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13 January 2004

Mr. Robert J. Pellatt
Commission Secretary
British Columbia Utilities Commission
PO Box 250
600 – 900 Howe Street
Vancouver, BC V6Z 2N3

Dear Mr. Pellatt:

**RE: British Columbia Hydro and Power Authority (“BC Hydro”)
Call for Tenders for Capacity and Associated Energy on Vancouver Island**

BC Hydro is pleased to reply to the comments of Bidders and comments of other interested parties, and to provide herewith documents relating to the revised Call for Tenders for Capacity and Associated Energy on Vancouver Island (“CFT”), which BC Hydro is requesting that the British Columbia Utilities Commission (the “Commission”) approve. The documents are listed in Appendix A.

The Regulatory Process

In its letter of 7 January 2004, BC Hydro asks that the Commission approve the terms of the CFT, including the evaluation criteria and methodology, the related documents, and the CFT schedule. BC Hydro’s letters to the Commission of 11 December 2003 and 7 January 2004 set out the reason for seeking this early approval, the proposed approval process to be followed, and noted the need to be sure that the regulatory process is consistent with the CFT process itself. Together, these parallel processes have provided ample opportunities for Bidders and other interested parties to participate in the development of the CFT, and to make their views known to the Commission and to BC Hydro.

The Commission has discretion on matters of process. The regulatory process followed here was fair, necessary and appropriate for the reasons set out in BC Hydro’s letters of 11 December 2003 and 7 January 2004.

In the CFT, BC Hydro has developed a fair and competitive process. BC Hydro has provided information on the CFT process continuously since its release, posted all questions and answers, held Bidder workshops and a forum, and considered all comments received from both Bidders and other interested parties. The first round of

Bidder comments and BC Hydro's responses to each of them was filed with the Commission on 15 December 2003. The final Bidder comments are enclosed herewith and BC Hydro's reply to some of the recurring themes can be found in Appendix B.

A number of first round comments are reflected in the changes to documents listed in Appendix A. Where a comment has given rise to other specific action that has been noted in Appendix C. However, BC Hydro has not sought to address every comment here. Some have been the subject of a previous BC Hydro response and others are simply argument on which BC Hydro believes its position and supporting rationale are clear and well founded. BC Hydro has noted either here or in its previous responses, all of the comments it has accepted. The lack of reply here is not to be taken as acceptance of any other comment by BC Hydro.

The Vancouver Island Generation Project ("VIGP") Decision

In the VIGP Decision, the Commission Panel encouraged BC Hydro to design the CFT to: (1) find the most cost effective new generation capacity on Vancouver Island, (2) do so using simplified evaluation methodology, and (3) do so expeditiously, in view of the critical timing imperative. In particular, the Panel made the following findings:

- There is a need to move expeditiously to reinforce electricity supply to Vancouver Island prior to the winter of 2007/08.
- The appropriate next resource addition should be on-Island generation, provided the proponents' projects can be confirmed near their expected values.
- The CFT need not be supported by a Resource Plan.
- BC Hydro is encouraged to proceed with a CFT on the schedule set forth in the hearing.
- Projects should have an aggregate capacity of at least 150 MW.
- Given the Commission panel's determination that the logical next resource addition is on-Island generation, it should be possible to develop a simplified Net Present Value ("NPV") model specifically for the CFT.
- It is the Commission Panel's impression that Bidders into the CFT can anticipate a fair and transparent process, especially given BC Hydro's willingness to engage an Independent Reviewer and the Commission's eventual review of a Certificate of Public Convenience and Necessity ("CPCN") application or Energy Purchase Agreement ("EPA") filing.

BC Hydro has designed the CFT to reflect these findings, and many of the comments received seek changes that are inconsistent with them. In each case BC Hydro has carefully considered whether the concern expressed can be addressed, wholly or partially, without compromising the related Commission finding. In those cases where it can, accommodations have been made. To some extent, tensions are inevitable. However, changes that depart from the Commission's expressed principles of simplified evaluation methodology and an expeditious process would risk compromising the ability of BC Hydro to meet its obligation to serve the ratepayers of Vancouver Island.

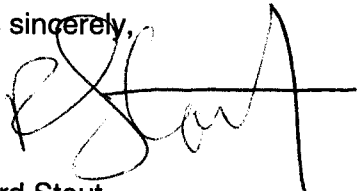
The VIGP Panel recognized the need for a CFT process that would allow BC Hydro to avoid the risk of a capacity shortfall on Vancouver Island and be understandable to suppliers and customers. To that end, the Panel accepted an expedited process and sought a simplified evaluation methodology. There is, of course, a trade off to achieve those objectives; but here BC Hydro believes little has been lost in completeness, and further delay would create an unacceptable risk to customers that BC Hydro would be unable to meet Vancouver Island peak load.

