UNITED STATES DEPARTMENT OF ENERGY
BEFORE THE
BONNEVILLE POWER ADMINISTRATION

2007 Supplemental Wholesale Power Rate Adjustment Proceeding

BPA Docket No. WP-07

BRIEF ON EXCEPTIONS OF THE

WESTERN PUBLIC AGENCIES GROUP

September 3, 2008 WP-07-R-WA-1

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BRIEF ON EXCEPTIONS OF THE

WESTERN PUBLIC AGENCIES GROUP

1. INTRODUCTION

This brief is submitted on behalf of the Western Public Agencies Group ("WPAG") in accordance with the Bonneville Power Administration's Rules of Procedure Governing Rate Hearings, 51 Fed. Reg. 7611 (1985), and the applicable orders of the Hearing Officer in this proceeding. It responds to the Draft Record of Decisions ("DROD") issued by BPA in August, 2008.

The DROD begins with a statement by the Bonneville Power Administration ("BPA") Administrator regarding this proceeding. DROD, p. vi. There are a number of points in that statement with which the WPAG utilities agree.

- *This is a case of first impression* – This is the first time since the passage of the Pacific Northwest Electric Power Planning and Conservation Act ("Northwest Power Act"), 16 U.S.C. § 839, *et seq.,* that the United States Court of Appeals for the Ninth Circuit ("9th Circuit") has invalidated a BPA settlement agreement, and has remanded to BPA power rates that have been held to be unlawful.
- *This case presents unique issues* – This case presents a situation that BPA has not experienced since the passage of the Northwest Power Act. This is due to the remand of BPA's rates made by the 9th Circuit, and fact that the BPA proceeding in response to that remand encompasses two separate rate periods that present materially differing fact patterns. For one rate period (FY2002-FY2006), BPA established rates that were finally approved by FERC, the rates were paid by the customers, and the rate period to which they applied is now over. BPA has elected not to reopen that rate proceeding or the administrative record on which they were based. For the second rate period (initially for FY2007-FY2009), BPA established the rates but they were never finally approved by FERC, and BPA has elected to reopen the proceeding and the administrative record on which they are based.
- *Beware of unintended consequences* – Decisions made in this proceeding may extend far beyond the duration of the proposed rates, and may visit consequences on BPA and its customers long after the rate period under contemplation in this proceeding has expired. For example, BPA's proposed modifications to the implementation of the § 7(b)(2) rate ceiling test, in combination with proposed revisions to the Average System Cost Methodology ("ASCM") that increase the

categories of costs that can be included in the calculation of Residential Exchange Program ("REP") benefits, will substantially increase the REP costs borne by BPA and its preference customers long after whatever short-term issues these changes are implemented to address have been resolved.

However, the most important point regarding this proceeding was not expressly set out in the Administrator's statement. This proceeding is proof positive that the Northwest Power Act imposes meaningful limits on the discretion the Administrator may exercise both when entering into settlement contracts and when setting rates. The fact that the 9th Circuit is willing to enforce these limits is the reason that this case is being conducted. More importantly, the 9th Circuit is willing to do so again should the limits on the Administrator's discretion be exceeded in this case.

There are two other aspects of the DROD about which the WPAG utilities wish to initially comment. First, although as explained below the WPAG utilities do not concur with BPA's calculation of the illegal overpayment they have made directly to BPA, and indirectly to the residential and small farm customers of the investor-owned utilities ("IOUs") due to the voided Residential Exchange Settlement Agreements (and related agreements and amendments, together "REP Settlements"), BPA's has responded to the request of WPAG by shortening the period over which the illegal overpayment will be repaid to a period equivalent to the seven years during which such overpayments were made. DROD, p. 211. This is a positive response by BPA to a major concern of its preference customers, and will serve to resolve the aftermath of the illegal REP Settlements much sooner than originally proposed by BPA. This will be to the benefit of BPA and all of its customers.

Second, BPA states throughout the DROD that its decisions in this proceeding are being driven by a careful reading and application of the provisions of the Northwest Power Act. (See, for example, DROD, pages ix - x). This is the correct standard by which BPA should judge its decisions, and this recognition of the statutory standard is both proper and heartening. However, as detailed below BPA has been inconsistent at best in its reading and application of the Northwest Power Act provisions, and the assumptions that it has made (and declined to make) as a result of its reading.

With regard to some issues, BPA has parsed the language of § 7(b)(2), 16 U.S.C. § 839e(b)(2), down to the word, and taken a strictly literal view of its obligations under the statute. See, BPA's interpretation regarding the treatment of Mid-Columbia non-federal resources and conservation as a § 7(b)(2) resource, DROD pp. 428-456; pp. 345-372. For other issues, BPA has taken a far more liberal approach based on its assessment of the statutory intent that often ignores the plain statutory language of § 7(b)(2). See, BPA's interpretation regarding within or adjacent to direct service industrial ("DSI") customer loads and the treatment of pre-Subscription surplus sales. DROD, pp. 458-471; pp. 472-479. BPA has offered no basis in the statute or from the legislative history of the Northwest Power Act to justify these completely disparate interpretative approaches.

BPA has also engaged in a similar inconsistent approach regarding the assumptions it has made in its "what if" determination of the amounts that BPA's preference customers have overpaid to BPA due to the illegal REP Settlements. In its "what if" analysis, BPA has assumed that in the absence of the REP Settlements, and with a revised PF base rate and revised PF Exchange rate, each IOU would either sign, or delay signing, Residential Purchase and Sale Agreements ("RPSAs") based on the economic self interest of each IOU regarding REP benefits.

See, BPA assumptions regarding IOUs signing RPSAs, and PacifiCorp declining to sign RPSA. DROD, p. 91. In contrast, BPA has not made parallel assumptions regarding preference customers in comparable circumstances. See, BPA assumptions regarding preference customer participation in REP. DROD, pp. 194-195, 453-454.

The results of BPA's inconsistent legal interpretations and analytical assumptions in this proceeding are stark when compared to BPA's decisions in the WP-02 and WP-07 rate cases. In the WP-02 case, the § 7(b)(2) rate ceiling test performed by BPA, and incorporated into the rates finally approved by FERC, limited the REP costs that could be included in the PF rates for preference customers during the FY2002-2006 rate period to $240 million (or $48 million per year). The § 7(b)(2) rate ceiling test performed by BPA in the WP-07 rate case limited the REP costs that could be included in the PF rates for preference customers during the FY2007-2008 rate period to approximately $60 million (or almost $30 million per year).

As revised by BPA in this proceeding, the § 7(b)(2) rate ceiling now permits $699 million (or $140 million per year) in REP costs to be included in PF rate for preference customers for the FY2002-FY2006 rate period, and $467 million (or an average of $233 million per year) in for the FY2007-FY2008 period.[1] This constitutes nearly a four-fold increase in REP costs included in the PF rate based on BPA's revisions proposed in this proceeding. Interestingly, the REP benefits available to the IOUs under BPA's revised § 7(b)(2) rate ceiling analysis now essentially equal the REP Settlement benefits BPA forecast in the WP-02 rate proceeding that were inappropriately available to the IOUs during the FY2002-FY2006 rate period.

[1] These amounts do not include the Load Reduction Agreement amounts for PacifiCorp and Puget Sound Energy, which BPA is allowing these utilities to retain as "protected payments".

It is beyond the scope of this brief to speculate on the motives underlying BPA's inconsistent approach to interpreting its obligations under the Northwest Power Act, sometimes focusing on a literal interpretation of the statutory language and at other times focusing on BPA's version of statutory intent to the exclusion of the plain statutory language, and BPA's reliance on materially different assumptions for virtually identical factual circumstances. However, the facts in this proceeding demonstrate that the result of BPA's inconsistent legal interpretations and analytical assumptions has been to re-establish for the IOUs REP benefits for the FY2002-FY2008 period that essentially replicate the benefits that BPA sought to provide to them under the original (and now void) REP Settlement Agreements. This leads to the conclusion that the BPA policy objective that underpinned the REP Settlement Agreements, to spread the benefits of the federal system broadly with special attention to the residential and small farm customers, still holds sway at the agency. From this one can only conclude that the inconsistent legal interpretations and analytical assumptions employed by BPA in this proceeding are an effort to implement that same BPA policy objective, and the benefit levels provided by the REP Settlements, by other means.

