UNITED STATES OF AMERICA
US DEPARTMENT OF ENERGY

BEFORE THE
BONNEVILLE POWER ADMINISTRATION

Proposed Residential Exchange Program Settlement Agreement Proceeding	BPA Docket REP-12

INITIAL BRIEF OF THE
ASSOCIATION OF PUBLIC AGENCY CUSTOMERS

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Pursuant to Section 1010.13 of the BPA Rules of Procedure Governing Rate Hearings and the Procedural Schedule adopted in this matter, the Association of Public Agency Customers (APAC)[1] files this Initial Brief.

I. SUMMARY AND INTRODUCTION

The settlement agreement proposed in this case should not be accepted by the Administrator for three reasons: First, by creating a residential exchange (ResEx) benefit significantly different than that required by the NWPA,[2] the settlement will exceed BPA's statutory authority, as did the REP Settlement Agreement overturned in *PGE* and *Golden NW*.[3] Second, even if the proposed settlement were statutorily permissible, it is unreasonable. Finally, BPA cannot unilaterally impose the terms of the proposed settlement on parties to the REP appeals that have not accepted it.

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1 Members include Georgia-Pacific LLC, Grays Harbor Paper LP, JR Simplot Co., Longview Fibre Paper and Packaging, Inc., Ponderay Newsprint Company and Weyerhaeuser Company.

2 Pacific Northwest Electric Power Planning and Conservation Act, 16 U.S.C. §839 et seq.

3 *Portland General Electric Co. v. Bonneville Power Administration,* 501 F.3d 1009, 1032 (9th Cir. 2007); *Golden Northwest Aluminum v. Bonneville Power Administration,* 501 F.3d 1037, 1047 (2007).

Alternatively, assuming the Administrator determines he will not accept the settlement agreement, BPA must, to ensure compliance with the NWPA, use the results of the §7(b)(2) rate test conducted in this case to set rates for the contemporaneous BP-12 rate case. BPA made three types of errors in its conduct of the §7(b)(2) test in this case:

- The five "legacy" issues identified in prior cases and pending judicial review have not been addressed. This includes the discounting of costs for the future four years on which APAC provided additional testimony in this case.
- The inclusion of incorrect values for the net value of reserves from the DSI contracts.
- The improper preservation of the level of conservation "informing" the determination of the Contract High Water Mark.

II. THE SETTLEMENT AGREEMENT IS ILLEGAL AND UNFAIR TO THE NON-SETTLING PARTIES AND SHOULD BE REJECTED

A. Acceptance of the Settlement Agreement by BPA Would Be a Direct Violation of the Ninth Circuit's Decisions in *PGE* and *Golden NW*

In the 2007 decisions which form the backdrop for the settlement agreement, the Ninth Circuit held that in exercising its authority to settle disputes, BPA must meet the statutory mandates of the Northwest Power Act, including §7(b)(2). Any settlement agreement accepted by BPA must produce a PF rate that complies with the same (*i.e.*, the settlement must provide the continued protections of §7(b)(2) to the Preference Customers).

As the Ninth Circuit held in the *Portland General Electric* case:[4]

> *whenever BPA engages in a purchase and exchange of power-whether on a yearly basis, under a REP program, or*

[4] *Portland General Electric Co. v. Bonneville Power Administration,* 501 F.3d 1009, 1032 (9th Cir. 2007).

> *pursuant to a settlement agreement-BPA acts pursuant to its § 5(c) authority, and is thus subject to the Congressionally imposed limitations on that authority as expressed in § 5(c) and § 7(b).*

The proposed settlement agreement violates the constraint identified in *PGE* because it does not comply with the directives of either §5(c) or 7(b). As explained more fully below, the implementation of the settlement would:

- Prohibit BPA from setting rates using the §7(b)(2) rate test;
- Allow the fixed benefits of the settlement to replace the results of the §7(b)(2) rate test;
- Require BPA to set residential exchange benefits which are not based on the difference, as dictated by §5(c), between utility Average System Costs (ASCs) and the BPA rates set under §7(b), and
- Exempt residential exchange rates from imposition of charges under the Cost Recovery Adjustment Clause.

