

INDEX
TESTIMONY OF
LOU ANN WESTERFIELD

Witness for the Idaho Public Utilities Commission

**SUBJECT: THE LOOKBACK ANALYSIS, DEEMER BALANCES, AND THE 1984
AVERAGE SYSTEM COST (ASC) METHODOLOGY**

	Page
Section 1: Introduction and Purpose of Testimony	1
Section 2: Background.....	2
Section 3: The Lookback Analysis is poor public policy because it is retroactive ratemaking	3
Section 4: Deemers	11
Section 5: Average System Cost Methodology	20

1 TESTIMONY OF

2 LOU ANN WESTERFIELD

3 Witness for the Idaho Public Utilities Commission

4 **SUBJECT: THE LOOKBACK ANALYSIS, DEEMER BALANCES, AND THE 1984**
5 **AVERAGE SYSTEM COST (ASC) METHODOLOGY**

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

7 Q. Please state your name and qualifications?

8 A. My name is Lou Ann Westerfield and my qualifications are described in WP-07-Q-
9 ID-1.

10 Q. What is the interest of the Idaho Public Utilities Commission (IPUC) in this
11 proceeding?

12 A. The IPUC regulates the retail rates and services of three of the investor-owned utilities
13 (IOUs) – Idaho Power, Avista, and PacifiCorp – eligible for Residential Exchange
14 Program (REP) benefits through the Northwest Power Act. Benefits from the REP
15 are passed directly through to residential and small farm customers using tariffs
16 and/or processes the IPUC approves.

17 Q. What is the purpose of your testimony?

18 A. The purpose of my testimony is to propose an alternative method to the Lookback
19 mechanism proposed by BPA for the years 2002 to 2008. My proposal looks forward
20 from the May 2007 decisions of the United States Court of Appeals, for the Ninth
21 Circuit (“May 2007 Decisions”), avoids retroactive ratemaking, and results in a fair
22 distribution of REP benefits and new WP-07 preference rates in the region. Thus, I

1 am recommending that BPA avoid the pitfalls of retroactive ratemaking by
2 abandoning both the Lookback Analysis and the inclusion of the deemer balances in
3 the Lookback Analysis and move forward with a clean slate to establish REP benefits
4 and new WP-07 preference rates.

5 **Section 2: Background**

6 Q. Did the May 2007 Decisions specify how BPA should address the remanded rates
7 from the WP-02 rate case?

8 A. No. The court remanded the cases to BPA “but provided little guidance to BPA in its
9 [May 2007 Decisions] regarding the subsequent actions BPA should take in response
10 to these opinions.” BPA Response to APAC’s Motion to Strike, WP-07-M-BPA-77
11 at page 5.

12 Q. Did the May 2007 Decisions address the WP-07 rate case?

13 A. No. However, as BPA explained in WP-07-E-BPA-52 at page 3, the remand of the
14 WP-02 rates implicated the WP-07 rates because the latter used the same
15 methodology to allocate the costs of the REP Settlement Agreements. BPA ceased
16 payments of REP benefits to the IOUs effective June 1, 2007 in response to the
17 Court’s decisions.

18 Q. What approach did BPA take in determining proposed rates in this case?

19 A. BPA performed a Lookback Analysis that compares the REP benefits the IOUs
20 received for the 2002-2007 time period under the Residential Exchange Program
21 Settlement Agreements (RESAs) entered into in 2001 to the REP benefits the IOUs
22 would have received using the 1984 Average System Cost Methodology (ASCM)

1 then in effect. BPA also used the Lookback Analysis to re-determine the Preference
2 Rate for its Consumer-Owned Utilities (COU) customers for the time period. BPA
3 also included repayment of the deemer balances, derived from Residential Purchase
4 and Sales Agreements (RPSAs) signed in 1981, in the Lookback Analysis.

5 Q. Is the Lookback mechanism the only approach or response to the May 2007
6 Decisions?

7 A. No. In Exhibit 52 BPA recognized that its proposed Lookback mechanism "is only
8 one of many possible approaches. During the course of this proceeding, BPA is open
9 to consider other alternatives that parties may advocate." WP-07-E-BPA-52, p. 11, ll.
10 18-20.

11 Q. What else does the Lookback Analysis propose?

12 A. The Lookback Analysis proposes to charge interest on the Lookback amounts
13 calculated for each IOU. (WP-07-E-BPA-52, p. 12, l.7.) Although retroactive
14 ratemaking is bad public policy, retroactive ratemaking plus interest is even worse
15 public policy. Additionally, including interest on the Lookback amounts raises the
16 issue of whether future REP benefits should be applied first to the interest or first to
17 the principal. Absence elimination of the Lookback mechanism all together, applying
18 the REP benefits first to the principal is a fairer solution because it reduces future
19 interest.

