Comments of the National Rural Electric Cooperative Association in Response to the "Defining the Future" Initiative

The National Rural Electric Cooperative Association ("NRECA") appreciates the opportunity to submit these comments in response to the Department of Energy ("DOE") Secretary Steven Chu's March 16, 2012 Memo ("Chu Memo") to the Administrators of the four power marketing administrations ("PMAs") as well as the subsequent DOE and the Western Area Power Administration's ("Western" or "WAPA") "Defining the Future" workshops and listening sessions.

I. Introduction

As will be explained throughout these comments, NRECA is concerned about the initiative laid out in the Chu Memo and the subsequent "Defining the Future" workshops and listening sessions in the WAPA region. In particular, the Chu Memo and "Defining the Future" initiative appear to reflect a misunderstanding of the PMAs, and WAPA in particular. This includes a lack of recognition of the PMAs' current and extensive activities to address many of the issues identified in the Chu Memo; the PMAs' relationship with and statutory obligation to preference customers; the PMAs' value to local consumers; and the importance of certain core principles to the PMAs' continued operation. In addition, elements of the initiative, as described in the Chu Memo, would violate the Flood Control Act of 1939, the Flood Control Act of 1944, the DOE Organization Act, the Water Resources Development Act of 1986, as well as numerous preference statutes and reclamation laws.

Furthermore, the reasons behind the initiative have not been made clear and appear to be continually evolving, having been stated differently in different contexts, including in the Chu Memo; Senior Advisor to the Secretary, Lauren Azar's April 26, 2012 Testimony before the U.S. House of Representatives Committee on Natural Resources; Secretary Chu's July

9, 2012 response letter to Members of Congress; and the DOE/Western Joint Outreach Team ("JOT")'s July 10, 2012 Defining the Future Workshop Pre-Read Materials.

Given that the PMAs' current activities already include efforts to address the goals laid out in this initiative, NRECA asserts that a change in course or focus as laid out in the Chu Memo would be counterproductive and serve no one, least of all the PMAs and their customers. The manner in which the initiative has been pursued has also been detrimental to success. Notwithstanding comments DOE made to the contrary at the Workshops, the Chu Memo and other initiative communications have created the clear impression within the preference community that preconceived and erroneous notions of how the PMAs operate have already served to formulate a "top-down" solution to problems that, to the extent they even exist, are already being addressed through the open and transparent "bottom-up" methods historically employed by the PMAs. The "solution looking for a problem" method employed in this initiative has only served to confuse, alienate and anger PMA customers and other stakeholders as evidenced by the lack of support for the initiative exhibited in the "Defining the Future" workshops and listening sessions as well as the comments submitted to the JOT so far. Thus, it is clear that this process is unlikely to reach a positive result from either a policy or public perception perspective and should be reconsidered.

If DOE decides not to terminate this initiative, it should start over based upon open discussions with the PMAs' preference customers, identifying with specificity a list of items sought to be addressed. Specifically, DOE and WAPA must articulate clear and specific goals for the initiative as well as the public policy objectives supposedly at the core of this exercise and establish a new process to discuss those goals and their implementation with PMA preference customers.

II. NRECA and its Relationship with the PMAs

NRECA is the national service organization representing more than 900 not-for-profit, member owned, member-controlled rural electric Cooperatives ("Cooperatives" or "Co-ops"). Most of NRECA's members are distribution Cooperatives, providing retail electric service to more than 42 million consumers in 47 states. NRECA members also include approximately 65 generation and transmission ("G&T") Cooperatives that supply wholesale power to their distribution Cooperative member-owners. Electric Cooperatives provide service to approximately 75% of the nation's land mass. Both distribution and G&T Cooperatives were formed to provide their members with adequate and reliable electric service at the lowest reasonable cost. For this reason Cooperatives evaluate opportunities and obligations from the perspective of whether they will provide certain, meaningful benefits to their consumers, either by lowering costs, increasing reliability or offering new service.

PMAs provide affordable power to more than 600 rural electric Cooperatives in 34 states. Cooperatives and the PMAs share a unique relationship and powerful bond built on shared principles. Indeed, the PMAs were founded on a partnership between electric co-ops, other preference customers, and the federal government, wherein the government invested in dams for flood control, recreation, and electricity generation and preference customers, including Cooperatives, agreed to buy the electric power at above market rates and repay through their power rates the federal government's original investment, in exchange for a guarantee of continued access to power and a promise of lower rates over the long term. This partnership, which remains intact today, helps Cooperatives keep electric bills affordable for consumer-members. At the heart of this relationship and agreement is an understanding that those who pay for the investment are to be the beneficiaries of that investment.