Having found in *PGE* that any residential exchange program must be bound by the requirements of §§5(c) and 7(b), the Ninth Circuit then considered whether the 2000 REP Settlement Agreements violated those constraints and were contrary to law. Among the factors the court considered in finding that the settlement agreement was contrary to law were the facts that ASCs were not used to determine benefit levels[5] and that BPA determined benefit levels based on "a critical set of assumptions" about the outcome of litigation that were unreasonable.[6] Similarly, in this case the settlement sets ResEx benefits independent of the differential between ASCs and BPA's rates and uses assumptions about the outcome of litigation which is unreasonable.

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[5] *Id.*, at 1033.

[6] *Id.*, at 1033-1034.

The proposed settlement is presented as a replacement for the determinations made by BPA in the WP-07S case.[7] As such it must comply with the mandates of the Ninth Circuit in the *PGE* and *Golden NW* cases.[8] However, in addition to requiring BPA to take actions contrary to the explicit statutory requirements of the NWPA, the settlement agreement purports to impose terms that clearly exceed the court's mandate. For example, the court rejected BPA's collection from Preference Customers of the costs of the illegal REP Settlement Agreements. The proper scope of BPA's response was limited to refunding those improper collections. But in the WP-07S ROD and implicitly in this settlement agreement, BPA adopts rate adjustments to its rates which fail to refund all of the improper overcollections and which reflect revisions to its ratemaking methodology exceeding the scope of the remand. The proposed settlement agreement must be rejected as an unacceptable response to the mandate of the Ninth Circuit in *PGE* and *Golden NW.*

Just as in the 2000 REP Settlement Agreement struck down by the Ninth Circuit in *PGE* and *Golden Northwest*, in this case BPA would implement a settlement agreement proposing another alternative for setting ResEx benefits. Like the 2000 Agreement, the proposed settlement violates requirements in the NWPA and the boundaries of the Ninth Circuit's mandates. Moreover, the proposed settlement agreement is not being supported by many publics and their consumers. Public utility consumers, as the ultimate parties who pays the rates billed by BPA to publics, are the

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7 REP-12-E-BPA-4, p. 3, line 24 – 4, line 2.

8 WP-07-B-AP-1, p. 25, *et seq.*.

real parties in interest here – and are the individuals and entities who have been and will be injured by BPA's continued error.

B. The Settlement Agreement Violates the NWPA in Several Ways

1. The settlement eliminates the required test of rates under §7(b)(2).

The NWPA requires BPA to run the §7(b)(2) test to set a rate ceiling, and then the costs in excess of that ceiling are allocated to other rates, including the Exchange rate. The settlement agreement stands that process on its head, and first determines the total exchange benefits, and then forces adjustments to the PF rate to meet BPA's total revenue requirement. Effectively, the PF rate is set to support the ResEx benefits that have been predetermined by the proposed settlement agreement, without any constraint by the §7(b)(2) rate test.

BPA Staff argues it has satisfied the statutory requirements of §7(b)(2) by testing the settlement agreement against many scenarios of projected economic factors and litigation outcomes. That is an unpersuasive semantic exercise. The NWPA clearly requires the rate test set the rate ceiling. Preference rates cannot be greater than those allowed under the ceiling. Section 7(b)(2) specifically states that "projected amounts" of costs may not exceed the costs under the assumptions of the §7(b)(2) Case. Staff's analysis fails to honor that absolute role of the §7(b)(2) rate test. In fact, Staff's analysis directly violates §7(b)(2) in that the projected costs under some of the various scenarios in Staff's analysis did exceed the §7(b)(2) Case. The Administrator cannot represent his best estimate of "projected costs" is not exceeded by the rates under the settlement agreement.

There are two other indications that Staff's analysis does not satisfy the statutory constraints of §7(b)(2). First, in every other rate case, the result of the §7(b)(2) rate test can be directly, arithmetically linked to the rates. In this case, as Staff admitted, there is no run of the §7(b)(2) rate test producing the rates proposed.[9]

Second, in the §7(b)(2) rate test, one must project actual costs for the rate period and the following four years; in this case, Staff analyzes possible litigation outcomes and then projects the resulting costs over 17 years. As APAC and WPAG testified, projecting costs over such an extended period produces an unreliable and unreasonable result. By definition, the reliability of a 17-year projection cannot be compared to the five-year projection chosen by Congress. BPA Staff attempts to justify its 17-year study window based on the IOUs' willingness to accept a defined benefit over that period:

