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TESTIMONY of
ALLEN L. BURNS, PAUL E. NORMAN and RAYMOND D. BLIVEN
Witnesses for Bonneville Power Administration

SUBJECT: BPA’S RESPONSE TO COURT’S REMAND OF FY 2002-2006 RATES

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5 **SUBJECT: BPA'S RESPONSE TO COURT'S REMAND OF FY 2002-2006 RATES**

6 **Section 1: Introduction and Purpose of Testimony**

7 *Q. Please state your names and qualifications.*

8 A. My name is Allen L. Burns and my qualifications are described in WP-07-Q-BPA-08.

9 A. My name is Paul E. Norman and my qualifications are described in WP-07-Q-BPA-65.

10 A. My name is Raymond D. Bliven and my qualifications are described in
11 WP-07-Q-BPA-58.

12 *Q. What is the purpose of your testimony?*

13 A. The purpose of our testimony is to outline the policy guidance for BPA's determination
14 of the amount of 2000 Residential Exchange Program Settlement Agreement (REP
15 Settlement Agreement) costs that were unlawfully allocated to BPA's preference
16 customers in BPA's WP-02 (FY 2002-2006) rates.

17 *Q. How is your testimony organized?*

18 A. Section 1 describes the introduction and purpose of this testimony. Section 2 describes
19 the relationship between BPA's 2000 Residential Exchange Program Settlement
20 Agreements (REP Settlement Agreements) with regional investor-owned utilities (IOU)
21 and BPA's WP-02 rates. Section 3 describes the conditions existing during the time
22 when BPA's WP-02 rates were being developed. Section 4 describes BPA's policy
23 direction for determining the changes in assumptions used in recalculating the PF-02
24 Exchange base rate so that the amount of costs improperly allocated to preference
25 customers can be determined.
26

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Witnesses: Allen L. Burns, Paul E. Norman and Raymond D. Bliven

1 **Section 2: REP Settlements and WP-02 Rates**

2 *Q. Why is BPA recalculating the PF-02 Exchange Rate?*

3 A. As detailed more fully in Bliven, *et al.*, WP-07-E-BPA-52, the United States Court of
4 Appeals for the Ninth Circuit (Ninth Circuit or Court) issued six opinions in 2007
5 concerning actions related to BPA's 2000 REP Settlement Agreements. In addition to
6 finding the REP Settlement Agreements unlawful, the Court remanded BPA's WP-02
7 (FY 2002-2006) power rates because BPA unlawfully allocated the costs of the REP
8 Settlement Agreements to its preference customers' rates. *Golden NW Aluminum, Inc. v.*
9 *Bonneville Power Admin.*, 501 F.3d 1037 (9th Cir. 2007) (*Golden NW*).

10 As explained below, in the absence of the REP Settlement Agreements, the IOUs
11 would have participated in the REP. The Court did not instruct BPA as to the benefits the
12 IOUs would have received under the REP, which would have been properly allocated to
13 preference customers in the WP-02 rates. Therefore, to determine the amount of REP
14 benefits the IOUs would have received in the absence of the REP Settlement Agreements
15 (and thus permit the determination of how much the REP Settlement Agreements
16 provided the IOUs in excess of the REP benefits), BPA must determine the
17 PF-02 Exchange rate.

18 *Q. Generally, how do you propose to determine the amount of REP benefits the IOUs would*
19 *have received in the absence of the REP Settlement Agreements?*

20 A. Establishing the IOUs' REP benefits requires determining the amount of REP costs that
21 would have been legally recovered from preference customers through BPA's
22 ratemaking. The section 7(b)(2) rate test is the prescribed mechanism to determine this
23 amount. However, determining the amount of REP benefits the IOUs would have
24 received in FY 2002-2006 is not a simple matter. Therefore, we set out the policy
25 guidance to be used to determine the appropriate PF Exchange rate for the purpose of
26 determining the lawful amounts of IOU REP benefits for the WP-02 rate period.