Conclusion

BC Hydro believes that the CFT process approvals it seeks will ensure the development of a cost-effective approach to the urgent challenge of meeting the electricity needs for Vancouver Island in 2007. By approving, at an early date, the CFT and related documents, including the schedule and the evaluation methodology as requested, the Commission will remove some of the regulatory risk to Bidders, which will ensure that the competition remains keen, and the best price is achieved for BC Hydro's ratepayers. Extending and adding formality to the process, as sought by R.B. Wallace, on behalf of NorskeCanada, and echoed by several non-Bidders would serve no valid objective, would frustrate the competition generated by the CFT and would jeopardize BC Hydro's ability to have the new supply needed for Vancouver Island by May 2007.

Twenty-three prospective Bidders have registered for the CFT. That is a strong indication of robust competition, which can only benefit BC Hydro's ratepayers. We believe that the NPV evaluation methodology is well designed to identify the most cost-effective solution from those who submit bids.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'R. Stout', written over a horizontal line.

Richard Stout
Chief Regulatory Officer

Appendices (3) and Enclosures (8)

APPENDIX A Documents Filed

Pursuant to the schedule in BC Hydro's letter of 11 December 2003 and accepted by the Commission, the following documents are attached:

1. Bidder Reply/Comment Forms received by BC Hydro by 4:00 p.m. on 9 January 2004, together with Reply/Comment Sheets;
2. BC Hydro Call for Tenders for Capacity and Associated Energy Supply on Vancouver Island, issued 31 October 2003, and Addenda Numbers 1 to 7 inclusive (this material has previously been available to the Commission and is enclosed for convenience);
3. Addendum Number 8, issued 13 January 2004, containing revisions to the CFT arising from our review of the Bidder Comment/Reply Forms and correspondence from interested non-Bidders received by 4:00 p.m. on 9 January 2004;
4. Revised Pre-Qualification Submission Forms/Instructions, issued 13 January 2004, in clean and black lined form;
5. Revised Preliminary Form EPA, issued 13 January 2004, in clean and black lined form;
6. Revised CFT Appendix 6 – Summary of Seller EPA Performance and Delay LDs, Liabilities and Securities, issued 13 January 2004, in clean and black lined form;
7. Revised CFT Appendix 7 – Preliminary Form VIGP Transfer Agreement, issued 13 January 2004, in clean and black lined form; and
8. Revised CFT Appendix 8 – EPA Pricing Structure, issued 13 January 2004, in clean and black lined form.

The black lined versions of the Revised Pre-Qualification Submission Forms/Instructions and of Appendices 5 to 8 (inclusive) show changes made to reflect the comments received that BC Hydro believes improve the CFT.

Each Bidder Reply/Comment Form consists of a "Bidder Information Sheet", which identifies the Bidder, and a "Reply/Comment Sheet" containing the replies and comments. Comment ID numbers in the Reply/Comment Sheets identify the reply or comment by reference only to the number in BC Hydro's Response to Bidder Comments filed and posted on 15 December 2003. Comments on the Quantitative Evaluation have been identified with the appropriate Bidder number followed by "EVA" and a comment number. One Bidder comment was received after the 9 January 2004 deadline, and, on the advice of the Independent Reviewer, has not been considered. For completeness, it is enclosed.

Before considering Bidder replies and comments, BC Hydro separated the Bidder Information Sheets from the Reply/Comment Sheets, so that BC Hydro personnel considering the replies and comments could do so without attribution to the Bidder. However, in accordance with Addendum Number 5 and the procedure settled with the Commission, we are filing the entire Bidder Reply/Comment Form with the Commission. We request that the Commission keep the identity of Bidders confidential.

BC Hydro also confirm that this letter and the enclosures, other than the Bidder Information Sheets and documents already available on the Vancouver Island Call for Tenders ("VI CFT") website, are to be posted to the VI CFT website today (13 January 2004).

APPENDIX B
Reply to Comments Received by 9 January 2004

Objectivity of Evaluation Methodology

The mandatory criteria and methodology seek to minimize the costs to ratepayers by identifying the portfolio with the highest value to the BC Hydro system. The methodology is based on a common set of clearly disclosed assumptions, inputs and criteria including full disclosure of related gas and electricity prices, and discount rates. These are described in CFT Addendum 1 – Quantitative Evaluation Methodology, which is posted on our VI CFT website. The evaluation model has been provided to and reviewed with Bidders. The evaluation takes into account a wide range of gas and electricity price forecasts in order to evaluate the uncertainty to which BC Hydro ratepayers may be exposed under various portfolio options.