The PMAs are perhaps of more critical value to Cooperatives and their communities than to any other sector, because they provide low-cost, affordable power that would not otherwise be available in Cooperative communities. The mission of Cooperatives, to serve largely agricultural and rural areas of the country is still as vital a purpose as it was when the Rural Electrification Act was signed into law in 1936. Low-cost, affordable power is vitally important to rural communities and jobs providers given the current era of economic recovery following a devastating recession. Cooperatives and their consumers simply cannot afford to serve as a bank to fund each new Administration's policy priorities, no matter how much value they may have in the abstract, if those initiatives will raise costs for preference customers without any clear and direct benefits for those same customers.

III. The Initiative As Proposed Would Violate Core Principles of Federal Hydropower and the PMAs

Meeting the goals laid out in the Chu Memo in the manner described therein would violate the PMAs' statutorily-mandated roles and responsibilities. Certain core principles were carefully drafted into legislation that narrowly constrain the PMAs' lawful activities and sources of funds. While Secretary Chu recognizes that the PMA enabling statutes may prohibit some of the actions he envisions the PMAs taking,[1] the initiative thus far has not adequately recognized the limits of the PMAs' roles. These core principles are intended to direct the PMAs in their mission and cannot legally be overlooked. Moreover, those core principles have proven to be critical to the partnership between Cooperatives and PMAs and to the value of both the

[1] *See* Chu Memo at 4, "While continuing to market and deliver federal hydropower at cost-based rates, to the extent allowed by their enabling statutes and existing contractual arrangements, I am directing the PMAs to create rate structures that incentivize the following:".

PMAs generally, including WAPA, and the rural and economically challenged communities that they serve.

First among these principles is that preference in the sale of federal hydroelectric power and energy by the PMAs is to be given to public bodies and Cooperatives. These not for profit "preference customers" have come to rely on preference power to build and support rural and municipal communities across America. Any attempt to circumvent this principle by providing power to non-preference customers ahead of preference customers or selling preference power into a centralized market would violate this core principle and would deliver a serious economic blow to rural communities.

Second is the principle that the PMAs must provide power and energy at the lowest possible rates to consumers consistent with sound business principles. Rate schedules are drawn to recover only the cost allocations and interest levels authorized by Congress. This principle clearly limits the authority of the PMAs to add additional costs that have not been approved by Congress. The lowest possible cost principle is key to the relationship forged between the PMAs and Cooperatives. Without it many of the communities served by Cooperatives would be economically crippled. A fundamentally sound business principle is that those who pay for investment are to be the beneficiaries of that investment. Contrary to this principle, the initiative appears to be geared toward shifting costs of third party generation and transmission to the PMAs' customers. This is clearly in violation of this very important business principle.

Third, and finally, is that the PMAs are administered through local control and local operation. To this end they have established local offices that have built close relationships with local preference customers. Local operation is necessary to reflect the difference in state policies, resources, grid connections and economic arrangements with customers across the PMAs. The regions within the PMAs themselves also reflect the different statutory obligations of different projects and any related obligation to handle costs and budgets differently.

In drafting its recommendations to the Secretary, the JOT must be cognizant that it may not take any action that would violate these core principles.

IV. The Initiative is Unneeded

The Chu Memo and the "Defining the Future" initiative process has thus far not provided sufficient explanation for why the initiative is needed, despite citing an ever-changing array of purported justifications, including the June 29, 2012 *derecho* storm in the Mid-Atlantic. However, the Chu Memo and the manner in which the initiative has been carried out have failed to recognize the ongoing efforts of the PMAs, and in particular WAPA, to meet many of the goals outlined in the Chu Memo. Contrary to the implications in the Chu Memo and Ms. Azar's Testimony, the PMAs are addressing transmission upgrades at the same pace, or in advance of, other electric utilities in the U.S. There is absolutely no evidence that the PMAs are out of step with other utilities or somehow not in compliance with federal policy regarding transmission investments. Significant new transmission investments have been undertaken in the region. For example, WAPA has actively participated in the Transmission Infrastructure Program ("TIP") implemented under the American Recovery and Reinvestment Act.

