**UNITED STATES OF AMERICA**
**DEPARTMENT OF ENERGY**
**BEFORE THE**
**BONNEVILLE POWER ADMINISTRATION**

| | | |
|---|---|---|
| 2010 WHOLESALE POWER | ) | **BPA Docket No. WP-10** |
| RATE PROCEEDING | ) | |
| PROCEEDING | ) | |

---

**DIRECT TESTIMONY OF**:

**PUBLIC POWER COUNCIL,**

**INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES, AND**

**CITY OF TACOMA, DEPARTMENT OF PUBLIC UTILITIES, LIGHT DIVISION, DBA TACOMA POWER**

**SUBJECT:**

**DSI SERVICE ASSUMPTIONS AND IP RATE**

---

WITNESSES:

Kevin P. O'Meara
Michael C. Deen
Barbara Beck
Lincoln Wolverton

March 20, 2009

*Q. Please state your names, positions of employment, and qualifications.*

A. My name is Kevin O'Meara. My qualifications are shown at WP-10-Q-PP-03.

A. My name is Michael C. Deen. My qualifications are shown at WP-10-Q-PP-04.

A. My name is Barbara Beck. My qualifications are shown in WP-10-Q-PP-05.

A. My name is Lincoln Wolverton. My qualifications are shown in WP-10-Q-IN-01.

**Section 1: Assumed Level of DSI Service**

*Q. What is the purpose of this portion of your testimony?*

A. To address the level of DSI service by BPA that BPA has assumed in the Initial Proposal.

*Q. How did BPA derive the aluminum DSI load level?*

A. Our understanding is that BPA determined the number by calculating the difference between the IP rate and market power price and then calculating the MWHs that could be provided at a cost of $59 million, which represents the cost that the agency deems appropriate to incur for the DSIs.

*Q. Is this a proper method of forecasting DSI load?*

A. No. BPA should forecast DSI loads using normal load forecasting methods aimed at accurately estimating actual amounts of expected load.

*Q. Why is it improper to simply assume that the DSIs will operate at a sufficient level to impose the entire cost BPA appears willing to incur for the DSIs?*

A. There are several reasons. The first is that the economy has deteriorated markedly over the past several months. Commodity prices have taken a hit. A recent Wall Street Journal table (3/12/09) shows that the spot market price for aluminum is down over 50% from a year ago. Press reports of statements from Alcoa and CFAC indicate that they could shut down or curtail production. BPA has not provided a reasonable basis for its assumptions about the likely magnitude of DSI load.

*Q. Would it ever be appropriate for BPA to assume a limit on the amount of costs it assumes to occur to provide DSI service?*

A. Yes. Our understanding is that BPA has no obligation to serve the DSIs, so if it chooses to, and is authorized to do so, it could make a reasonable determination to serve them only up to an amount that would correspond with a certain cost. However, the issue here is that BPA is unreasonably assuming that the DSIs will operate at a level that will correspond with the amount of service that BPA may provide.

*Q. Would it be reasonable to assume instead a continuation of the current financial benefits?*

A. No. Our understanding is that the Ninth Circuit invalidated major portions of the contracts under which the DSIs had been receiving financial benefits. Since the Ninth Circuit's opinion, BPA has entered into subsequent contracts with Alcoa and CFAC. However, those arrangements are temporary and expire at the end of this fiscal year. Further, these temporary arrangements are the subject of ongoing litigation, and may be invalidated as well. Given that BPA has not executed new contracts that would provide financial benefits to any of the DSIs during the FY 2010-11 period, that economic conditions may mean that the DSIs do not operate during this period, and that even the current contracts for FY 09 may not be valid, it would be unreasonable to assume a continuation of the current financial benefits into the next rate period.

*Q. How has BPA responded to the PNGC ruling and the potential effects on DSI service for FY 2010-2011?*

A. On January 13, 2009, BPA issued a letter announcing that it had signed a contract to provide payments to Alcoa during FY 2009. In that letter, BPA stated it will take time in 2009 to engage with the public more fully on any potential amendments to address service in FY 2010-2011. BPA further stated it is aware of the need to find a way to address overpayments made in 2007 and 2008 as part of that process. This uncertainty also weighs against BPA's assumption of significant DSI load operating during the FY 2010-11 period. Our brief will address the deficiencies in BPA's response.