The CFT is designed to accommodate a wide range of new capacity supply options from proven technologies. This is reflected in the fact that there is a wide range of projects registered for the CFT. It is structured to be indifferent to project size or type of fuel other than on the basis of the net price of the dependable capacity. Tenders will be compared using a simplified NPV portfolio analysis to determine the most cost effective portfolio of projects.

Why is BC Hydro valuing energy as well as capacity?

The energy associated with the capacity under the CFT is evaluated by comparing its value to expected future market prices. While the call is for capacity, BC Hydro will recognize the value of any energy that is associated with a capacity bid to the extent that this value (on a risk adjusted basis) reduces the net cost of capacity. This creates opportunities for lower cost for ratepayers to the extent that some capacity costs can be offset by energy values. In terms of valuing the energy, five scenarios that represent the opportunity cost of new supply purchases for BC Hydro are considered. They cover a range of expected future prices beyond our current acquisition price; reflecting the significant uncertainty about the cost of new supply.

Why is a Transmission Deferral Credit included but no provision for the staged addition of capacity resources?

The CFT Evaluation Methodology uses a transmission deferral credit to value the benefit of capacity tendered under the CFT in excess of the minimum 150 MW needed in 2007 to offset the retirement of the HVDC cables. This evaluates the opportunity of deferring future Vancouver Island capacity additions incrementally from 2009 when they would otherwise be required, by capacity in excess of 150 MW.

The approach provides a basis to test whether a larger portfolio offers a lower cost solution than a smaller portfolio. BC Hydro still retains the option for the earliest in-service date of the transmission option in the event a smaller portfolio is more cost effective.

Several registered Bidders have commented that the CFT does not provide for the staged addition of capacity resources. Such a provision would expand the scope and complexity of the CFT.

The objective of the CFT is to solve the capacity shortfall in 2007 in the most cost effective manner. The “cost effective” component of the objective is the reason that the CFT defines a range of eligible portfolios of dependable capacity (150 MW – 300 MW) to be in service in May 2007. Limiting eligible portfolios to exactly 150 MW would be an unmerited constraint and might preclude the most cost effective solution. Accepting an aggregate of less than 150 MW would not solve the capacity shortfall in 2007. 300 MW also allows an Independent Power Producer (“IPP”) to make a bid utilizing the VIGP assets.

Why is Demand Side Management (“DSM”) not included?

The CFT for on-Island generation is one of several complementary activities being pursued to meet Vancouver Island’s electricity requirements. In addition to the CFT, Power Smart programs are expected to deliver demand side savings in excess of 100 MW, which are already included in the load forecast for Vancouver Island. BC Hydro is also planning rate design changes to capture additional savings through load management.

Capacity is needed beyond that which DSM activities can provide. BC Hydro’s current DSM activities through Power Smart are aggressive and include a price cap that equates the cost of DSM to the expected new cost of supply. To expand the current target for DSM would exceed the price cap and could impose additional costs and rate-impacts in excess of expected new generation capacity costs.

Further, the Commission, in its 8 September 2003 decision on VIGP, concluded that, “no contracted demand reductions should be added to dependable supply” and “peak shaving measures should not be included until they have been demonstrated to be reliable and a normal means for reducing firm peak loads”. Short-term, day-by-day load curtailment is particularly inappropriate where the new capacity is required in order to replace existing supply infrastructure.

In its decision, the Commission Panel found “that the logical resource addition is on-Island generation”. Based on that finding it concluded that, “it should be possible to develop a simplified NPV model specifically for the CFT.” Introducing DSM would be contrary to the Commission’s finding and would introduce unacceptable complexity to the CFT.

Why is BC Hydro seeking only on-Island generation?

Whether or not new generation for meeting Vancouver Island’s future capacity requirements should be located on Vancouver Island received significant attention in the VIGP hearing. In its decision, the Commission expressed its clear preference against further consideration of transmission alternatives necessary to support Mainland generation. BC Hydro has taken guidance from that decision.

Specifically, the Commission said at paragraph 9.1 that “The evidence in this hearing suggests that the appropriate next resource addition should be on-Island generation.”

And at paragraph 9.4: “The NPV model should be available to Bidders in advance and the Commission Panel believes it could be limited to on-Island generation costs...”.

Of the transmission line, the Decision says at paragraph 6.2.5: “The Commission Panel recognizes that the 230 kV line option may be the best reliability reinforcement if on-Island generation becomes prohibitively expensive.”