> *If the IOUs are willing to take a fixed amount of REP benefits over multiple rate periods, we believe that it makes sense to run the 7(b)(2) rate test for an equivalent amount of time to determine whether the protections afforded to the COUs by the rate test have been met.*[10]

A ratepayer's voluntary offer to take a particular benefit does not release BPA from its statutory obligation under §7(b)(2). The NWPA prohibits an exchanging IOU from receiving a benefit greater than the difference between its ASC and the PF Exchange rate. The NWPA clearly contemplates that this benefit may change to reflect the economic realities of any particular rate period. Allowing a group of ratepayers to

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9 REP-12-E-AP-07; *Transcript*, Vol. II, p. 175, lines 7-11.

10 REP-12-E-BPA-12, at 6.

voluntarily set their own rate in violation of the statute is particularly egregious where it imposes a greater likely cost burden on other ratepayers.

Although it may not directly affect BPA's statutory obligations, BPA should be concerned about the COUs' ability to perform. The settlement agreement requires the COUs to pay rates sufficient to produce the Scheduled Amounts for the IOUs regardless of actual costs. Although any one COU would only be responsible for a portion of such benefits to the extent it purchased power, such pre-ordained liability seems comparable to that of the COUs examined in the WPPSS litigation. In the *Chemical Bank* case,[11] the Washington Supreme Court held that publicly-owned utilities could not undertake the "dry hole liability" of paying costs regardless of whether the project was built or generated electricity. Similarly, under the proposed settlement agreement in this case, regardless of actual costs, the COUs would undertake the obligation to pay $182 million to the IOUs in the first year, and a commensurate amount each year thereafter. As the Ninth Circuit has held several times, the §7(b)(2) rate test guarantees that COUs pay no more in rates than they would have paid absent the ResEx program.[12] In providing a guaranteed benefit to the IOUs, the settlement agreement would force COUs to pay their share of those benefits regardless of its effect on their rates. BPA must examine whether COUs can undertake an obligation that ignores those statutory protections.

2. The proposed settlement disregards the difference between ASCs and BPA's PF Exchange rate in setting ResEx benefits.

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[11] *Chemical Bank v. Washington Public Power Supply System,* 666 P2d 329 (WA 1983), *reh. en banc,* 691 P2d 524.

[12] *Golden Northwest Aluminum v. Bonneville Power Administration,* 501 F.3d 1037, 1047 (2007).

The proposed settlement agreement violates the NWPA by setting a ResEx benefit without regard to the IOUs' ASC or the difference between the ASCs and the PF Exchange rate. The REP benefit should be set as the difference between the Exchange rate and the utilities' ASCs, based on the sale and purchase construct.[13] *"The REP essentially acts as a cash rebate to the IOUs where the IOUs' power costs exceed those of the BPA."* [14]

However, contrary to that construct, the settlement agreement sets the ResEx benefit without regard to the comparative level of ASCs and Exchange rate. Although the total ResEx benefits are allocated among the individual IOUs using their respective ASCs, that limited use of the ASCs only allocates the proportion of REP benefits between IOUs. It does not determine whether the actual level of ResEx benefits assigned to a particular IOU is permissible under the NWPA. This is another example of BPA's efforts to turn the NWPA's directives on their head. The NWPA is quite clear. The Exchange rate is set first, as a result of the §7(b)(2) rate test. Then the level of ResEx benefits is determined as the difference between that rate and the ASCs. In contrast, under the settlement agreement, the level of ResEx benefits is set first, and the Exchange rate may be varied in each rate period to support the predefined benefit.

BPA's disregard of actual ASC levels is also demonstrated by §6.1.2 of the settlement agreement, pursuant to which BPA would adjust unconstrained benefits if ASCs are too low to pay all of the settlement amount. If an exchanging utility would not have been entitled to ResEx benefits because its ASCs are lower than BPA's Exchange

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[13] 16 U.S.C. §839c(c).

[14] *Portland Gen. Elec.,* 501 F.3d at 1015; *see also WUTC v. FERC,* 26 F.3d 935,936-37 (9th Cir. 1994) *CP Nat'l v. BPA,* 928 F.2d 905, 907 (9th Cir. 1991).

rate, this provision may permit manipulation of the benefit calculation such that that utility could receive benefits, solely to preserve the payment of the scheduled amounts. In sum, under the proposed settlement agreement, the predetermined settlement amounts drive the rate determinations in this case, not the IOUs' actual costs.