The PMAs, including WAPA, have been, and are continuing to, make great efforts to integrate new resources, including increased levels of variable renewable resources such as wind and solar power. For example, the Upper Great Plains Region ("UPGR") Eastern Division preference customers of Western have developed or purchased over 700 MW of wind power, achieving a penetration rate of 23.7%.

WAPA also has worked diligently at building and maintaining a culture of compliance with North American Reliability Corporation ("NERC") and Western Electrical Coordinating Council ("WECC") Reliability Standards. Furthermore, and despite statements indicating the contrary, intra-hourly scheduling is already being implemented in the West. In addition, in Order No. 764 the Federal Energy Regulatory Commission ("FERC") has already addressed intra-hour scheduling by instituting reforms requiring public utility transmission providers, which through their reciprocity OATTs would implicate the PMAs, to offer intra-hourly scheduling by June 24, 2013.

WAPA's 2011 Annual Report makes clear that it is actively participating, and in many cases leading, in addressing the issues identified in the Chu Memo. At page 14 the report highlights WAPA's efforts to interconnect power resources for future need and efforts to expand the Bulk Electric System by building transmission lines and interconnecting new and existing energy resources collaboratively with WAPA customers. At page 10 the report discusses WAPA's efforts to operate the grid with renewable energy in mind and WAPA's addition in July 2011 of intra-hour scheduling to make the transmission and scheduling services WAPA provides even more flexible for customers. At page 18 the report indicates WAPA has completed its Reliability Centered Maintenance consolidation project to improve WAPA's compliance with regulatory requirements, improve its maintenance program documentation to assist in compliance audits and enable more systemic maintenance practices and goals. Finally, at page 19 of the report WAPA discusses its successful efforts to connect six Federal agencies with renewable resources by coordinating Renewable Energy Credit purchases.

In addition, the Western States Power Corporation, composed of preference customers, has invested hundreds of millions of dollars in WAPA, Corps of Engineers, U.S.

Department of Energy and U.S. Bureau of Reclamation facilities as part of coordinated modernization effort, conducted on a cooperative basis. Cooperatives are also doing their part on their own. At least 441 Cooperatives currently have AMI/AMR Smart Grid technology already deployed either wholly or partially across their systems, with another 23 working on deployment. Over 512 Cooperatives offer one or more types of demand-side management programs to members and 729 Cooperatives offer one or more energy efficiency programs to members. This results in 93% of WAPA's Cooperative preference customers offering some sort of energy efficiency programs to members. With regard to renewables, as of May 2012, Cooperatives owned or purchased nearly 4,100 MW of renewable capacity beyond their roughly 10,000 MW of carbon free preference power purchases.

V. JOT Must First Endeavor to Do No Harm

Any actions taken under this initiative must operate consistent with the key goal of first doing no harm. As stated elsewhere in these comments, NRECA does not believe this initiative as laid out in the Chu Memo and as it has been pursued in the "Defining the Future" workshops and listening sessions is warranted. It is unneeded; the PMAs, and in particular WAPA, are already tackling these problems consistent with the "bottom up" approach utilized for PMA projects; and accomplishing the goals in the manner laid out in the Chu Memo would violate the core principles under which the PMAs must operate. Nevertheless, unless DOE discontinues this process, the JOT will be required to provide recommendations to the Secretary. Despite indications to the contrary, these recommendations to the Secretary must not be inconsistent with the core principles outlined above. In addition, the recommendations must recognize the extraordinary efforts WAPA and WAPA's preference customers have undertaken toward the goals outlined in the Chu Memo and must not undo or interfere with these ongoing efforts. Any recommendations to the contrary would be counterproductive, wasteful and contrary to U.S. law as explained above.

Efforts to implement such recommendations would also lead to political backlash and litigation that would slow or stop ongoing positive efforts by the PMAs that are consistent with the goals of the Chu Memo. That result would be highly unfortunate as those ongoing efforts are being appropriately developed, evaluated and implemented in partnership with the preference customers and with the input of stakeholders through the PMA regions and have potential significant value for all involved.