1 There are three primary components in determining the lawful amounts of IOU
2 REP benefits for FY 2002-2006: the IOUs' respective eligible exchange loads; the IOUs'
3 respective average system costs (ASC); and the PF-02 Exchange rate. The difference
4 between an IOU's ASC and the PF Exchange rate is multiplied by the IOU's residential
5 load to determine REP benefits. The IOUs' respective eligible exchange loads and ASCs
6 are discussed in Manary, *et al.*, WP-07-E-BPA-61. This leaves the third component, the
7 PF-02 Exchange rate, which is the subject of this policy testimony.

8
9 **Section 3: Conditions Leading to a Recalculation of Power Rates for**
10 **FY 2002-2006**

11 *Q. Please describe the circumstances existing prior to the development of BPA's WP-02*
12 *rates.*

13 *A. In 1996, BPA and the region had completed a process called the Comprehensive Review*
14 *of the Northwest Energy System, convened in January 1996 by the Governors of Idaho,*
15 *Montana, Oregon, and Washington to address and resolve many questions regarding the*
16 *impact of energy deregulation and competition on BPA and the Pacific Northwest. In its*
17 *Final Report, the Comprehensive Review recommended that BPA institute a*
18 *"subscription-based system" for marketing power and offering new power sales contracts*
19 *to its regional customers. The Comprehensive Review identified general parameters to*
20 *guide BPA in this undertaking, as well as a priority among customers for power*
21 *subscriptions.*

22 BPA then undertook three major public consultation and review processes: the
23 Cost Review process; the Fish and Wildlife Funding Principles process; and the Power
24 Subscription Strategy process. The WP-02 rate case would implement policy decisions
25 reached in these three processes. In the Power Subscription Strategy, BPA described the
26 availability of Federal power post-2001; BPA's approach to selling power by contract to
27 its customers; the products from which customers could choose; and frameworks for

1 pricing and contracts, including risk management. Particularly, the Power Subscription
2 Strategy anticipated that regional IOUs would sign REP Settlement Agreements to settle
3 disputes regarding BPA's implementation of the REP. The REP Settlement Agreements
4 would offer the IOUs 1,000 aMW of power and 800 aMW (later revised to 900 aMW) of
5 financial benefits, after meeting all consumer-owned utility (COU) net firm load
6 requirements. BPA also said that it would offer regional utilities Residential Purchase
7 and Sale Agreements (RPSAs) to implement the REP, but did not expect that these would
8 be signed, given the very extensive public process that led to the REP Settlement
9 Agreements, and the very broad regional support for the basic structure of those
10 agreements.

11 *Q. Given that background, how did BPA determine rates for FY 2002-2006?*

12 *A.* Although BPA expected the REP Settlement Agreements to be signed, BPA could not be
13 certain this would occur, and therefore established rates in its WP-02 rate proceeding in
14 order to allow implementation of either the REP or the REP Settlement Agreements.

15 In order to establish rates for each alternative, BPA developed its proposed rates
16 in two steps: a Rate Design Step and a Subscription Step. In the Rate Design Step, BPA
17 used its normal practice of forecasting costs, loads, and revenues. In this Step, BPA
18 assumed the IOUs would elect to participate in the REP. Also in this Step, BPA
19 conducted the section 7(b)(2) rate test. The rate test triggered, causing BPA to allocate
20 the 7(b)(3) trigger amount to non-preference rates, including the PF Exchange rate. This
21 established the PF Exchange rate for use in implementing the REP. Because BPA did not
22 expect the IOUs to sign RPSAs to implement the REP, issues affecting the 7b2 trigger
23 amount did not receive great scrutiny due to the expectation that the PF Exchange Rate
24 would not be used to establish IOU REP benefits.

25 BPA, however, still needed to establish rates reflecting the IOUs' expected
26 election to execute the REP Settlement Agreements. The Residential Load (RL) Firm

1 Power rate was necessary to implement the power sales portion of the Agreements.
2 Therefore, BPA performed the Subscription Step to set rates to recover the costs of
3 implementing the settlements. The Subscription Step removed the costs of the REP and
4 replaced them with the costs of the REP Settlement Agreements. Is it this latter step that
5 the Court found contrary to the Northwest Power Act in *Golden NW*.

6 After establishing its proposed WP-02 power rates in May 2000, BPA filed the
7 rates with FERC for confirmation and approval.