3. The settlement agreement also improperly excuses Exchange rates from the imposition of a CRAC.

Under the settlement agreement, the level of ResEx benefits is protected from the operation of a Cost Recovery Adjustment Clause (CRAC). Since their creation, CRACs have been applicable to all rates. They provide BPA with a mechanism to assure recovery of costs if the established rates prove inadequate. For example,

> *"The **Load-Based** Cost Recovery Adjustment Clause, or **LB CRAC**, allows an adjustment to the **base rates** to recover the anticipated augmentation costs to meet load that cannot be recovered with the base rates.*[15]

The settlement agreement excuses IOU Exchange customers from sharing in the responsibility of assuring full recovery of BPA's costs. As a result, the responsibility for assuring full recovery of BPA's costs will fall more heavily on other customer classes.

4. The *in lieu* protections in the ResEx program are improperly eliminated.

The settlement agreement also prohibits BPA from utilizing the *in lieu* provisions of §5(c)(5). The *in lieu* provision allows BPA to control ResEx costs where a utility's ASCs are higher than resources available in the market. In the proposed settlement agreement, Preference Customers are forced to pay the scheduled amounts under the settlement agreement regardless of how those amounts compare with market prices.

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[15] http://www.bpa.gov/power/psp/rates/adjustments/lbcrac/.

The *in lieu* provision is a statutory safeguard that benefits all BPA customers who must share in the cost of supporting the ResEx program. With the potential that 20% or more of COU load may not accept the settlement agreement, the effect of that protection in controlling prices and ResEx benefits would be significant.

5. BPA is prohibited from setting rates for more than five years.

In accepting the settlement agreement, BPA is agreeing to set REP benefits for 17 years. The NWPA, however, limits rate setting to a five year window.[16] FERC regulations also limit BPA rate filings to a five year window of costs. 18 C.F.R. 300.1 provides:

> (6) *Proposed rate approval period* means the period for which confirmation and approval of the rate schedules is requested. This period must not exceed five years.

18 C.F.R. 300.21(e) provides:

> (1) Confirm and approve the rate schedules for the period beginning with the date such rates where [sic] placed in effect on an interim basis or the effective date requested in the application to the expiration date requested in the application but not to exceed a five-year period, or for such lesser period, as the Commission deems appropriate; …

An argument which suggests the Administrator is not violating these restrictions because he is only setting rates for a two-year rate period in the BP-12 case is unpersuasive. On the contrary, the Administrator's decision here is whether he will accept a settlement agreement that predetermines the ResEx benefits and effectively the PF Exchange rate, and the PF rate for a 17-year period. Any agreement by the

[16] 16 U.S.C. §832d(a).

Administrator involving rate determinations for a period greater than five years runs afoul of applicable statutory and regulatory requirements.

6. The "Refund Amount" is not a proper exercise of BPA ratemaking authority.

The final example of how the settlement agreement is contrary to the NWPA and BPA's statutory authority is its the treatment of the Lookback Amounts from the WP-07S case. The "Refund Amount" is not actually a refund of the Lookback Amounts because it does not reduce the amounts the IOUs would otherwise receive. The Agreement in Principle signed by BPA, the IOUs and certain COUs establishes a net present value of total ResEx benefits of $2.05 billion. After the Agreement in Principle was finalized, the COUs added the concept of "Refund Amounts" to address perceived inequities within their ranks and to provide a basis for fixing rates for other classes (*e.g.*, the IP rate).[17]

As WPAG testified, *"This increase to the PF rate could be eliminated in its entirety and the REP payments to the IOUs under the Settlement Agreement would not change."*[18] The Preference customer rates required by the settlement agreement include collection of a Refund Amount from the Preference customers. Except for some possible recovery of Refund Amounts from the Surcharged Rates, the Preference customers will pay for the refunds being provided ***through increased rates***. Effectively, BPA has agreed to adjust its rates solely at the request of its customers – an action for which BPA has no statutory authorization. No additional cost will be recovered by the PF rate increase that will be charged to recover the Refund Amounts.

