to

import energy from California. The Pacific Northwest needs new resources, yet no significant new development is taking place. My utility along with many of BPA's customers, have stated that we don't want BPA developing new generating resources. This raises the question of who will build new generating resources. My utility's participation in purchasing output from a new generating resource is contingent upon being able to purchase Slice. Slice offers the potential of improving system reliability in the Pacific Northwest, and the entire west coast by default as a result of the interconnected system.

The advantage of a 10-year contract from BPA's perspective is that it creates a portfolio of power sales contracts (most other BPA contracts are likely to be 3 to 5 years), thereby reducing the agencies overall risk.

**BPA Reserve Levels**

A number of questions have been raised about the level of financial reserves that BPA is projecting to accumulate during the Fiscal Year 2002 through 2006 time period. As a Slice purchaser, I do not have access to BPA reserve funds. Slice purchasers are required to carry their own reserve funds, and my utility has already begun the process of building-up such a reserve fund. My only comment on BPA's reserve levels is that any prudent business should maintain a reasonable contingency fund. With the increased volatility in market prices, it is probably appropriate for BPA to carry a higher reserve level than has been the case historically.

BPA Transmission Issues

Fiber Optics. BPA needs to install fiber optic cable for load control, monitoring and operations. Given the economies of scale associated with fiber, it makes economic sense to install standardized cable with more capacity than BPA's immediate needs. I believe it is sound public policy for BPA to use this surplus capacity to facilitate development of telecommunications products and services into the rural regions of the Pacific Northwest. We have a unique opportunity to bridge the "digital divide", and I strongly support taking advantage of that opportunity.

BPA Involvement in Regional Transmission Organization Development. BPA should be a participant in the RTO but not be the RTO. I believe that the key to developing a successful RTO is to have both transmission owners and users work collaboratively on RTO development.

# # #