VI. Initiative Issues That Cannot or Should Not be Addressed by the PMAs

Some of the concepts discussed in the Chu Memo and other initiative materials are either not appropriate for the PMAs to address or are not at a stage where implementation is warranted. In the case of the former, the JOT should recognize the statutory limits of the PMAs and in the case of the latter the JOT should recognize the practical limitations of technology and the limited time provided to address complex issues. In neither instance should these issues be addressed by DOE and WAPA at this time.

Chief among these issues is the implementation of an energy imbalance market ("EIM"). The Chu Memo seems to have prejudged WAPA's decision to move forward with an EIM, which is in error. This concept has been inadequately studied up to this point, but all credible analyses developed have either been inconclusive or shown that costs to WAPA preference customers would exceed any illusory benefits under an EIM. WECC's study commissioned in October 2011 resulted in a range of $941 million of net benefits and $1.25 billion of net costs. The study was, however, deeply flawed in several ways, including that it fails to take into account a number of steps the industry in the West, including WAPA, have taken to improve the efficiency of the grid, including intra-hour dispatch and dynamic scheduling. The study released by DOE's National Renewable Energy Laboratory ("NREL") is also similarly flawed. As a result, both of these studies overinflate the potential benefits and should be redone in a manner that reflects grid realities. Even Secretary Chu acknowledges that the collaborative process to institute an EIM will increase costs immediately and in the near term.

The initiative should also recognize that FERC has recently opined on the need for an EIM. In Order No. 764, wherein FERC required public utility transmission providers to provide intra-hourly scheduling by June 24, 2013, the Commission declined to require additional reforms to move toward an EIM, such as an intra-hour imbalance settlement, an intra-hour transmission product, increasing the frequency of resource commitment through sub-hourly dispatch and the formation of intra-hour imbalance markets, finding that any marginal additional benefits these additional reforms would provide did not warrant the additional costs they would impose.[2]

In addition, WAPA's obligation to provide power and energy at the lowest possible rates to consumers consistent with sound business principles would seem to bar WAPA from participation in a market that guarantees that the highest offer price for the last megawatt hour dispatched to serve demand in a given hour would be paid to all megawatts sold in the market, guaranteeing that all resources other than that setting the price would earn more than their offers to sell. Finally, such a market would undoubtedly shift costs to customers in the WAPA region.

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[2] *Integration of Variable Energy Resources*, Order No. 764, 139 FERC ¶ 61,246 at P 98 (2012).

Another concept that should be shelved for the time being is the consolidation of existing balancing authorities ("BAs"). Sufficient time has not been provided in this process to adequately consider this far-reaching, complex proposal. Drafting or following through on recommendations regarding this initiative without adequate further study could lead to unintended and disastrous consequences, including reduced reliability.

The Chu Memo also contemplates the PMAs tackling retail issues including energy efficiency and demand response, for which they are ill equipped. The PMAs were authorized by Congress as providers of wholesale generation and transmission services and, as such, they have a limited market presence that does not include provision of retail services outside of providing power for summer irrigation. While DOE may believe that the pre-existing, statutorily-mandated requirement for integrated resource planning ("IRP") already grants WAPA authority to somehow direct customers to increase the use of efficiency, demand response, and to integrate electric vehicles, the current Energy Planning and Management Program ("EPAMP"),[3] does not give WAPA such broad powers. EPAMP requires preference customers to establish a process to consider their resource options and to develop a resource plan; it does not set WAPA up as a public utility commission with the power to amend preference customers' IRPs. Even if the Hoover Powerplant Act would permit WAPA to exercise such authority, a full Administrative Procedures Act-compliant process would be required to consider such changes to the program.

Of course, however, no such change is needed to address the Chu Memo's retail objectives. There is already a great deal of work being done by preference customers in the WAPA region to aggressively implement energy efficiency and demand response. In fact, the

[3] 10 C.F.R. pt. 905 (2011).

demand response efforts in the UGPR of WAPA were implemented in a more comprehensive manner and far earlier than in other regions of the United States.

Secretary Chu's initiative to direct the PMAs to take actions to minimize rate pancaking should also be shelved for the time being. Although the Chu Memo indicates that this should not be viewed as a call for the creation of a regional transmission organization, this directive is far too undefined and any solution could be far more complex that the time allowed would permit for full consideration.

The initiative further contemplates changing the PMA's, including WAPA's, rate design to provide incentives for new resources. As addressed elsewhere in these comments, WAPA is statutorily obligated to provide power and energy at the lowest possible rates to consumers consistent with sound business principles. Providing incentives to others would by definition violate this principle. And, therefore, preference customers would be subsidizing renewables development, energy efficiency, demand response and electric vehicle programs whether or not they receive any benefits.