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[17] REP-12-E-JP02-02, p. 26-27.

[18] REP-12-E-WP-1, p. 13.

The legislative history of the NWPA is unambiguous that BPA's rates should be set to recover its full costs, but *not more* than its full costs.[19]

In addition, §7(i) requires the Administrator to fully justify the rates being adopted. Increasing rates to return a benefit to the same ratepayers paying the increase seems inherently unjustifiable. It certainly serves no purpose related to BPA operations. Where rates are set by ratepayers, and are wholly unrelated to actual costs to be incurred by BPA, the rate increase is by definition arbitrary and capricious. For that reason alone, the Administrator cannot adopt the proposed settlement agreement.

C. The Settlement Agreement is Unfair and Unjust

Even if the aforementioned legal defects did not prevent the Administrator from entering into the proposed settlement agreement, he should reject it because its terms are unjust and unreasonable. The standard of review used by courts in examining a settlement agreement is whether the agreement is "fundamentally fair or just." [20]

The review of this settlement agreement is analogous to the settling of a class action, where only part of the affected class was permitted to actively negotiate the settlement agreement. A court in approving a class action settlement sanctions its application to other class members who are either actively opposing the settlement or inactive.

> *The general standard that has been used by the courts when determining whether to approve a class settlement or a compromise is that the proposal must be fair, reasonable, and adequate in the way in which it addresses the interests of all those who will be affected by it.*[21]

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[19] H.R. Rep. No. 96-976, Part II, 96th Cong., 2nd Sess., at p. 52.

[20] *Moore v. City of San Jose,* 615 F.2d 1265, 1271 (9th Cir.1980).

[21] *Austin v. Pennsylvania Dep't of Corrections*, D.C.Pa.1995, 876 F.Supp. 1437, 1456, *citing* Wright,

For the reasons set forth below, the proposed settlement is not fair, reasonable or just. It should be rejected.

Under the proposed settlement, the COUs agree to support fixed levels of ResEx benefits for the IOUs. In exchange, the COUs a) forfeit all rights and protections of the §7(b)(2) rate test; b) forfeit the right to have rates set for each rate period according to actual costs projected for the rate period (not those projected five or 10 years earlier for the rate period); c) agree to forego any further collections of the Lookback Amounts or any deemer balances; d) relinquish the protections of the *in lieu* and CRAC mechanisms; and e) in light of the defects in BPA's handling of this matter arguably give up the likelihood of a more favorable outcome in the pending litigation. In exchange, the IOUs receive stable ResEx benefits for 17 years, despite the fact that the NWPA would not have delivered such predictability or stability. The benefits given to the COUs and to the Exchange customers under the proposed settlement agreement are woefully out of balance.

The settlement agreement effectuates the Agreement in Principle, which set a net present value of ResEx benefits of $2.05 billion. As BPA Staff's analysis shows, such a net present value (NPV) is high when compared to many possible outcomes of the appellate litigation.[22] The COUs could prevail on one issue, either the issue of load augmentation for existing conservation or the inclusion of Mid-C resources in the §7(b)(2) resource stack, and produce an NPV of ResEx benefits comparable to the

Miller & Kane, 7B Fed. Prac. & Proc. Civ. §1797.1 (3d ed.).

[22] REP-12-E-BPA-01 and BPA-01A.

settlement agreement.[23] If the COUs prevail on just two issues, the inclusion in the Lookback Amount of payments under the Load Reduction Agreements and the treatment of conservation, it would produce a significantly lower NPV of ResEx benefits than the settlement. If the COUs prevail on additional issues, the NPV is even lower, and acceptance of the settlement agreement as an alternative imposes an even greater penalty. It is unreasonable to accept a settlement that does not provide at least as much benefit as likely outcomes of the litigation.

BPA Staff declined to estimate the probabilities of success in the various litigation scenarios.[24] The absence of such a prediction is a major deficiency in Staff's conclusions regarding the reasonableness of the settlement because assessment of the likelihood of success in litigation is a critical element of settlement agreement analysis.[25] As the US Court of Appeals for the Seventh Circuit held:

> *Generally, the first factor, the strength of Plaintiffs' case measured against the terms of the settlement, is the most important factor. In analyzing this factor the Court should "begin by quantifying the net expected values of continued litigation to the class" by "estimate[ing] the range of possible outcomes and ascrib[ing] a probability to each point on the range.*" [26]

The settlement can only be judged reasonable if its financial rights and obligations are comparable to the likely outcome of litigation.