20 **Section 3: The Lookback Analysis is poor public policy because it is retroactive**
21 **ratemaking**

22 Q. Does the Lookback Analysis constitute retroactive ratemaking?

1 A. Yes. BPA is proposing to recalculate the REP settlement benefits for the IOUs for FY
2 2002-2008 and in turn, the 2002-2007 preference rates for the COUs. BPA would
3 then return the past overcharges to the COUs by offsetting further REP payments to
4 the IOUs.

5 Q. Is retroactive ratemaking normally used in setting rates?

6 A. No. State regulatory commissions and the Federal Energy Regulatory Commission
7 (FERC) generally set retail and wholesale rates, prospectively, based on the revenues,
8 expenses, and investments of a recent test-year period, adjusted for known and
9 measurable changes. In May 2000 under Section 7 of the Northwest Power Act, BPA
10 established the prospective WP-02 rates (subsequently approved by FERC) for the FY
11 2002-2006 period. In November 2005, BPA began the process of establishing
12 prospective rates in the WP-07 proceeding for FY 2007-2009.

13 The intent of the regulatory ratemaking process is to establish rates that are as
14 close as possible to the current time period in order to avoid regulatory lag, the time
15 gap between the incurrence of prudent costs and the recovery of those costs in rates.
16 Utilities are not static: customer needs, resources used to serve those needs, available
17 technologies, legal requirements, and financial and economic factors change over
18 time. Utility business decisions must address the ongoing nature of providing utility
19 service, and utilities must demonstrate the appropriateness of their operations and
20 planning processes through the regulatory review process.

21 Q. How does retroactive ratemaking comport with the regulatory compact?

1 A. Retroactive ratemaking imposes uncertainty and risk on BPA, utilities and
2 ratepayers/customers because it would allow second-guessing of BPA and utility
3 decisions and their consequences. The regulatory compact between regulators and the
4 utilities they regulate (in this case BPA and its customers) seeks to strike a balance
5 between establishing rates necessary for the utilities to recover the costs of providing
6 safe, adequate, and reliable service at a fair and reasonable cost to the consuming
7 public and providing the utilities the opportunity to earn a reasonable return for their
8 shareholders. In order to strike this balance, the ratemaking process includes the
9 certainty that, once a ratemaking authority has examined the books, records, costs,
10 and activities of a utility for a time period covered in a rate proceeding and issued an
11 order, these items will not be re-examined for prudence at some future time. If
12 retroactive ratemaking were the norm, no utility would be certain of recovery of its
13 costs, particularly, the long-term costs of major capital facilities.

14 For example, if an electric utility built a generator with an expected life of 40
15 years, those costs would normally be placed in rates when the generator becomes
16 operational and the utility files an application to include the generator's capital,
17 operating, and maintenance costs in rates. If retroactive ratemaking were the norm, a
18 ratemaking authority could decide in year ten of the generator's operation to remove
19 the generator's costs from rates. Thus, retroactive ratemaking would wreak havoc on
20 utility decisions and operations, and utilities would be reluctant to invest in new
21 facilities, even when needed.

1 On the customer side, retroactive ratemaking has several adverse effects on
2 customers. First, it would create rate uncertainty in the form of unanticipated changes
3 in customers' bills. Past costs excluded from rates today might be included in rates
4 tomorrow and result in increased rates for customers. Under retroactive ratemaking,
5 utility rates might yo-yo up and down for years in rate proceedings rehashing past
6 matters. Adding to this expense and to rates would be the costs of these additional
7 proceedings.

8 Q. What are the implications of retroactive ratemaking?

9 A. In addition to the ratemaking issues identified, retroactive ratemaking tries to
10 reconstruct decisions made in the past. Thus, retroactive ratemaking contains not only
11 the exercise of recalculating the numbers underlying rates, but also the exercise of re-
12 determining and re-evaluating options available when past business decisions were
13 made, selecting a different decision from the one actually made, and determining rates
14 based on that different outcome. Opening the door to retroactive ratemaking creates
15 the opportunity to overturn both good and bad past decisions and sends the wrong
16 signal to utilities for future decisions and investments needed to continue serving their
17 customers.

18 BPA's proposal in the WP-07 supplemental proceeding is a good example of the
19 pitfalls of retroactive ratemaking. BPA has proposed to recalculate REP benefits,
20 recalculate ASCs, add interest, address treatment of LRA payments, include dormant
21 deemers, and adjust future REP benefits well into the future. In addition, there are

1 numerous smaller issues that are subject to new decisions (calculating loads, new
2 loads, resource stacks, etc.) that are included in the Lookback mechanism.

