Department of Energy
Western Area Power Administration
Desert Southwest Customer Service Region
P.O. Box 6457
Phoenix, AZ 85005-6457

NOV 17 2011

Colorado River Commission
555 E. Washington Avenue
Suite 3100
Las Vegas, NV 89101
Attn: Craig Pyper

Dear Mr. Pyper:

In response to your letter dated October 20, 2011 as it relates to the Cost Allocation Methodology Proposal, we are providing the following responses to your questions:

"From the materials and explanations provided to date by Western, the CRC is not able to identify with any degree of accuracy which cost components are characterized as "cost savings" and which as "cost avoidance." Further, it is unclear what criteria were used by Western to categorize any anticipated change in future costs as either "cost savings" or "cost avoidance." As a result, we believe it would be impossible to evaluate the reasonableness of the projected beneficial dollar impacts after implementation of the underlying reorganization, a key factor in judging the value of the reorganization from the customers' point of view. The CRC would like additional information regarding slide 8, titled OCI Cost Savings/Avoidance."

1) First, we request an explanation of the criteria used to distinguish between "cost savings" and "cost avoidance." (See Slide 8 of Presentation)

   RESPONSE: Cost savings denotes a potential cost or budget reduction. Cost avoidance denotes a neutral budget; but if the activity had not been previously performed or is a new requirement, an increase in budget would have been required.

   a. Do those terms, as they facially suggest, relate respectively to projected reductions in currently experienced cost levels and projected reductions in anticipated future cost increases?

      RESPONSE: Yes, The FERC 890 example on Slide 8 is an example of an unanticipated cost savings. Both DSW and RMR would have had to purchase this software module. With OCP, only a single module had to be purchased with the same functional results. The savings was $250k.

   b. How are they defined? RESPONSE: See response to question #1 above.

2) Second, we request additional information regarding which specific items are cost avoidance and which are future savings, and, which year savings would be expected to be achieved.

   RESPONSE: It is important to note that Slide 8 refers to capital costs that are not included in the cost allocation methodology. The cost allocation is for Operations labor only. Slide 8 provides an estimate of savings and avoided costs that Western's customers are benefiting from today due to OCP. It is apparent to Western that as new initiatives are required more savings will be realized.

3) Lastly, the CRC is a customer of projects in both regions, it will therefore be necessary to find out how the proposed cost allocation will affect the present 10 Year Plan for each project. Western will need to provide revisions to each Project's 10 Year Plan and detailing each line item affected. This would provide a much better understanding of all projected cost "savings" and "avoidance," and also, would help to assess after-the-fact whether Western was able to achieve the anticipated savings as indicated on page 8 of the presentation.

   RESPONSE: DSW and RMR 10-Year plans show only costs that will be capitalized; therefore, not all cost associated with Operations Consolidation will be represented on the plans. Once items such as the Alternative Control Centers or other costs have been eliminated or altered the 10-Year plans are changed to accommodate. Final versions of these plans are sent out annually to the customers and reflect the most recent cost estimates. Western anticipates updating customers periodically on the Operations effort and savings, and providing information during customers meetings or other informal discussions.

4) Western also indicated that they would be reviewing the cost allocation methodology "on a periodic basis" as changes to the cost allocation would be "based on changes to the power system." The CRC suggests that Western automatically review the methodology and its reasonableness when it has at least 3 years of experienced data (2014 – 2016) and then review its conclusions and all data and results with the customers.

   RESPONSE: You are correct; we mentioned at the Customer Meeting on September 19, 2011 that Western would be reviewing the cost allocation methodology "on a periodic basis". In addition to updating and revalidating the data annually, we anticipate on reviewing the cost allocation on a 3-5 year basis. We believe this is sufficient time to analyze how costs have been affected and if Trust work has been added/deleted over that period what affect it has on the 9 Federal Projects.

5) And finally, please explain why transmission miles were used as part of the allocation methodology but not transmission capacity and capability.

RESPONSE: As it was pointed out during the presentation, Western's goal is to use a metric which is representative of work done by operations staff, in addition to being available without a major effort in compiling and maintaining the data. While transmission capacity was considered as a metric, the shortcoming of it is that transmission capacity is not a fixed quantity. There are seasonal variations to transmission capacity (winter ratings and summer ratings). New NERC Standards are resulting in entities reevaluating their capacity ratings and Western's may be required to change some facility ratings. It should be noted that transmission capacity calculated by planning engineers and negotiated between adjacent transmission providers has come under a major review due to new NERC Standards, including NERC Mod-029.

Please contact either Darren Buck, RMR Power Systems Operations Manager at 970-461-7693 or myself at 602-605-2404 if you have any further questions or comments. Thank you in advance for your assistance in this matter.

Sincerely,

Catherine M. Castle

Catherine M. Castle
Cost Allocation Project Manager

cc: G0000, Darrick Moe
G6000, Debby Emler
J4000, Darren Buck