Finally, the initiative contemplates WAPA gaining Congressional approval for a revolving fund similar to that of the Bonneville Power Administration that would allow it to fund capital improvements. As is obvious, nothing the JOT or DOE does in this process can make this a reality short of Congressional action. The preference customers oppose the creation of a revolving fund in the WAPA region as unnecessary and these customers will oppose any such legislation. DOE should instead focus on getting Congressional approval for normal capital investments.

VII. A New Process is Warranted

As indicated previously, the Chu Memo and "Defining the Future" process has only served to confuse, alienate and anger PMA customers and other stakeholders. Based upon reports from its members, NRECA has confirmed that the vast majority of participants in the "Defining the Future" workshops and listening sessions have expressed deep concern about the assumptions that have been made about the manner in which PMAs operate and the seemingly foregone conclusions that have been made. In addition, participants have been frustrated by a procedural process that has been unnecessarily rushed and lacking in true opportunity for **meaningful** input from preference customers and other stakeholders. An initial review of the comments submitted to the JOT thus far confirms these general sentiments.

Thus, it seems clear that DOE must reassess its goals at this point. First and foremost DOE must reset its expectations. The "top-down," "solution looking for a problem," "sea change" methods encompassed by the initiative thus far will not work. If DOE wishes to move forward on an initiative akin to that laid out in the Chu Memo, it must start anew. A new open and meaningful process should be initiated that begins by working with technical experts within the preference community to shape objectives, perform proper analysis and develop appropriate implementation processes for those objectives that pass muster. Working toward a few incremental positive steps, reflecting the recommendations of preference customers would result in solutions that address any existing problems and avoid duplication of efforts and inefficiencies

VIII. In the Absence of a New Process, the Current Process Should Track the APA

NRECA notes that these comments are submitted by August 17, 2012, the deadline established for comments by the JOT. NRECA understands that the comments submitted in this process and the feedback presented in the "Defining the Future" workshop breakout sessions will be utilized in developing the JOT draft recommendations to be published in the Federal Register for formal comment. *See* July 10, 2012 JOT Defining the Future Workshop Pre-Read Materials at 4. NRECA appreciates, and looks forward to, the opportunity to submitting formal comments on the draft recommendations. However, NRECA is concerned that during the "Defining the Future" workshops JOT members indicated that as little as two weeks would be permitted for the draft recommendation comment period. NRECA believes that 60 days is an appropriate for this comment period if the JOT is truly interested in the views of the stakeholders and preference customers. At a bare minimum 30 days should be permitted.

NRECA expects that the comments submitted on the draft recommendations will be utilized in formulating the final recommendations and that the Federal Register notice containing the final recommendations will discuss the comments DOE receives on the draft recommendations and will explain why the JOT accepted or rejected those comments in developing the final recommendations. NRECA also expects that the final recommendations will be published in the Federal Register with an appropriate comment period of 60 days, or at a minimum 30 days, for stakeholder and preference customer input to the Secretary. Only such a process, that tracks the requirements of the Administrative Procedure Act ("APA") for formal rulemakings, would provide the transparency that DOE has said it supports in this process.

IX. Conclusion

In conclusion, NRECA wishes to reiterate its concern with the Chu Memo and the WAPA "Defining the Future" initiative. NRECA believes that, as proposed, the initiative could violate core principles of Federal hydropower and the PMA enabling statutes. This is particularly troubling to NRECA given that the initiative is not necessary to address the goals of the Chu Memo in a collaborative, bottom-up process. NRECA believes that the initiative could, in fact, subvert activities currently underway at the regional and local level to address the Chu Memo objectives. Furthermore, NRECA believes that several of the initiative concepts are either not appropriate for the PMAs to address or are not at a stage where implementation is warranted. NRECA strongly believes that a new process is needed if the DOE wishes to move forward with this initiative. Absent that, NRECA asserts that this process must track the requirements of the APA in order to result in reasoned decisionmaking that can withstand legal scrutiny. As such, NRECA urges the JOT, in drafting its recommendations, to remain cognizant of the statutorily defined role of the PMAs and avoid making recommendations that would be counterproductive to the work already being done at the regional and local level.

Respectfully submitted,

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