2. ASSIGNMENTS OF ERROR REGARDING RESPONSE TO REMAND

The WPAG utilities make the following assignments of error regarding the proposed decisions contained in the DROD. In addition, consistent with the Rules of Procedure Governing Rate Hearings and the order of the Hearing Officer, WP-07-HOO-91, WPAG reserves the right to join and adopt as part of this Brief on Exceptions portions of its briefs of other parties with whom they have a common interest within the time limits set forth in the aforementioned order.

A. BPA Has Exceeded the Scope of the Remand

In *Portland General Electric Co. v. Bonneville Power Administration,* 501 F.3d 1099 (9th Cir. 2007) ("*PGE*"), the 9th Circuit held that the REP Settlement Agreements violated §§ 5(c) and 7(b)(2) of the Northwest Power Act, 16 U.S.C. §§ 839c(c), 839e(b)(2) were beyond BPA's authority and were void. 501 F.3d at 1036-37. The 9th Circuit also held that REP Settlement Agreement costs were costs of the Residential Exchange Program ("REP"), and that the § 7(b)(2) rate ceiling test performed by BPA in the WP-02 rate proceeding limited the amount of REP costs, including REP Settlement Agreement costs, that BPA could include in preference customer rates. *Id.*

In *Golden Northwest Aluminum, Inc. v. Bonneville Power Administration,* 501 F.2d 1037 (9th Cir. 2007) ("*GNA*"), the 9th Circuit held that the BPA's settlement authority is subject to the constraints of both § 5(c) in determining the amount of REP Settlement payments, and to the § 7(b)(2) rate ceiling test rate in determining the amount of REP Settlement payments because it limits the amount of such costs that can be allocated preference rates. 501 F.3d at 1047-48. Citing to the *PGE* decision, the 9th Circuit held that the rates BPA set in the WP-02 rate case (and by implication those set in the WP-07 rate case) improperly burdened preference customers with the costs of the REP Settlement Agreements, in plain violation of the § 7(b)(2) rate ceiling test performed by BPA in that case. *Id.* The 9th Circuit remanded the matter to BPA to ". . . set rates in accordance with this opinion." *Id.* at 1053.

Based on these decisions, the scope of this remand proceeding is limited to two tasks. The first is to determine the amount preference customers were overcharged due to the illegal inclusion of the costs of the REP Settlements in their BPA rates. The second is to determine a

method to timely reimburse preference customers for the illegal overcharges imposed on them under the WP-02 and WP-07 rates. While BPA has some latitude in responding to the remand of the 9th Circuit, that latitude is not without limits.

The records from the WP-02 and WP-07 rate cases contain the information needed by BPA to comply with the remand directive of the *GNA* decision. In both cases, BPA performed the § 7(b)(2) rate ceiling test in accordance with its then applicable Legal Interpretation of Section 7(b)(2) of the Pacific Northwest Electric Power Planning and Conservation Act ("1984 Legal Interpretation") and the Implementation Methodology of Section 7(b)(2) of the Pacific Northwest Electric Power Planning and Conservation Act ("1984 Implementation Methodology"). BPA determined both the PF-02 and PF-07 rates without including any REP Settlement costs. BPA also forecast Average System Costs ("ASCs') for the IOUs assuming their participation in the REP, and established PF Exchange Rates for use in calculating the REP payments that would be available to the IOUs.

In both the WP-02 and WP-07 cases, BPA determined that the § 7(b)(2) rate ceiling test limited the REP costs that could be included in the PF-02 and PF-07 rates, which amounts were $48 million per year (or $240 million for the rate period) for the PF-02 rate, and almost $30 million per year (or approximately $60 million for the rate period) for the PF-07 rate. Pursuant to § 7(b)(3), 16 U.S.C § 839e(b)(3), BPA then allocated to other adjustable firm power rates, such as the PF Exchange rate, the REP costs in excess of those amounts that BPA had determined could be lawfully allocated to the PF-02 and PF-07 rates. Hence, the record in both the WP-02 and WP-07 cases contains the preference customer rate produced by a lawful application of the § 7(b)(2) rate ceiling test *without* the inclusion of REP Settlement costs. WP-07-E-WA-05, pp. 5-10.

Again, in both the WP-02 and WP-07 rate cases as a completely separate step, BPA calculated the PF-02 and PF-07 rates with the REP Settlement costs included. In this step, BPA established the PF-02 and PF-07 rates without regard to the results of the § 7(b)(2) rate ceiling test, and with the inclusion of the full costs of the REP Settlements. Hence, the record in both the WP-02 and WP-07 cases contains the preference customer rate produced *with* the lawful application of the § 7(b)(2) rate ceiling test, as well as the PF-02 and PF-07 rates *with* the unlawful inclusion of REP Settlement costs. Finally, the additional costs of the REP Settlements, such as the costs of the Load Reduction Agreements ("LRAs") and the "litigation penalty", were included in the PF rate by operation of periodic cost recovery adjustment clauses throughout the applicable rate period. As a consequence, these amounts are also part of the record in these cases, and are known and determinable.

The difference between these two rates established in each of the WP-02 and WP-07 rate cases constitutes the amount the *GNA* decision identified as being illegally allocated to preference customers. It is these amounts, and the costs of the LRAs collected through the cost recovery adjustment clauses, that BPA is legally mandated to return to its preference customers.

In the DROD, BPA has elected not to rely on the decisions made in the WP-02 and WP-07 rate cases, and to not limit its activities to correcting the error identified by the 9th Circuit by using the PF rates established in the WP-02 and WP-07 rate cases with the lawful application of the § 7(b)(2) rate ceiling test. Rather, BPA asserts in the DROD that it needs to "supplement" the record in order to calculate the overpayment made by the preference customers. DROD, pp. 54-67. The fact is that BPA's actions in this case go well beyond any reasonable supplementation of the record, and in fact constitute a complete reversal of every major decision made in the WP-02 and WP-07 rate cases. By failing to use the decisions made in the WP-02

and WP-07 rate cases, and by reversing virtually every major decision in these cases, BPA has exceeded the scope of permissible actions in responding to the remand order.

B. BPA's Rationale for Reversing Prior Decisions is Insufficient

BPA asserts in the DROD that it must "supplement" the record from the WP-02 and WP-07 rate proceedings to determine the amount of the overpayments made by the preference customers to BPA due to the illegal inclusion of REP Settlement costs in the PF rate. BPA asserts that its actions are required because the rates BPA established in the WP-02 and WP-07 rate cases are "fatally flawed". DROD, p. 32; 49. This assertion is unfounded.

BPA's assertion that the rates established in the WP-02 and WP-07 rate cases are fatally flawed is based solely on BPA's decision to re-run the § 7(b)(2) rate ceiling test for the FY2002-2006 and FY 2007-2008 rate periods in order to change the treatment of non-federal resources that are available in the 7(b)(2) Case. When BPA implemented the § 7(b)(2) rate ceiling test in both the WP-02 and WP-07 rate cases, it did so in conformity with the then applicable regulations governing that activity, the 1984 Legal Interpretation and the 1984 Implementation Policy. These regulations required that BPA include in the non-federal resources available in the 7(b) Case the low cost non-federal Mid-Columbia resources.