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23 Table 10.4, REP-12-E-BPA-01, p. 188.

24 REP-12-E-BPA-13, p. 14, *et seq*.

25 *Reed v. General Motors Corp.,* 703 F.2d 170, 172 (5th Cir.1983) ("A district court faced with a proposed settlement must compare its terms with the likely rewards the class would have received following a successful trial of the case."); *In re Nutraquest, Inc.***,** 434 F.3d 639 (3rd Cir. 2006); *Kellogg USA, Inc. v. B. Fernandez Hermanos, Inc.*, 269 F.R.D. 95 (U.S. D.C. PR 2009); *In re Heritage Organization*, 375 B.R. 230 (Bk. N.D.Tex. 2007).

26 *Synfuel Technologies, Inc. v. DHL Express (USA), Inc.,* 463 F.3d 646, 653 (7th Cir.2006).

In addition to ignoring the probabilities of success or failure in litigation, the conclusion of BPA Staff as to the reasonableness of the settlement is also defective because Staff's analysis used projected costs over a 17-year period; all parties agreed projections over such a period has inherent uncertainty:

> *Forecasts of this nature are not capable of providing reliable predictions of precise future outcomes, such as the amount of REP cost protection that preference customers will or will not receive from the implementation of the statutory provisions over the next 17 years."* [27]

Finally, the settlement is unreasonable because all of the risk is on the side of the COUs. The COUs are guaranteeing the payment of the scheduled amounts to the IOUs without regard to the financial conditions of any particular rate period. They are also guaranteeing the IOUs a pre-determined amount while the Preference customers retain the risk of rates varying dependent on the financial conditions during any particular rate period. The rates paid by the COUs may also vary by CRACs, no part of which the ResEx customers shoulder.

For all these reasons, the Administrator should find that the settlement agreement has not been proven to be fair, equitable or just.

D. It is Illegal to Impose the Settlement Agreement on Non-Settling Parties

By its terms, this settlement agreement would be imposed by BPA on all customers whether they accepted it or not, which is improper. APAC and many COUs have properly asserted challenges to rate determinations made by the Administrator in the WP-07S and WP-10 rate cases. Although the settlement putatively seeks to resolve

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[27] *Testimony of WPAG,* REP-12-E-WG-01, p. 19. *See, also,* Testimony of Lincoln Wolverton, REP-12-E-AP-01, p. 6; BPA Staff testimony, REP-13-E-BPA-13, p. 6-7.

or moot those challenges, APAC and some COUs have not accepted the settlement; therefore, these challenges can only be finally determined by the Ninth Circuit. A partial settlement which, as here, does not resolve *all claims between all adverse parties* does not moot a pending appeal of those claims that remain live.[28]

If successful, APAC's appeal would require BPA to correctly apply the mandatory rate test set forth in §§7(b)(2) and 7(b)(3) and to make full and immediate refunds of the identified overpayments. BPA's attempt to avoid those issues by adopting a new REP-12 Settlement ROD does not moot APAC's appeal because, generally, actions for refunds of allegedly unlawful charges and for other affirmative relief present a live controversy regardless of intervening agency action.[29] BPA cannot impose the settlement agreement upon non-settling parties, or in any way use it to compromise the substantive legal challenges currently pending.

III. BPA COMMITTED ERRORS IN PERFORMING THE §7(b)(2) RATE TEST IN THIS CASE

If the Administrator properly declines acceptance of the settlement agreement for all of the reasons stated above, rates to be set in the BP-12 case must be based on the §7(b)(2) rate test performed in this case. However there are several groups of errors that must be corrected by BPA before the results of the test are used.

A. BPA Perpetuated Five Errors from Prior Cases

There are five issues that BPA continues to treat improperly in the rate test implementation in the RAM. The five "legacy" issues continued from prior cases are:

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28 *Federal Deposit Ins. Corp. v. Jennings,* 816 F.2d 1488, 1491 (10th Cir. 1987). *See, also, Biopolymer Engineering, Inc. v. Immunocorp.*, 397 Fed.Appx. (Fed. Cir. 2010).