3 Q. Does BPA's proposed retroactive ratemaking mismatch rates among generations of
4 ratepayers?

5 A. Yes. The worst aspect of retroactive ratemaking is the case when it assigns increased
6 costs to future ratepayers for actions that benefited past ratepayers. The regulatory
7 process cannot time the assignment of costs to rates with perfect precision, but
8 attempts to the greatest extent possible to match costs and benefits to the appropriate
9 ratepayer generations. The Lookback Analysis BPA proposes would directly transfer
10 past costs to future ratepayers. In the worst-case scenario, BPA calculates that
11 approximately 400,000 Idaho Power residential and small farm customers will forego
12 REP benefits for more than 20 years – past 2028. WP-07-E-BPA-44, p. 207, ll. 25-
13 27. This demonstrates that even though present and future eligible customers received
14 no REP benefits, they bear the consequences of retroactive ratemaking.

15 Q. Were the rates from the WP-02 rate case still in effect when the May 2007 Decisions
16 were issued?

17 A. No. The WP-02 rate period ended on October 1, 2006. "BPA's WP-07 rates were
18 filed with FERC for confirmation and approval, and interim approval was granted on
19 September 1, 2007. Subsequent to interim approval," BPA asked FERC to Stay final
20 approval and BPA renewed its Stay of the final WP-07 rates on March 4, 2008. WP-
21 07-E-BPA-52, p. 6, ll. 16-17. If the proposed Lookback Analysis is used, future IOU
22 ratepayers will receive decreased benefits due to the difference between REP benefits

1 paid during that period and REP benefits determined using the Lookback Analysis,
2 including interest.

3 Q. Did any party to the WP-02 rate case, the subject of the May 2007 Decisions, ask for a
4 stay of those rates?

5 A. According to BPA's response to Data Requests ID-BPA-1, WU-BPA-2, and WU-
6 BPA-3 attached as Exhibit WP-07-E-ID-2, no party requested a stay. Thus, the WP-
7 02 rates remained in effect during most of the litigation period. This also makes the
8 Lookback Analysis inappropriate for addressing the May 2007 Decisions. The
9 decisions do not mandate retroactive ratemaking, much less adding interest, as the
10 solution.

11 Q. In performing the Lookback Analysis, what assumptions did BPA make concerning
12 what the IOUs would have done in the WP-02 rate case absent the RESAs?

13 A. Specifically, BPA assumed the IOUs would have signed agreements based on rates
14 established using the 1984 ASCM, even though REP benefits were not established in
15 the WP-02 or WP-07 rate cases using the 1984 ASCM.

16 Q. Is this a reasonable assumption?

17 A. No. There is no way to reconstruct in 2008 what the IOUs would have done in 2001
18 absent the opportunity to sign the RESAs they did in fact sign. There is also no way
19 to determine in 2008 whether the 1984 ASCM would have been modified or litigated
20 in the WP-02 or the initial WP-07 BPA rate proceedings if the RESAs had not been
21 offered to the IOUs. Thus, the Lookback Analysis is based on the false assumption
22 that REP benefits and ASCs would have been determined in both BPA proceedings

1 using the 1984 ASCM when the IOUs might have challenged the use of the 1984
2 ASCM absent the RESAs.

3 Q. Is retroactive ratemaking bad public policy?

4 A. Yes. For all the reasons discussed, retroactive ratemaking is bad public policy
5 because it creates rate uncertainty for utilities and ratepayers, transfers cost
6 responsibility and benefit eligibility unfairly among generations of ratepayers, and
7 undermines the decision-making process necessary for utilities to serve their
8 customers on an ongoing basis.

9 Q. Is there another factor in this proceeding that exacerbates the negative aspects of
10 retroactive ratemaking as a policy?

11 A. Yes. Because the IOUs involved in the REP simply pass through the benefits to their
12 retail ratepayers, ratepayers bear the entire brunt of the retroactive ratemaking
13 treatment proposed in the Lookback Analysis through reduced future REP benefits.

14 Q. Is the impact of reduced future REP benefits significant?

15 A. Yes. Although PacifiCorp and Avista will still be eligible for REP benefits pursuant
16 to the calculations in the Lookback Analysis, these benefits are reduced to reflect the
17 difference between benefits received and benefits that would have been received using
18 the 1984 ASCM. Thus, using the Lookback Analysis harms their current and future
19 residential and small farm ratepayers through reduced benefits.