In this proceeding, BPA no longer wishes to be bound by those regulations, and has implemented the § 7(b)(2) rate ceiling test in conformance with the 2008 Legal Interpretation and the 2008 Implementation Methodology that BPA is proposing to adopt at the conclusion of this proceeding. This proposed new regulation reverses BPA's long-standing interpretation of § 7(b)(2)(D)(ii), 16 U.S.C. §839e(b)(D)(ii), and excludes the low cost non-federal Mid-Columbia

resources from the 7(b)(2) Case.[2] The legality of this new interpretation of § 7(b)(2)(D)(ii) is discussed below in this brief. However, absent this reversal of BPA's long-standing interpretation of § 7(b)(2)(D)(ii), there would be no need or justification for re-running the § 7(b)(2) rate ceiling test for the FY2002-FY2006 and the FY2007-FY2008 rate periods, for establishing new PF Exchange rates, for recalculating ASCs, for eliminating the cost recovery adjustment clauses, or for establishing a new base PF rate completely unrelated to those actually paid by preference customers during the FY2002-FY2006 and FY2007-FY2008 rate periods.

In fact, the real fatal flaw is BPA's desire to implement the § 7(b)(2) rate ceiling test in a manner that conflicts with the express directives of the applicable regulation (the 1984 Legal Interpretation and Implementation Methodology), and in conformity with its proposed regulation that has not yet been adopted (the proposed 2008 Legal Interpretation and Implementation Methodology).

It is asserted in the DROD that BPA can revise the Legal Interpretation and Implementation Methodology in any § 7(i) proceeding, 16 U.S.C. § 839e(i), and this is just an example of an agency correcting an error in its regulations. DROD, p. 452. These arguments lack merit.

Perhaps the best indicator of how the regulations governing the implementation of the § 7(b)(2) rate ceiling test can be modified is provided by BPA's approach when it adopted the 1984 Legal Interpretation and Implementation Methodology. In that instance, BPA conducted a separate § 7(i) proceeding in which each of these regulations was subjected to careful public examination, followed by adoption in a record of decision. No rates were set during that § 7(i)

[2] The proposed 2008 Legal Interpretation appears at WP-07-E-BPA-50, Att. A; the proposed 2008 Implementation Methodology appears at WP-07-E-BPA-50, Att. B.

proceeding. After adoption of this regulation, it was applied in all subsequent § 7(i) rate proceedings to implement the § 7(b)(2) rate ceiling test. DROD, p. 326. Amending an applicable regulation during the § 7(i) rate proceeding in which it is being applied, which is what BPA proposes to do here, is an unprecedented departure from BPA's accepted practice regarding the revision of regulations governing the implementation of the § 7(b)(2) rate ceiling test.

Assuming, *arguendo,* that BPA may amend a regulation governing the implementation of the § 7(b)(2) rate ceiling test in the same § 7(i) rate proceeding in which it is being applied, there may be some basis for doing so with regard to the rates set in the WP-07 rate case. The rates established in the WP-07 rate case were never finally approved by FERC, and in this proceeding BPA has reopened the docket and the administrative record of that case. However, this is not the situation for the rates established in the WP-02 rate for the FY2002-FY2006 rate period.

With regard to the WP-02 rate case and rates that were established in that proceeding, BPA has elected to not reopen the WP-02 rates and not reopen the WP-02 docket or administrative record. FRN vol. 73, no. 27, Feb 8, 2008 p. 7539. As a consequence, there is no § 7(i) rate proceeding applicable to the WP-02 rates in which to modify the 1984 Legal Interpretation and Implementation Methodology as it applies to those rates. So even if BPA were correct regarding their assertion that they can modify an applicable regulation in the same proceeding in which it is to be applied, and it is not, BPA's proposed approach does not apply to the WP-02 rates because the applicable § 7(i) proceeding has been closed for about six years, and has not been reopened by BPA. There is simply no appropriate § 7(i) proceeding within which to perform the alteration to the 1984 Legal Interpretation and Implementation Methodology that BPA desires with regard to the WP-02 rates.

By attempting to avoid the proper application of the plain terms of the 1984 Legal Interpretation and Implementation Methodology to the WP-02 and WP-07 rates, and by electing instead to apply the substance of the proposed 2008 Legal Interpretation that have not yet been approved, BPA has committed error.

C. BPA's Actions Are Not Reasonable Supplementation

In the DROD, BPA has suggested that its actions constitute a mere "supplementing" of the record necessary to properly determine how much its preference customers were overcharged due to the inclusion of the illegal REP Settlement costs in the PF rates during the FY2002-FY2008 period. DROD, p. 64. Rather than a reasonable supplementation of the record in the WP-02 and WP-07 proceedings, BPA has revisited and reversed every major decision made in the WP-02 and WP-07 rate cases, and far exceeded the bounds of reasonable supplementation.

The assertion that BPA is merely "supplementing" is not supported by the facts. BPA has proposed to abandon the § 7(b)(2) rate ceiling determinations made in both the WP-02 and WP-07 rate cases, and to do completely new § 7(b)(2) rate ceiling determinations. BPA has proposed to abandon the applicable regulation governing the implementation of the § 7(b)(2) rate ceiling test, and substitute for it substantive portion of the proposed 2008 Legal Interpretation and Implementation Methodology that has not yet been adopted. BPA has proposed to jettison the ASC determinations made in the WP-02 and WP-07 rate proceedings, and substitute for them new ASC determinations based on facts that were not available when the WP-02 and WP-07 rates cases were originally conducted. BPA has proposed to ignore the PF Exchange rates calculated in the WP-02 and WP-07 rate cases, and replace them with new PF Exchange rates based on the revised implementation of the § 7(b)(2) rate ceiling test. Lastly, BPA has proposed

to eliminate the cost recovery adjustment clauses that preference customers paid throughout the FY2002-FY2006 rate period, and replace them with a completely new PF rate that was never established nor paid by preference customers during rate period.

These actions do not constitute reasonable "supplementing" of the administrative records in the WP-02 and WP-07 rate cases. Rather, in sum they are the creation of an alternative reality that has essentially reversed all of the major decisions and actions actually taken by BPA. The result of BPA's re-writing of the WP-02 and WP-07 rate cases is to retroactively bestow on the IOUs REP benefits that are equivalent to the benefits BPA sought to provide the IOUs through the REP Settlement Agreements.

In order to achieve this result, BPA has had to reach back in some cases more than eight years, and has had to reverse long-standing treatments of specific issues. Ironically, BPA has in the DROD condemned just this type of retroactive revisionism when it has sought to defend its decisions in other areas. For example, in defense of its decision to "protect" from reimbursement the payments made under the LRAs, BPA argues that it has no authority to reach back seven years and unravel historical events. DROD, p. 149. Yet in this case what BPA has done is precisely to reach back and attempt to unravel history.

One final point is relevant to this topic. BPA has elected to reopen the WP-07 docket and administrative record, so for the WP-07 rates there is at least a record to be supplemented, even though BPA's actions in that regard go well beyond the limit of reasonable supplementation. However, the docket and administrative record for the WP-02 rates has not been reopened. As a consequence, even if BPA sought to reasonably supplement the record of the WP-02 rate case, it cannot do so since the record for that case has been closed for about six years, and remains closed today.

BPA's wholesale revision of every major decision made in the WP-02 and WP-07 rate cases, based on its desire to implement the § 7(b)(2) rate ceiling test in a manner conflicts with the applicable 1984 Legal Interpretation and Implementation Methodology constitutes error.

D. BPA Is Repeating the Same Error of Law

In the WP-02 and WP-07 rate cases, BPA determined the amounts of REP costs that could be lawfully included in the PF rate and charged to preference customers by implementing the § 7(b)(2) rate ceiling test. BPA then proceeded to allocate to the PF rate REP Settlement costs in excess of the amounts so determined, thereby charging preference customers PF rates that exceeded that amounts permitted by the § 7(b)(2) rate ceiling test. In the *GNA* decision, the 9th Circuit held that these actions by BPA were contrary to law, because they resulted in an allocation to preference customers of REP costs in excess of the amounts permitted under the § 7(b)(2) rate ceiling test. BPA is committing the same error of law in this proceeding.