8 *Q. Please describe the events occurring after BPA filed its WP-02 Final Proposal rates for*
9 *confirmation and approval.*

10 *A. Shortly after completion of the WP-02 Final Proposal in May 2000, BPA's financial*
11 *position began to deteriorate as a result of the West Coast energy crisis, coupled with the*
12 *return of more COU loads than expected. This undermined the basis for the rates*
13 *determined in the WP-02 Final Proposal and threatened BPA's ability to recover its costs*
14 *through rates as required by the Northwest Power Act. Market prices climbed*
15 *dramatically and unpredictably, due in part to lack of resource additions and market*
16 *manipulation in the California market. BPA requested a stay of FERC's review of BPA's*
17 *WP-02 Final Proposal rates in order to determine how to respond to these unprecedented*
18 *conditions. On August 3, 2000, Administrator Judi Johansen sent a letter to BPA's*
19 *customers asking their advice on how to correct BPA's rates. BPA's customers wanted*
20 *to strengthen the Cost Recovery Adjustment Clause (CRAC) rather than modify base*
21 *rates. BPA took this advice and filed an Amended Rate Proposal in November 2000 that*
22 *provided for a more robust CRAC.*

23 Unfortunately, BPA was in one of the worst water years on record, causing
24 conditions to continue to deteriorate, and it was clear that even BPA's amended proposal
25 was not sufficient to ensure the recovery of BPA's costs. This assessment also included
26 the knowledge that the IOUs had executed the REP Settlement Agreements, and BPA

1 knew it would have to serve 1,000 aMW of power under the Agreements instead of
2 implementing the REP. BPA requested a further stay of FERC's review of the WP-02
3 Final Proposal rates and immediately began additional discussions with its customers.
4 There were two basic options: (1) the adoption of modified CRACs, or (2) revising
5 BPA's base rates by reflecting the changed conditions in revised studies. Through these
6 discussions, and based on the circumstances at that time, BPA and its customers agreed to
7 leave the WP-02 Final Proposal rates in place and instead implement a set of three
8 CRACs and a Dividend Distribution Clause (DDC), which BPA included in its WP-02
9 Supplemental Rate Proposal in February 2001. At the conclusion of the supplemental
10 hearing, BPA filed its revised rates with FERC in July 2001. FERC granted interim
11 approval to the revised rates on September 28, 2001, and final approval of the WP-02
12 rates on July 21, 2003.

13
14 **Section 4: Recalculating the PF Exchange Rate for FY 2002-2006**

15 *Q. Why does BPA propose to recalculate the PF Exchange rate for FY 2002-2006?*

16 *A. In 2000, each IOU sent a letter to BPA notifying BPA of its intent to participate in the*
17 *REP for the Subscription period, FY 2002-2011. As part of its Subscription Strategy,*
18 *BPA offered the IOUs a choice between signing an RPSA to participate in the REP or*
19 *signing an REP Settlement Agreement to resolve outstanding REP disputes. The IOUs*
20 *could not sign both agreements. As expected, all of the IOUs elected to sign the REP*
21 *Settlement Agreements.*

22 *In Portland General Electric v. Bonneville Power Admin., 501 F.3d 1037 (9th Cir.*
23 *2007), the Court held that BPA's 2000 REP Settlement Agreements were contrary to the*
24 *Northwest Power Act. Therefore, in reconsidering BPA's WP-02 rates in response to the*
25 *Golden NW decision, BPA must assume that it did not offer, and the IOUs did not*
26 *execute, the REP Settlement Agreements. In the absence of the REP Settlement*

1 Agreements, regional utilities had a right to participate in the REP. Generally, IOUs have
2 ASCs higher than COUs and have been the primary beneficiaries of the REP. It is logical
3 to assume that, absent the REP Settlement Agreements, the IOUs would have participated
4 in a program that provides significant dollars in rate relief to their residential and small
5 farm consumers. Thus, in the absence of the REP Settlement Agreements, BPA believes
6 the IOUs would have signed RPSAs and participated in the REP from October 1, 2001,
7 through September 30, 2011.