29 *Atlantic Richfield Co. v. Bonneville Power Administration*, 818 F.2d 701, 705 (9th Cir. 1987).

- Improper and inconsistent financing assumptions as between the Program and §7(b)(2) Cases.
- Overstated purchase prices for the conservation that BPA has improperly added to the resource stack.
- Augmentation of Preference-customer (or COU) electric power loads based on conservation resources.
- Faulty calculation of the §7(b)(2) "trigger" protection due to an inappropriate discounting method that biases the §7(b)(2) result against Preference customers.
- Exclusion of Mid-C resources from the stack of resources available to serve §7(b)(2) loads.

As to these issues, pursuant to the Order Incorporating Arguments and Evidence,[30] APAC incorporates by reference its evidence and arguments previously filed on these issues in the WP-07S and WP-10 cases. These errors have been perpetuated because BPA believes must apply the same methodologies as in prior cases, and yet. Yet in this case, BPA is willing to radically alter the way in which the §7(b)(2) rate test has been performed over time, and how it will be perform it for the next 17 years.

With respect to the issue of how a discounting method is used in the calculation of the trigger protection, APAC supplemented its evidence with additional testimony which demonstrates how the use of the discounting method distorts the results of future years and reduces the rate protection properly due to Preference customers. In running the §7(b)(2) rate test, the NWPA requires the comparison of the costs incurred in the Program Case and the §7(b)(2) Case over the rate period *plus* the following four years. BPA Staff agreed that purpose for making the comparison over the longer period of time is to compensate for any aberrant result in the forecast for any one year.

Mr. Doubleday testified:

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30 REP-12-HOO-11.

> *A. … I think using the four ensuing years does tend to make the rate test more steady, if you will, rate period to rate period.*
>
> *Q. Do you mean that between, for instance, the 7(b)(2) test in the 2010 rate case and the rate test for the 2012 rate case, that the results would be closer?*
>
> *A. (Mr. Doubleday) Yes. The results would not -- in one -- say, the WP-10, if the WP-10 had an aberrant set of data in one of those years, using the forecasts for all six years would make that result more like the result in 2012.*[31]

However, the effect of discounting the costs in future years is to give them *"somewhat less weight than rates in the earlier years."* [32] In setting rates for 2012, the goal should be to compare the most accurate forecast of the costs in the Program Case and the §7(b)(2) Case. BPA and the parties are more assured of the accuracy of the costs for 2012 if they are close to the costs forecast for the next four years. With such close and corroborating estimates for the next four years, the effect of discounting is to automatically create unnecessary and deceptive disparity among those forecasts.

B. The Value of Reserves from DSI Contracts

In addition to the perpetuation of those five legacy issues, BPA committed two additional errors in the implementation of the §7(b)(2) rate test in this case. The first is in the costs of DSI reserves included in the §7(b)(2) Case. The §7(b)(2) rate test allows inclusion in the §7(b)(2) Case of a cost for the value of reserves available from DSI service. The benefit to BPA's ratepayers from the reserves provided by the DSIs has been measured by BPA in prior cases[33] as the difference between the value to BPA's

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[31] *Transcript,* April 4, 2011, p. 13, lines 15-25.

[32] *Id.*, p. 17, lines 15-16.

[33] *See*, for example, WP-07-A-05, p. 643.

ratepayers of the reserves provided by the DSIs and the credit paid to the DSIs in their rates for their reserves for the upcoming rate period.[34] If the DSIs were assumed to have been paid a credit equal to the full value of those reserves, there would be no net benefit to ratepayers to include as a cost in the §7(b)(2) rate-test calculation. The benefit ceases to exist when the full value of the reserves is paid.[35] BPA has proposed to recover in rates the full cost of DSI reserves. Thus, based on the comparison of value and contract credit described above, the amount of benefit to the other ratepayers is zero. The RAM should be corrected to remove any cost added to the §7(b)(2) Case attributable to the value of DSI reserves.

C. Improper Preservation of the Level of Conservation Informing the CHWM for the Entire 17-year RD Contract Term

The §7(b)(2) rate test has two errors in the treatment of conservation in addition to those raised before: 1) the preservation of a level of conservation through the 17-year contract period, and 2) the elimination from the resource stack of those conservation programs still achieving load reduction but no longer requiring BPA funding.