In this proceeding, BPA has recalculated the amounts it is permitted to charge preference customers in accordance with its revised view of how the § 7(b)(2) rate ceiling test should have been implemented in the WP-02 and WP-07 rate tests. After doing so, BPA then treats the payment obligations under the Load Reduction Agreements ("LRAs") as protected, meaning the IOUs who received payments under the LRAs do not have to pay back to the preference customers those LRA payments. This decision effectively charges to preference customers the amounts paid to the IOUs under the LRAs over and above the amounts that BPA may properly charge the preference customers even under BPA's version of the § 7(b)(2) rate ceiling test.

BPA argues that this is the appropriate course of action because the LRAs are still valid contracts that have never been challenged, and that it is too late to do so because the statute of

limitations has run on them. BPA also argues that the "sanctity of contract" warrants treating these LRA payments as protected from repayment. DROD, pp. 131-137. These are interesting arguments, but they are beside the point. It is not a question of whether these contracts are still valid, and for reasons pointed out in the Brief on Exceptions filed by Cowlitz Public Utility District they are, in fact, no longer valid. Rather, it is a question of whether BPA can lawfully charge preference customers the costs of these agreements, and to that question the answer is no.

The LRAs were agreements between BPA and PacifiCorp and Puget Sound Energy which converted the power delivery obligation of BPA established in the REP Settlement Agreements into an obligation to pay money. The obligation of BPA to provide deliveries of power to PacifiCorp and Puget was established in section 4 of the REP Settlement Agreements, which stated in part:

> BPA shall provide to <<Customer Name>> a total benefit comprised of Firm Power and Monetary Benefit, both of which are expressed in annual average megawatts (aMW).

Section 4 of the REP Settlements went on to state:

> Subject to the terms of this Agreement, BPA shall make available and sell, and <<Customer Name>> shall purchase, Firm Power at a "flat" rate of delivery (100 percent load factor) during every hour under the RL Rate.

The 9th Circuit determined in *PGE* that the REP Settlement Agreements were transactions to fulfill BPA's obligations under the REP authorized by § 5(c) of the Northwest Power Act, 16 U.S.C § 839c(c)(1). As such, these benefits under the REP Settlement Agreements were therefore subject to the limitations imposed on REP benefits established by operation of the § 7(b)(2) rate ceiling test. Since the payments made to the IOUs under the LRAs were to monetize BPA's power delivery obligation under the REP Settlement Agreements, these payments were

also made to fulfill BPA's obligations under the REP. They are, therefore, subject to the limitations imposed on such benefits by operation of the § 7(b)(2) rate ceiling test.

By treating the LRA payments as "protected", BPA has imposed on preference customers REP costs in excess of the amounts that BPA has determined by application of its revised § 7(b)(2) rate ceiling tests that can be lawfully charged preference customers during the WP-02 and WP-07 rate periods. BPA is not free to implement the § 7(b)(2) rate ceiling test, and then charge preference customers REP costs in excess of the amounts so determined because it wants to "protect" payments made under a separate agreement. By treating the LRA payments as protected, and charging preference customers the costs of the LRAs without regard to the limits established under the § 7(b)(2) rate ceiling test, that is precisely what BPA has done. By doing so, BPA has committed the same error of law that the 9th Circuit found unlawful in the *GNA* decision.

3. ASSIGNMENTS OF ERROR REGARDING BPA'S LEGAL INTERPRETATIONS

For the reasons set forth herein, BPA's wholesale revisions to the decisions made and the actions taken in the WP-02 and WP-07 rate cases is in error. Assuming, *arguendo*, that for some reason these proposed revisions are sustained, BPA has made inconsistent and contradictory legal interpretations, has used conflicting assumptions to virtually identical factual situations, and as a consequence has committed error.

A. The Mid-Columbia Resources Must Be Included In The 7(b) Case Resources

The purpose of the § 7(b)(2) rate ceiling test set out in the Northwest Power Act is to ensure that the power costs of BPA's preference customers under the Northwest Power Act that are no greater than they would have been in the absence of that statute. As explained in the legislative history:

> Section 7(b)(2) establishes a "rate ceiling" for preference customers that seeks to assure these customers that their rates will be no higher than they would have been had the Administrator not been required to participate in power sales or purchase transactions with non-preference customers under this Northwest Power Act. The assumption[s] to be made by the Administrator in establishing this ceiling are specifically set forth. It is through rate ceilings that this Northwest Power Act provides additional protection to public bodies and cooperatives' preference customers as to the price of the sale of power by the Administrator.

H.R. Rep. No. 976, Part I, 96th Con., 2d Sess. 34 (1980) at 68-69.

Congress directs the Administrator to make five assumptions when implementing the § 7(b)(2) rate ceiling test, which assumptions are set out in the statute in detail and with specificity. Each of these assumptions is contrary to the facts that were expected to pertain under the Northwest Power Act, and will be contrary to the reality on the ground each time the § 7(b)(2) rate ceiling test is implemented. This is due to the fact that the § 7(b)(2) rate ceiling test is intended to forecast the costs of serving the general requirements of preference customers as if there were no Northwest Power Act.

These assumptions were grounded on certain accepted expectations about what would occur in the "without the Act" world that § 7(b)(2) rate ceiling test is intended to capture. These included the expectation that the Federal base system ("FBS") would be used entirely to serve preference customer loads, but would be insufficient to serve all such loads; that preference

customers would construct new generating resources to serve the portion of their load not served by BPA (including the within or adjacent to DSI loads), since BPA's power supply could not expand to meet growing preference customer loads; and that these resources would be more costly absent the Northwest Power Act. These expectations provide the context for understanding the purpose and operation of the specific provisions of the § 7(b)(2) rate ceiling test.

i. BPA's Applicable Regulation Properly Determines the Resources Available in the 7(b)(2) Case

As discussed elsewhere in this brief, the resources available in the 7(b)(2) Case must be determined in accordance with 1984 Legal Interpretation and Implementation Policy, which regulations correctly state the assumptions the Administrator must make to determine the resources available to serve the general requirements of preference customers when implementing the § 7(b)(2) rate ceiling test.

The provisions of the 1984 Legal Interpretation regarding the resources that must be assumed to be available when implementing the § 7(b)(2) rate ceiling test are grounded in the language of § 7(b)(2)(D). This section directs the Administrator to assume, in addition to the power available from FBS, that resources that were ". . . purchased from such customers by the Administrator . . . or not committed to load pursuant to section 838c(b) of this title, and were the least expensive resources owned or purchased by public bodies or cooperatives . . ." are available to serve the general requirements of preference customers. *Id.*

The 1984 Legal Interpretation properly applies to the § 7(b)(2) rate ceiling test implementation in the WP-02 and WP-07 rate cases, and it details three types of resources, in addition to the power available from the FBS, that the Administrator must assume to be available

to serve the general requirements of preference customers when implementing the § 7(b)(2) rate ceiling test. It states in part:

> Three types of additional resources are available in the 7(b)(2) case. The first type of resource is described in section 7(b)(2)(D)(i) as being resources that were "purchased from such customers by the Administrator pursuant to section 6." These are resources actually acquired by BPA from the 7(b)(2) customers in the program case. Section 7(b)(2)(D)(ii) describes the second type of resource as those "not committed to load pursuant to section 5(b)." These are resources owned or purchased by 7(b)(2) customers that *are not dedicated to their own loads.* (Emphasis supplied)

1984 Legal Interpretation, p.19

Hence, BPA's contemporaneous interpretation of § 7(b)(2)(D)(ii) as set forth in the 1984 Legal Interpretation is that the least expensive resources owned or purchased by preference customers that were not dedicated to that preference customer's load under § 5(b), 16 U.S.C. § 839c(b), must be assumed to be available to serve the general requirements of preference customers in the 7(b)(2) Case.