8 BPA proposes to return to the winter and spring of 2000-2001 (December 1,
9 2000, through June 20, 2001), during the West Coast energy crisis, and recalculate rates
10 assuming the REP Settlement Agreements had not been developed and signed. BPA
11 must reconsider the decisions it made at that time under new assumptions that directly
12 affect the determination of REP benefits. First, BPA experienced dramatic increases in
13 loads and market prices. Second, the IOUs would have signed RPSAs. Third, there
14 would have been an active REP. Fourth, these factors would have affected the outcome
15 of the 7(b)(2) rate test and the resulting PF Exchange rate. Fifth, these different
16 assumptions would be important components of the calculation of the IOUs' REP
17 benefits. The major outcome of returning to the winter of 2000-2001 would likely have
18 been a decision to revise base rates instead of adopting a system of CRACs, leading to a
19 revised PF Exchange rate and re-determined ASCs for each IOU for FY 2002-2006.

20 *Q. Please describe the situation BPA faced when setting rates in the winter and spring of*
21 *2000-2001.*

22 *A.* The West Coast Energy crisis was a very volatile and complex time. By the winter of
23 2000-2001, BPA was faced with the decision of how to address, through power
24 acquisitions and revised power rates, significant increases in customer loads. The load
25 increases included substantially higher than expected COU loads in combination with
26 commitments of 1,000 aMW of power to the IOUs and 1,500 aMW to the DSIs. The cost

1 and rate effects of having to meet these increased loads were exacerbated by
2 unprecedented and extremely high market prices. Even removing REP Settlement
3 Agreements and the associated 1,000 aMW of power sales to the IOUs, BPA would still
4 have been short of power and facing an expensive and volatile electric market.

5 Q. *Does BPA propose to reconstruct the WP-02 Final Proposal, the Amended Proposal, and*
6 *the Supplemental Proposal under a no-REP Settlement assumption?*

7 A. No. BPA proposes to recalculate rates based the information available when work was
8 being done for the WP-02 Supplemental Proposal (December 1, 2000, through June 20,
9 2001). BPA believes that a three-step recalculation process that would require revisiting
10 the WP-02 Final Proposal, Amended Proposal, and Supplemental Proposal, is not
11 necessary. Such an approach would require very speculative and controversial
12 assumptions about what would have been different in each of those three steps, and
13 would add much unneeded complexity.

14 Q. *Specifically how does BPA propose to recalculate rates for FY 2002-2006, which then*
15 *allows the PF Exchange rate to be calculated?*

16 A. BPA proposes to recalculate FY 2002-2006 average base rates, which are needed in order
17 to calculate the FY 2002-2006 PF Exchange rate, based on information available at the
18 time work was being done for the WP-02 Final Supplemental Proposal that was
19 published in June 2001 (December 1, 2000, through June 20, 2001), changing
20 assumptions only as necessary. Specifically, only changes to the load and market price
21 forecasts in the June 2001 Final Supplemental proposal, and several changes to revenue
22 requirements resulting from known events are incorporated into the revised base rates.
23 Other changes resulting from these assumptions are also incorporated, such as associated
24 revenue requirements (e.g., REP costs, augmentation costs, 7(b)(2) rate test decisions)
25 and ASC forecasts. The assumption is made that the 1000 aMW of FPS sales under the
26 REP Settlement Agreements would have been used to serve the increased COU loads.

1 The changes in assumptions for the recalculated PF Exchange rate are presented with
2 more detail in other BPA testimonies.

3 *Q. What guidance did you give to BPA staff for this Supplemental Proposal?*

4 A. Based on the foregoing rationales and conclusions, we directed BPA staff to proceed on
5 reconstructing the PF Exchange rate for FY 2002-2006 as if the rates were being
6 developed in the winter and spring of 2000-2001 (December 1, 2000, through June 20,
7 2001). Staff was directed to use the same data as was actually used in the actual
8 2000/2001 rate proceedings with the exception of data changes that were a logical
9 consequence of the no-REP Settlement assumption, or which reflected information that
10 was known at the time, and which would have made a material difference in the conduct
11 of the ratesetting process and determining the level of the rates.

12 *Q. Does this conclude your testimony?*

13 A. Yes.