Q. *Even if BPA continues to assume some level of service to the DSIs in this rate period, are BPA's proposed costs for DSI service reasonable?*

A. No. Even if BPA continues to assume that the DSIs will operate, there are errors in the proposed costs of serving the loads. First, the assumption that the subsidy will remain at $59 million per year is likely incorrect. Second, the assumed cost of augmentation is too high.

Q. *Why is the assumption of a continuing $59 million per year subsidy incorrect?*

A. As PPC's brief will explain, even without a change in market prices the PNGC decision will not permit the same level of subsidy as before.

Q. *Why is the assumed cost of augmentation too high?*

A. BPA's current market price forecast is out of date and should be revised downward based on current market conditions. Lower market prices mean that BPA will be able to acquire any needed power at a lower cost than currently projected in the Initial Proposal.

**Section 2: IP Rate**

Q. *Do you have any commentary on BPA's implementation of the IP rate in this proceeding?*

A. Yes, we have comments on several aspects of BPA's proposed IP rate implementation, including the calculation of the Industrial Margin and the value of reserves adjustment.

*Q. How did BPA determine the IP rate in its Initial Proposal?*

A. The IP rate was determined by adding an Industrial Margin of approximately 0.57 mills/kwh to the PF rate at 100% load factor and then making adjustments for the value of reserves and the allocation of Section 7(b)(3) protection amounts.

*Q. Did BPA follow its past practice in determining the Industrial Margin?*

A. Not completely. In the 2002 and 2007 rate cases, PPC surveyed its members to gather cost-of-service information that was used to determine the typical margin charged by preference customers to their large industrial customers. For the current rate proceeding, no such survey was undertaken.

*Q. How was the Industrial Margin determined for BPA's Initial Proposal?*

A. BPA merely used the WP-07 value without update.

*Q. Is this an appropriate approach?*

A. No. Four years have passed since the last survey was performed. Many utility costs have risen during that time, so leaving the margin unchanged understates the size of the typical margin.

*Q. How can this shortcoming be remedied?*

A. The most correct method would be to re-perform the Industrial Margin survey and study. If BPA is unable to do so because of the press of time, the next best option is to adjust the level of the margin by an inflation factor, such as the GDP Implicit Price Deflator.

*Q. Are there other aspects of BPA's Industrial Margin approach that are inappropriate?*

A. Yes. In WP-07, BPA excluded the Washington state revenue tax from the Industrial Margin. The rationale for this was that, since Washington is the only Northwest state charging this tax, it is not typical and should be excluded.

*Q. Do you agree with this rationale?*

A. No. Two out of three current DSIs are located in Washington, as is the majority of public utility load served by BPA. Additionally, the vast majority of DSI load in terms of aMWs is in Washington. Therefore, the tax appears typical and should be included in the Industrial Margin.

*Q. Is there any other aspect of the WP-07 Industrial Margin methodology with which you disagree?*

A. Yes. In WP-07, BPA excluded all of the utility's own distribution costs from the margin. This is unreasonable since standard ratemaking practice would have all customers paying rates based on the utility's costs of providing service. Industrial customers frequently utilize their local utility's distribution systems and would typically pay a portion of those costs.

*Q. Please summarize the changes you propose to the implementation of the Industrial Margin in this proceeding.*

A. We believe BPA should either completely update the study or at least adjust the cost levels using an inflation factor such as the GDP Implicit Price Deflator. As discussed, BPA should also include revenue taxes as a typical cost in the margin. Finally, BPA should not exclude local utilities' distribution costs from the margin calculation.

*Q. Apart from the Industrial Margin, do you have comments on any other aspects of the IP rate?*

A. Yes, we have comments on the Value of Reserves adjustment.

*Q. What are your comments on the Value of Reserves Adjustment?*

A. While we recognize that the proposed credit is small--$1 per MWh amount (WP-10-E-BPA-30, page 11)—establishing a value is problematic for several reasons. First, there is no contractual definition of what will be provided; there are no adequate contracts in place for the rate period (ibid, page 10); *see also* BPA Response to PN-BPA-14. Second, there limitations on usage of those reserves in terms of length of an interruption and the number of times per month such interruptions can take place, and there are differences in terms between the unsigned contractual proposal and BPA's testimony. Third, if the DSIs are last-off-first-on in any interruption, some reduction in value needs to be assessed for the lack of flexibility in being able to use those reserves.

If BPA thinks that DSI reserves are valuable, it should offer those DSI interruption rights to third parties, and see what value the market places on those rights.

*Q. Does this conclude your testimony?*

A. Yes.