This interpretation has been affirmed in subsequent BPA rate cases. The Administrator stated in the 1996 BPA Wholesale Power Rate Proceeding Final Record of Decision that:

> Congress provided that the resources owned by preference customers but not dedicated to their loads should be included in the 7(b)(2) Case resource stack regardless of whether sales are made from such resources.

WP-96-A-02, p. 254

This interpretation is consonant with the other portions of this section of the statute. When read in conjunction with § 7(b)(2)(D)(i), it results in all least cost resources own or purchased by preference customers being available to serve such customers' general requirements load in the 7(b)(2) Case, except for those preference customer resources that have been dedicated to serve preference customer load under § 5(b). The effect of this subsection is to

avoid double-counting least cost resources owned or purchased by preference customers that have been declared to load under § 5(b), since these resources are subsumed in the term general requirements used in § 7(b)(2)(D).[3]

It also effectuates the underlying expectation of the "without the Act" world, in conjunction with § 7(b)(2)(D)(i), that in the absence of a growing power supply from BPA, all least cost resources owned or purchased by preference customers would be used by them to serve their load, regardless of any prior sales arrangements with IOUs. This also implements the common sense expectation that in a "without the Act world" in which BPA's power supply would be limited, preference customers would not have surplus output from non-federal resources to share with the IOUs.

BPA's long-standing interpretation of § 7(b)(2)(D), as articulated in the 1984 Legal Interpretation, harmonizes the subsections of this statutory provision, is consistent with the underlying purpose of the § 7(b)(2) rate ceiling test, and is the proper regulation to apply to the § 7(b)(2) rate ceiling test performed for the WP-02 and WP-07 rate cases.

ii. BPA's Interpretation Reversal is Not Justified

For purposes of calculating the § 7(b)(2) rate ceiling test for the WP-02 and WP-07 rates, BPA seeks to abandon its long-standing legal interpretation set out in its currently applicable 1984 Legal Interpretation, asserting that the same statute interpreted in the 1984 Legal

[3] The term "general requirements" as used in § 7(b)(2)(D) is defined in § 7(b)(4), 16 U.S.C. §839e(b)(4), to mean the ". . . electric power purchased from the Administrator under section 839c(b). . .". Pursuant to § 5(b), the amount of power that a preference customer can purchase from BPA is equal to its load less any non-federal resources used to serve load prior to 1980, or dedicated to serve its load under a BPA power contract. Hence, the term general requirements means a preference customer's load net of its non-federal resources declared to load service under § 5(b).

Interpretation now requires exactly the opposite result – that if the output from a least cost resource owned or purchased by a preference customer is sold to a non-preference customers and is declared to load under § 5(b), it is no longer available to serve 7(b)(2) Case loads. DROD, pp. 428-457.

BPA seeks to defend this interpretative about-face by arguing that prior decisions were not subject to extensive debate, that the application of the 1984 Legal Interpretation in prior rate cases was moot because it did not move actual dollars, and that it is required to abandon its long-standing interpretation for this new position by the plain language of the Northwest Power Act. *Id*. These arguments are not persuasive.

In defending its treatment of conservation in the DROD, BPA argues that if rate case parties had an opportunity to contest an interpretation and failed to do so, the absence of such comment adds validity to such interpretation, and provides BPA with a basis for continuing to rely on such interpretation. DROD, p. 370. However, with regard to the inclusion of the Mid-Columbia resources in the 7(b)(2) Case, BPA argues just the opposite position – that the absence of comment on the portion of the 1984 Legal Interpretation dealing with Mid-Columbia resources is evidence that this long-standing legal interpretation lacks merit. In a similar vein, BPA suggests that the fact that the 1984 Legal Interpretation has been in place since 1984, and has been relied upon by BPA in every subsequent rate case, is of little moment. In contrast, in defending its treatment of conservation in the context of the § 7(b)(2) rate ceiling test for both the WP-02 and WP-07 cases, BPA argues that the fact that its approach has been used in many rate cases over a long period of time lends it credence. *Id*.

In essence, BPA seeks to have it both ways. When defending an interpretation that it wishes to retain, lack of comment and long-standing use are sound reasons for retention.

However, when BPA seeks to reverse a long-standing interpretation, the very same lack of comment and long-standing use are treated as providing no basis for retaining such long-standing interpretation and in fact a partial justification for its reversal. The latest legal interpretation of an agency that is willing to deploy the same arguments in support of completely opposite results must be viewed with skepticism.

In the DROD, BPA also argues that its prior reliance on the portion of the 1984 Legal Interpretation dealing with Mid-Columbia resources in final records of decision in prior rate cases should be disregarded, because the treatment of the Mid-Columbia resources did not affect the level of the final PF rate. DROD, p. 436. Because the 1984 Legal Interpretation did not move dollars in a particular case does not change the fact that the Administrator, in a final record of decision, addressed the issue in detail and with finality.

Lastly, BPA asserts that the plain language of § 7(b)(2)(D) compels it to reverse its 1984 Legal Interpretation regarding the treatment of Mid-Columbia resources in the § 7(b)(2) rate ceiling test. In its place, BPA seeks to rely on the substance of the following portion of the proposed, but not yet adopted, 2008 Legal Interpretation:

> Type 2 are those resources owned or purchased by the 7(b)(2) Customers and not dedicated to load by public agencies or investor-owned utilities pursuant to section 5(b).

2008 Legal Interpretation, Interpretation 11, p. LI-15.

This yet to be adopted legal interpretation flatly contradicts the interpretation of this same statutory provision set out in the 1984 Legal Interpretation. It also fails to effectuate the underlying purpose of § 7(b)(2)(D)(i) and (ii), which is to ensure that all least cost preference resources are assumed to be available to serve 7(b)(2) Case loads. Further, it renders the statutory provisions regarding least cost non-federal resources owned or purchased by preference

customers being available to serve 7(b)(2) Case loads mere surplusage. *United States v. Fields*, 783 F.2d 1382, 1384 (9th Cir. 1986). *Boise Cascade Corp. v. U.S.E.P.A.*, 942 F.2d 1427, 1432 (9th Cir. 1991). Such interpretations are to be avoided.

BPA's stated desire to adhere to the plain language of § 7(b)(2) also appears to be episodic. As discussed below in this brief, when interpreting the statutory language ". . . direct service industrial customer loads which are served by the Administrator. . ." the power costs of the general requirements. . ." BPA asserts that the payment of money to the DSIs is sufficient to include the costs of such subsidy in the 7(b)(2) Case power costs, even though BPA is providing no electrical service whatsoever to such loads. DROD, pp. 458-471. The legal interpretations of an agency that appears to be bound by the plain language of the statute only episodically, and only when doing so advances its own policy objectives, should not be given great credence, and its proposed treatment of the Mid-Columbia resources in the § 7(b)(2) rate ceiling test is in error.

iii. **§7(b)(2) Does Not Require a § 5(b) Contract**

In this proceeding BPA has reduced the low cost resources available in the 7(b)(2) Case by reversing its long-standing position and ignored its current regulation by excluding the Mid-Columbia resources from the 7(b)(2) Case. BPA goes a step further by imposing an additonal condition on the availability of least cost resources owned or purchased by preference customers for serving load in the 7(b)(2) Case. BPA asserts that either the owner of the resource, or the purchaser of the output from a non-federal resource, must hold a § 5(b) contract with BPA in order for such resource to be considered available under the § 7(b)(2) rate ceiling test. DROD, p. 445-446. Interestingly, this condition is found nowhere in the properly applicable 1984 Legal Interpretation, and does not appear to be contained in the 2008 Legal Interpretation either. In

applying this condition, BPA excludes from the 7(b)(2) Case the portion the Rocky Reach Hydroelectric Project owned by Chelan PUD and sold to Alcoa. Neither Chelan PUD nor Alcoa have a § 5(b) contract with BPA, and all parties acknowledge this portion of Rocky Reach has not been declared to load pursuant to § 5(b) of the Northwest Power Act. The imposition of this condition, and BPA's application of it to the Rocky Reach Project, does not square with the facts or the law.