As part of the implementation of tiered rates, BPA assumed the level of conservation which contributed to or "informed" the CHWM of the Preference Customers in 2010 must be maintained for the entire 17 years of the Regional Dialogue contracts. This locking in of the contribution of a specific resource is contrary to BPA's

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34 *"The value is measured as the difference between the costs in the two cases of the rate test. If the full cost of the reserves is credited to the DSIs, then there is no benefit to the PF rate as measured by a cost differential between the Program Case cost and the 7(b)(2) Case cost."* REP-12-E-BPA-15, p. 6; *see, also, Implementation Methodology,* WP-07-A-07, p. 9.

35 *Direct Testimony of Lincoln Wolverton,* REP-12-E-AP-1, p. 20.

treatment of all other resources in the resource stack. All other resources which satisfy the CHWM in 2010 are allowed to age and their capacity to decrease, or their energy output to vary among rate periods,[36] but the conservation programs existing in 2010 are replenished and replaced. In addition, for all other purposes BPA assumes that conservation programs expire;[37] in fact, BPA Staff admitted that certain programs that informed the CHWM would not be in the §7(b)(2) resource stack because they had "expired." [38] However, for this purpose, BPA has determined that the conservation programs in 2010 cannot expire and must be preserved.

To maintain the current level of conservation in Tier 1, BPA establishes five types of conservation, each with different characteristics.[39] Types D and E are only useable in the §7(b)(2) resource stack because of the assumption that continuation of tiered rates requires maintenance of the conservation that "informs" the FY2010 CHWM setting. For instance, Type E conservation is defined as the conservation used by customers to self-supply their loads above their RHWM. Such conservation in no way satisfies the Administrator's load obligation. Yet BPA will use that conservation if it is *"needed to maintain the level of conservation savings that informed the determination of the customers' CHWMs."* [40]

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36 *Transcript*, April 4, 2011, p. 20, line 24 – p. 21, line 4.

37 In identifying this discrepancy in treatment, APAC is not waiving its argument that existing conservation should not be included in the §7(b)(2) resource stack.

38 *Transcript*, April 4, 2011, p. 19, lines 7-12.

39 REP-12-E-BPA-08, pages 13-15.

40 BPA-15, p. 28.

The effect of this construct is to artificially preserve a level of conservation, which also preserves an artificially high level of load augmentation in the §7(b)(2) rate test.[41] The conservation resources assumed to reduce the Administrator's load obligation are also included in the §7(b)(2) resource stack. BPA has increased the cost of those resources by removing from the resource stack any conservation program that BPA is no longer financing. Although a conservation program may be reducing the Administrator's load obligation, BPA Staff has removed it from the stack if BPA funding is no longer required. The effect of this is to remove from the stack resources having zero cost, thereby raising the costs of the §7(b)(2) Case.

IV. CONCLUSION

The proposed settlement agreement must be rejected by the Administrator. First and foremost, any action by the Administrator regarding the Residential Exchange program must be consistent with the obligations and requirements of §§5(c) and 7(b) of the NWPA. The proposed settlement agreement violates many provisions of the Act, and its acceptance would exceed the Administrator's statutory authority, as found by the Ninth Circuit in the *PGE* case. The proposed settlement agreement fails to conform with the requirements of the Act because it sets rates without regard to the §7(b)(2) rate test, it eliminates the requirement to set rates using the utilities' ASC; and it unreasonably terminates the applicability of the *in lieu* and the CRAC provisions to the Residential Exchange.

Finally, in addition to violating the requirements of the NWPA, the financial terms of the proposed settlement agreement are unreasonable, unjust and unfair to the non-

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[41] REP-12-E-AP-01, p.24-25; WP-07-B-AP-01, p. 35 *et seq*.

settling parties. For all these reasons, the Administrator should reject the proposed settlement agreement and set rates for FY2012-2013 using the statutorily-mandated §7(b)(2) rate test. To do so properly, the errors in BPA's current implementation of §7(b)(2) must be corrected, including the five "legacy errors" perpetuated from the WP-07S and WP-10 rate cases, the treatment of conservation to perpetuate the level of conservation informing the high water mark, and the value ascribed to reserves from the DSI contracts.

Respectfully submitted,

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