As noted above, Vancouver Island’s capacity needs are expected to grow. Depending on the capacity acquired through the CFT, the 230 kV cable may be required as early as 2009. BC Hydro has instructed the British Columbia Transmission Corporation (“BCTC”) to maintain the option of achieving the earliest in-service date.

The role of the Independent Reviewer (“IR”)

In the VIGP decision the Commission Panel stated its “impression that Bidders into the CFT can anticipate a fair and transparent process, especially given BC Hydro’s willingness to engage an Independent Reviewer ...”. It also stated that, “the Commission Panel does encourage BC Hydro to select an Independent Reviewer as set forth in Schedule A, Section 7.1 ...”

PricewaterhouseCoopers (“PwC”) was selected to be the IR pursuant to a competitive Request for Proposals (via the BC BID website). PwC is assisted by Merrimack Energy (“Merrimack”), who acted in this capacity in recent calls for Hydro Quebec and Portland General Electric. PwC and Merrimack were found to be the most suitable candidates based on their experience, qualifications and proposal.

The IR is charged with determining the fairness of the CFT process. In order to report at key stages, the IR sees all information, and monitors all actions that BC Hydro takes in developing and executing the CFT and in responding to Bidders. The IR actively monitors each phase of the process, providing feedback to BC Hydro whenever it perceives there are issues that may affect fairness and transparency. At various stages, the IR issues fairness reports signed by a Senior Partner (much like an auditor’s report) outlining its findings and including a statement of its professional judgment on fairness, transparency and objectivity. The IR’s Terms of Reference are outlined in Appendix 9 of the CFT, and the first two series of reports are included in Appendix 8 of the CFT.

One measure the IR requires to ensure fairness is that BC Hydro and Bidders follow a structured process that makes Bidder comments and questions unattributable. Bidder access to the IR is therefore inappropriate and could compromise the IR’s objectivity.

APPENDIX C

Suggestions to be Reflected in Subsequent Changes

In addition to the comments reflected in the attached documents, there were several useful suggestions made that fall outside the scope of Preliminary Form CFT and Preliminary Form EPA. The following is a list of those comments, and a description of how BC Hydro will incorporate them:

1. 22EVA01
The Bidder suggested that instead of representing maintenance hours as integers they should be represented as equivalent operating hours for greater flexibility in expressing Scheduled Planned Outage Allowance Hours. The next version of the evaluation model will incorporate this approach to maintenance hours.

2. 22EVA04
The Bidder requested clarification on how a facility will qualify as a peaking facility. BC Hydro will post a question and the answer clarifying this determination on the VI CFT website.

3. 23CFT04
The Bidder requested confirmation that BC Hydro input the VIGP Benchmark assumptions into the Evaluation Model and provide the results to Bidders. BC Hydro previously committed to complete this analysis and publish the results and will do so.

4. 24CFT10
The Bidder suggested BC Hydro should include the BC Hydro Greenhouse Gas (“GHG”) offsets, required in the VIGP Environmental Assessment Certificate, as part of the VIGP asset and/or offer these offsets to other non-VIGP Bidders at a price by BC Hydro. BC Hydro is reviewing this issue and will clarify its position shortly.

5. 24EPA27
The Bidder requested modifications to the Preliminary Form EPA confidentiality sections to reflect United States federal requirements. BC Hydro will investigate this matter further and, if required, make the necessary modifications.

6. 25EPA02
The Bidder suggested that the BCTC should be encouraged to conduct a workshop in the first part of February to provide more information on the transfer capability north of cut-plane D on the current BCTC map. BC Hydro will discuss this request with BCTC.

7. 26CFT04
One of several points made in this reply suggested that updates to the gas and electricity price schedules should be provided by BC Hydro sooner than the current CFT deadline (30 days before the tender deadline). BC Hydro agrees that it is in everyone’s best interest to do so and will provide these updates as soon as possible.

8. Tolling of Gas Commodity, Without Gas Transportation

If unutilized existing gas transportation capacity currently held by, or under the control of, a Bidder can be made available to service a gas-fired plant in respect of which a Tender is submitted, that may be a worthwhile option to include in the CFT and the Preliminary Form EPA. BC Hydro is currently assessing how best to accommodate this concept within the program.

The Bidder Reply/Comment Forms also contain a number of questions, rather than comments or suggestions for changes in the CFT or Preliminary Form Agreements. These questions are being processed for posting with replies to the Question and Answer ("Q&A") portion of the VI CFT website in the normal way, consistent with the terms of the CFT.