In order for a non-federal resource to qualify for use in serving the general requirements of public bodies and cooperatives in the 7(b)(2) Case, it must be ". . . the least expensive resources owned or purchased by *public bodies or cooperatives*. . .", and must be either ". . . not committed to load. . ." or ". . . purchased from such customers by the Administrator. . .". § 7(b)(2)(D).

The term "public body" is defined in the Bonneville Project Act to mean ". . . states, public power districts, counties and municipalities, including agencies or subdivisions thereof." 16 U.S.C. 832b. The same statute defines cooperative as ". . . any form of nonprofit-making organization or organizations of citizens supplying, or which may be created to supply, members with any kind of goods, commodities, or services, as nearly as possible at cost." *Id.* There is no requirement that a consumer owned utility have a § 5(b) contract with BPA to qualify as a public body or cooperative, and § 7(b)(2)(D) does not impose such a requirement. As a consequence, any non-federal resource owned by a public body or cooperative that has either been acquired by BPA or has not been dedicated to the resource owner's load under § 5(b) is available to serve load in the 7(b)(2) Case, regardless of the presence or absence of a § 5(b) contract with BPA.

Similarly, § 7(b)(2)(D) is completely silent regarding the contract status of any purchaser of output from any non-federal resource. There is no language in § 7(b)(2)(D) that even implies,

let alone requires, that the purchaser of output from a non-federal resource have a § 5(b) contract with BPA. This is not at all surprising, since § 7(b)(2)(D) focuses on the status of the resource owner and their actions with regard to the specific resource, as BPA has historically interpreted this statutory provision, rather than those of the purchaser.

BPA argues that this is not a new condition, and that failure to impose this condition would result in non-federal resources owned by public bodies and cooperatives located in far-away places (such as New York) being eligible for inclusion in the 7(b)(2) Case, a clearly absurd result. DROD, p. 449. These are make-weight arguments that fail to address the issue presented.

The definition to which BPA refers that is set out in the 1984 Legal Interpretation and it states:

> *7(b)(2) customers:* Those firm power customers of BPA that are listed in section 7(b)(2) of the Northwest Power Act as subject to the rate test, *viz*, public bodies, cooperatives and Federal agencies.

1984 Legal Interpretation, p. 5, section II(A)(1).

This definition does not, as asserted by BPA, require that all non-federal resources included in the 7(b)(2) Case be owned or purchased by an entity with a § 5(b) contract with BPA. In fact, this definition does not refer to resources at all.

What this definition actually does is identify those entities that are subject to, and receive the benefits of, the cost protections provided by the § 7(b)(2) rate ceiling test. This definition is a direct reference to the language in the first paragraph of § 7(b)(2), which states in part:

> After July 1, 1985, the projected amounts to be charged for firm power for the combined general requirements of *public body, cooperative and Federal agency customers* . . . may not exceed in total . . . an amount equal to the power costs of general requirements *of such customers* . . .

The reference in the definition to "firm power customers" confirms this interpretation. Because the § 7(b)(2) rate ceiling provides protection to such customers by limiting the costs that can be included in the rates for their BPA power purchases, it is axiomatic that to obtain such protection a public body, cooperative or federal agency must purchase power from BPA. Simply stated, this definition has nothing to do with the issue of whether a non-federal resource must be owned or purchased by an entity with a § 5(b) contract in order to be included in the 7(b)(2) Case.

With regard to BPA's suggestion that without such a condition there would be no geographical or other limit on the resources owned by public bodies and cooperatives that could be considered available for inclusion in the 7(b)(2) Case, it is answered by the plain language of the Northwest Power Act. The statutory provision that immediately precedes § 7(b)(2) states in part:

> The Administrator shall establish a rate or rates of general application for electric power sold to meet the general requirements of public body, cooperative, and Federal agency customers *within the Pacific Northwest* . .

16 U.S.C. § 839e(b)(1)

This language clearly establishes that in the context of the rate directives contained in § 7 of the Northwest Power Act, including § 7(b)(2), references to "public body, cooperative and Federal agency customers" refers only to those located in the Pacific Northwest. And it is resources owned or purchased by such customers to which § 7(b)(2)(D) refers.

There is no basis in § 7(b)(2) or in the 1984 Legal Interpretation for imposing the condition, as proposed by BPA, that the public body owning the resource or the purchaser of such resource have a § 5(b) contract with BPA in order for that resource to be included in the 7(b)(2) Case. Imposing such a condition is contrary to the language of § 7(b)(2)(D), and in the

case of the Rocky Reach Project owned by Chelan PUD, results in the improper exclusion of a least cost resource from the 7(b)(2) Case. This results in an improper decrease in the cost protection provided to preference customers by the § 7(b)(2) rate ceiling test. It is error to impose such a condition.

B. Pre-Subscription Contracts Should Not Be Deducted From the FBS In The 7(b)(2) Case

BPA signed contracts with certain preference customer prior to the WP-02 rate case under which it committed to cap the rates for power purchased from BPA. In order to provide these rate caps, these transactions were consummated as surplus sales made under § 5(f) of the Northwest Power Act, 16 U.S.C. § 839c(f), and they were made under a surplus power rate, and not the PF rate set under § 7(b). Nevertheless, BPA has proposed to deduct these loads from the FBS capability available to serve the general requirements of public body, cooperative and Federal agency loads in the 7(b)(2) Case. DROD, p. 479. BPA's proposal is contrary to the law.

In the first instance, these Pre-Subscription contracts do not qualify as obligations that can reduce the size of the FBS available to serve the general requirements of public bodies and cooperatives in the 7(b)(2) Case. Only contracts that were in existence as of December 5, 1980, can be deducted from the FBS, and there is no question that these contracts were not in existence as of that date. See, 16 U.S.C. 839e(b)(2)(B).

Further, the Pre-Subscription loads cannot be included in the load of public bodies and cooperatives under the § 7(b)(2) rate ceiling test. The loads protected by, and the loads included in, the § 7(b)(2) rate ceiling test are limited to the general requirements of public bodies and cooperatives. As stated in part in § 7(b)(2):

> After July 1, 1985, the projected amounts to be charged for firm power for the combined *general requirements* of public body, cooperative and Federal agency customers . . . shall not exceed in total . . . an amount equal to the power costs of *general requirements* of such customers . . . (Emphasis supplied)

16 U.S.C. § 839e(b)(2)

The Northwest Power Act also defines the term general requirements, stating that it means ". . . the public body, cooperative or Federal agency customer's electric power purchased from the Administrator under section 839c(b) of this title . . .". 16 U.S.C. § 839e(b)(4) The Pre-Subscription contracts were not requirements power sales under § 5(b), but were surplus sales under § 5(f) of the Northwest Power Act. As such, they do constitute general requirements as that term is defined in § 7(b)(4), and cannot, consistent with § 7(b)(2), be included in the general requirements of public bodies and cooperatives in the 7(b)(2) Case.

BPA suggests that it is appropriate to deduct these loads from the FBS capability available to serve the general requirements of public body, cooperative and Federal agency customers in the 7(b)(2) case because these purchasers have historically been part of BPA's general requirements load, the Pre-Subscription contracts are taking the place of the § 5(b) contracts these purchasers formerly had with BPA, and upon the expiration of these Pre-Subscription contracts these customers will once again become part of BPA's general requirements load. Based on these factors, BPA concludes that it is appropriate to deduct the Pre-Subscription contract sales from the FBS capability for purposes of the 7(b)(2) Case. DROD, pp. 472-479.

While all of the factors cited by BPA may be worthy of consideration, they are irrelevant to the question of whether the Pre-Subscription contract sales can be deducted from the FBS capability used in the 7(b)(2) Case, regardless of when that deduction occurs. The loads served

by the Pre-Subscription contracts are not purchases under § 5(b) contracts, and hence they cannot be included in the category of general requirements under the § 7(b)(2) rate ceiling test. The only other contract loads that may be deducted from the FBS in the 7(b)(2) Case obligations are specifically noted ". . . to other entities under contracts existing as of December 5, 1980 . . .". § 7(b)(2)(B). Clearly the Pre-Subscription contracts were not in existence as of December 5, 1980.

BPA's proposal to deduct the load served under the Pre-Subscription contracts is contrary to the plain language of § 7(b)(2). BPA's willingness to ignore this plain statutory directive stands in stark contrast to its professed desire to implement the § 7(b)(2) rate ceiling test in accordance with the plain language of the statute.

C. Cash Payments to DSIs Cannot be Included as 7(b)(2) Case Power Costs

BPA is proposing to include in the power costs under the 7(b)(2) Case, the cash payments it is expecting to make to the DSIs, even though BPA will provide no actual load service to the DSIs. DROD, pp. 458-471. This proposal appears to be motivated by the desire by BPA to avoid shifting the costs of the DSI subsidy payments to the IOUs. While BPA's goal is understandable, its interpretation flies in the face of the plain statutory language.

Section 7(b)(2)(A) of the Northwest Power Act, 16 U.S.C. § 839e(b)(2)(A), requires the Administrator to assume, when implementing the § 7(b)(2) rate ceiling test that:

> The public body and cooperative customers' *general requirements* had included during such five-year period the direct service industrial customer loads which are
>
> (i) Located within or adjacent to the geographic service boundaries of such public bodies and cooperatives; (Emphasis supplied)

16 U.S.C. § 839e(b)(2)(A)

The term "general requirements" is defined in the statute to mean ". . . the public body, cooperative or Federal agency customer's *electric power purchased from the Administrator* . . .". 16 U.S.C. § 839e(b)(4) The plain meaning of this statutory language is that the actual electrical load of a "within or adjacent to" DSI must be assumed to be included in the power costs for public body or cooperatives for purposes of implementing the § 7(b)(2) rate ceiling test. This is the manner in which the costs of serving the DSIs are accounted for under the § 7(b)(2) rate ceiling test.

BPA has elected to provide "benefits" to the DSIs in the form of cash payments, rather than making actual power deliveries to the DSIs to serve their loads. The fact that BPA has elected to provide benefits to the DSIs in a form that is not cognizable under the express provisions of the § 7(b)(2) rate ceiling test does not give BPA the discretion to include the costs of this cash subsidy in the power costs of the 7(b)(2) Case. The statutory language only permits the costs of DSI loads served by the Administrator to be included in the 7(b)(2) Case power costs. The cash payment method that BPA has elected to use for the DSIs guarantees that they will not be served by BPA, and as a consequence of the plain statutory language of § 7(b)(4) these subsidy costs cannot be included in the 7(b)(2) Case.

This is yet another example of where BPA's pursuit of its policy goal of continuing to provide benefits to the DSIs after BPA's obligation to do so has long since expired has prompted it to propose a treatment under the § 7(b)(2) rate ceiling test that ignores the plain language of the statute. The proposal to include the DSI subsidy costs in the 7(b)(2) Case power costs is in error.

D. The BPA Has Made Inconsistent Assumptions Regarding REP Participation

In calculating the amount of reimbursement preference customers are entitled to for the FY2002-2006 period, BPA has updated virtually every fact related to the IOU participation in the REP. This has included updating the costs used to forecast their ASCs, including purchased power costs, and revising the operation of the § 7(b)(2) rate ceiling test to permit the payment of substantially higher REP benefits. Further, BPA has assumed that each IOU would act in its own financial self interest by either signing, or deferring the signing, of RPSAs in a manner that maximizes the financial benefits received. DROD, pp.194-195; 453-454.

BPA has not performed a comparable update for potential preference customer participants in the REP, such as Clark Public Utilities ("CPU"). WP-07-E-WA-05, pp. 39-43. Further, BPA has rejected the notion that CPU would have made different decisions regarding participation in the REP under the vastly different circumstances postulated in BPA's "what if" analysis. DROD, pp. 128-130. As a consequence, in the context of its "what if" analysis, BPA has materially understated the portion of the REP payments that would be made to preference customers, and substantially overstated the amount of REP payments the IOUs would receive in the FY2002-2006 period.

By failing to apply to preference customers in similar circumstances the same assumptions that it has used for the IOUs, BPA has committed error.

E. BPA Has Erroneously Assumed That Actual REP Payments Are Unlimited

BPA argues in the DROD that the actual REP payments made to the IOUs, and those BPA has forecast it would have made in the FY2002-FY2008 period absent the REP Settlement

Agreements, are not subject to any limit due to the operation of the § 7(b)(2) rate ceiling test. According to BPA, the § 7(b)(2) rate ceiling test operates only on a forecast rate-setting basis, and BPA is free to pay the IOUs whatever level of benefits result from the application of the ASCM. DROD, pp. 91; 112. In this regard BPA is in error.

The purpose of the § 7(b)(2) rate ceiling test, as established by Congress, is to provide preference customers real cost protection, and not the illusion of cost protection that could be forecast on the one hand and then taken away in reality on the other. The purpose of the § 7(b)(2) rate ceiling test was described in the legislative history of the Northwest Power Act as follows:

> . . . section 7(b) reserves for preference customers the price benefits for Federal power that they would have enjoyed in the absence of this legislation. This is accomplished by a "rate ceiling" which governs preference customer general requirements rates. Under this provision, the Northwest preference customers could pay less – but not more – for power under the legislation than they would have in any five-year period.

BPA's proposal to pay actual REP benefits without any limit, and without regard to the results of the § 7(b)(2) rate ceiling test, is not consonant with the statutory purpose. If BPA pays (or forecasts the payment as is the case for the FY2002-FY2008 period) actual REP benefits in excess of the levels used to implement the § 7(b)(2) rate ceiling test, the inevitable result of such overpayments will be either the decrease in BPA's financial reserves for which BPA's preference customers will be charged later, or the triggering of a cost recovery adjustment clause to recoup the costs of REP payments in excess of forecast levels, again from preference customers. In either case, the net result is that the rates paid by preference customers will be increased above the amounts, determined pursuant to the§ 7(b)(2) rate ceiling test, that BPA can

lawfully charge those customers. Such an outcome would violate the express language, as well as the Congressional intent, of the § 7(b)(2) rate ceiling test.

BPA cannot do indirectly what it lacks the authority to do directly. Paying actual REP benefits in excess of levels forecast in the applicable § 7(b)(2) rate ceiling test results in preference customers paying indirectly amounts in excess of the amounts that Congress intended them to pay. This is exactly the type of "end around" that the 9th Circuit found unlawful in the *PGE* and *GNA* decisions. But also as recognized in those decisions, BPA would be free to make actual REP benefit payments in excess of levels forecast in the applicable § 7(b)(2) rate ceiling test if, but only if, the costs of such overpayments are borne by customers other than BPA's preference customers. This limitation is not acknowledged in the DROD, and is not incorporated into the forecast REP benefits calculated by BPA for the FY2002-FY2008 period. Failure to do so constitutes error.

4. BPA HAS ERRORED IN FAILING TO PROPERLY CALCULATE THE AMOUNT OF ILLEGAL OVERCHARGES AND BY FAILING TO ENSURE REIMBURSEMENT TO PREFERENCE CUSTOMERS

A. The Illegal Overcharges Were Improperly Calculated

BPA calculated the total illegal overcharge imposed on preference customers during the FY2002-2008 period at about $2.602 billion, before any adjustments for amounts allegedly due the IOUs according to the updated Table 15.3 provided by BPA at the August 27, 2008 workshop (Updated Table 15.3). However, BPA does not subtract from this amount the REP costs BPA determined it was lawful to charge preference customers in the WP-02 and WP-07 cases, which would result in a total repayment obligation of 2.3 billion. Instead, BPA engages in a number of legally unsustainable calculations, faulty legal interpretations and revisionist

assumptions that result in a material decrease in the reimbursement to which, according to BPA, preference customers are entitled. Among other things, BPA has:

- Recalculated the § 7(b)(2) rate ceiling test in a manner that materially reduces the cost protection provided to preference customers.
- Relied on a different PF Exchange rate to determine the level of REP benefits available to the IOUs.
- Assumed that the cost recovery adjustment clauses ("CRACs") that were actually in place during the respective rate periods would not have been adopted or implemented.
- Used an entirely different PF rate than the one determined by BPA in the WP-02 rate case would have been in place.
- Forecast ASCs for the IOUs using information not available when the respective rate tests were actually performed in the WP-02 and WP-07 cases.
- Forecast actual REP payments to the IOUs without any limitation based on the amounts BPA determined it could lawfully charge its preference customers under the applicable§ 7(b)(2) rate ceiling test.
- Charged the preference customers the costs of the LRAs, which costs are at bottom REP costs, over and above the amounts the BPA determined it could lawfully charge its preference customers the § 7(b)(2) rate ceiling test.

As a result, the calculation of the amounts owed to the preference customers due to the illegal inclusion of REP Settlement costs in the PF rates in excess of the § 7(b)(2) rate ceiling test limits calculated by BPA in the WP-02 and WP-07 cases is substantially understated.

Reliance on the § 7(b)(2) rate ceiling test determinations actually made by BPA in the WP-02 and WP-07 rate cases produces a far different result. For the FY2002-FY2006 rate period, preference customers were charged a total of $1.93 billion in REP Settlement costs,[4] based on the updated Table 15.3, compared to the $240 million that BPA determined in the WP-02 rate case that it could lawfully charge preference customers in REP costs for the FY2002-FY2006 rate period under the § 7(b)(2) rate ceiling test. WP-02-FS-BPA-05A, p. 166. Subtracting this $240 million in permissible REP costs from the total unlawful overcharge of $1.93 billion results in a reimbursement amount owed to preference customers of $1.69 billion for the FY2002-FY2006 rate period.

Similarly, for the period FY2007-FY2008, the preference customers were charged a sum of $673 million in REP Settlement costs,[5] WP-07-E-BPA-44A, Table 15.3, pp. 1041-1043, compared to the $58 million that BPA determined in the WP-07 rate case that it could lawfully charge preference customers for the REP costs under the § 7(b)(2) rate ceiling test. WP-02-FS-BPA-05A, p.31. Subtracting the $58 million in permissible REP costs from the total REP Settlement amounts charged preference customers during the FY2007-2008 period results in an amount owed of $615 million. The sum of the amounts owed preference customers periods for these two periods results in a reimbursement amount owed to preference customers of $2.3 billion. When interest is added to this sum, the total amount that should be reimbursed to preference customers for the FY2002-2008 period is $2.59 billion.[6]

In contrast, BPA is proposing to reimburse preference customers about $259.6 including interim payments of the $673 million in REP Settlement costs collected from preference

[4] This amount includes payments under the LRA, but does not include deemer balances which were not part of the REP Settlement overcharges.
[5] This amount includes litigation penalty payments.
[6] The interest calculation is based on the T-bill rate, and is explained at WP-07-E-WA-05, pp. 49-51.

customers in the FY2007-2008 period. Workshop handout, p. 3. For the FY2002-2006 period, BPA is proposing that the IOUs be responsible for repaying about $166.9 million. Workshop handout, p. 3. Or said another way, BPA is proposing that the liability of preference customers for REP Settlement costs for the FY2002-2008 period should be $1.87 billion, compared to the $300 million determined by BPA's application of the § 7(b)(2) rate ceiling test in the WP-02 and WP-07 rate cases. *Id.*

BPA's re-examinations, reinterpretations and recalculations in this proceeding have increased the liability of preference customers for REP Settlement costs five-fold, compared to the liability for such costs BPA determined in the initial WP-02 and WP-07 rate cases. The net result of BPA's efforts has not been to determine what is owed its preference customers for bearing seven years of illegal overcharges that have flowed from their customers to the benefit of the IOU customers, but to sustain REP Settlement benefits for the IOUs at about $240 million per year for the overcharge period, compared to assured reimbursement to the preference customers of approximately $60 million per year.

BPA's proposed result does not comport with its obligation under the remand in the *GNA* decision. This proposed result is inequitable, and is not sustainable legally or politically.

B. No Method Has Been Proposed to Assure Reimbursement of the Preference Customers

BPA has proposed a shorter schedule for the repayment of the amounts that preference customers were overcharged due to the illegal inclusion of REP Settlement costs in the PF rate during FY2002-FY2008 period, and has proposed to increase the amount of overcharge repayment that will be provided in FY2009. DROD, pp. 210-212. These are both positive

proposals. However, the fundamental issue with regard to surety of repayment remains, because as the WPAG utilities understand the BPA proposal, and the amount of the IOU repayment can be revised in any subsequent rate proceeding.

As matters now stand, the BPA repayment proposal for preference customers is deficient in three areas. First, the amount of the IOU repayment obligation is woefully understated, due to BPA's failure to properly respond to the remand order in the *GNA* decision as described herein. Second, while the repayment period has been shortened and the payment amount for FY2009 has been increased, the only certainty provided to preference customers is for FY2009, since these proposals can be revisited and altered in any subsequent rate proceeding. Third, this modest increase in the speed of repayment and the initial amounts has come at the cost of a permanent three-fold increase in the REP costs preference customers will have to shoulder long after the seven year repayment period has ended.

Because BPA has been unwilling to fulfill its legal responsibility to retrieve from the IOUs the money that was illegally provided to them, and illegally included in BPA rates paid by preference customer during the FY2002-FY2008 period, BPA has pursued an approach of increasing the REP payments to the IOUs to a level where the illegal overpayments could be offset without eliminating the REP benefits received by the IOUs. As a consequence, the agency's legacy for this period will be a small repayment to preference customers, followed by an apparently permanent three-fold increase in REP costs that will be included in their rates.

At the end of the day, BPA is proposing to allow the IOUs to retain about $1.70 billion of the $2.59 billion in illegal overcharges paid by preference customers during the FY2002-2008 period. This approach turns the remand order on its head, and ensures that those who benefitted from the imposition of the illegal overcharges on the preference customers will retain the bulk of

the benefits of such overcharges in the future. By taking this approach, BPA has failed to respond in a lawful manner to the remand order in *GNA.*

5. CONCLUSION

The Administrator has responded procedurally (shortening the repayment period and increasing the initial payment) to this opportunity to demonstrate to his preference customers that he is willing to make the hard decisions necessary to right the wrong that was committed. Based on the other positions taken in the DROD, however, it appears that BPA's response will be limited to procedural changes, and that opportunity to right the fundamental wrong suffered by preference customers during the FY2002-FY2008 period by appropriately calculating and returning to them the illegal amounts they paid will not be seized. Instead, it appears that the same legal error that was made in the WP-02 and WP-07 rate cases is going to be replicated in this proceeding, leading to the same aftermath that followed those rate cases.

Once again the WPAG utilities urge the Administrator to lay a solid foundation for the post-2011 business relationship by acting to right the wrong that was committed against preference customers in the two prior BPA rate proceedings, even if doing so requires the Administrator to abandon his policy goal of "spreading the benefits of the FCRP as broadly as possible" throughout the region.

Dated this 3rd day of September, 2008.

Respectfully submitted,

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