20 Q. What is the impact on Idaho Power?

21 A. Taking into consideration only the proposed Lookback Analysis, Idaho Power has a
22 Lookback balance (not including deemers) of approximately \$95.6 million per BPA

1 Table 15.4 in BPA Exhibit 44 at page 201. Idaho Power will receive no REP benefits
2 for approximately ten years. Idaho Power is the only IOU in this situation.

3 Q. What will be the result for Idaho Power's residential and small farm ratepayers?

4 A. During that ten-year period, the approximately 400,000 residential and 17,000 small
5 farm customers of Idaho Power will not receive any REP benefits while the customers
6 of the other five IOUs will receive some benefits, although reduced by the Lookback
7 Analysis.

8 Q. Is this an acceptable solution for the region?

9 A. No. The Northwest Power Act contemplated the distribution of REP benefits
10 throughout the Northwest region – not the skipping over of a substantial number of
11 ratepayers or the skipping over of the majority of IOU customers in the state of Idaho.
12 The Lookback Analysis proposes a punitive solution to Idaho ratepayers of all three
13 IOUs, but particularly punitive to Idaho Power's ratepayers.

14 Q. What alternative solution are you proposing?

15 A. In order to avoid retroactive ratemaking and its associated negative results discussed
16 above, I propose that the level of REP benefits be established on a forward-looking
17 basis to take effect in fiscal year 2009 at the conclusion of this proceeding. Further,
18 the REP benefits established for fiscal year 2009 should be determined using the new
19 2008 ASCM concurrently proposed in a separate rulemaking. The withheld 2007
20 REP payments together with any true-up of the 2008 interim REP payments will be
21 available to BPA. For the WP-02 rate period, what is done is done.

1 The better solution at this point is to wipe the slate clean and move forward
2 without imposing any penalties on the REP benefits in the past. Establishing new
3 REP benefits levels for the IOUs' ratepayers using an updated and transparent method
4 for determining ASCs is a fairer solution for the region than trying to rehash and
5 recast decisions made over eight years ago under very different circumstances.

6 **Section 4: Deemers**

7 Q. What role do the deemer balances play in the Lookback Analysis?

8 A. The deemer balances stem from the 1981 Residential Purchase and Sales Agreement
9 (RPSAs) entered into by three IOUs – Idaho Power, Avista, and Northwestern
10 Energy. At the time their ASCs, using the 1981 methodology, were purportedly
11 below the PF exchange rate. In establishing the REP, the Northwest Power Act did
12 not contemplate the possibility that ASCs for the IOUs would be lower than the
13 exchange rate, but, rather, assumed that the IOUs' ASCs would all be above the
14 exchange rate. As a result, the three IOUs entered into 20-year RPSAs in 1981 that
15 included provisions to carry the difference between their lower ASCs and the
16 exchange rate as deemed balances and to not pay REP benefits to the three IOUs until
17 the deemers had been satisfied.

18 Q. Did the May 2007 Decisions address the deemers?

19 A. No. BPA proposes that the deemer balances be included in the Lookback mechanism.
20 Recast REP benefits are applied first to the deemer balances for the three IOUs, then
21 to the Lookback balances for the rate period 2002 – 2007. The inclusion of the
22 deemers constitutes an extreme case of retroactive ratemaking as the deemers arose

1 twenty-seven years ago and in the case of Idaho Power will adversely affect
2 ratepayers for more than 20 years in the future under BPA's proposal. I will address
3 the deemers that pertain to Idaho Power and Avista.

4 Q. What is the result for Avista and Idaho Power of including the deemer balances in the
5 Lookback Analysis in this proceeding?

6 A. When the deemer balances are combined with the Lookback amounts, the result is the
7 reduction of REP benefits for Avista in FY 2007 and the complete elimination of REP
8 benefits for Idaho Power for at least the next twenty years. Although Avista is able to
9 resume flowing its REP benefits to eligible ratepayers in FY 2007 even after
10 consideration of the deemer balances and the Lookback, reducing future benefits for
11 the deemers is not appropriate. In Idaho Power's case, the result of adding the deemer
12 balance to the Lookback amount in this case will deprive its ratepayers – 400,000
13 residential and 17,000 small farm – of REP benefits over an unacceptable amount of
14 time, while the other IOUs in the region pass the REP benefits through to their
15 eligible customers.

16 The Northwest Power Act did not frame the REP program as applicable to IOU
17 customers in the Northwest except in the state of Idaho. Using the deemers to deprive
18 Idaho's ratepayers of future REP benefits is bad public policy.

19 Q. Did the REP Settlement Agreements entered into in 2000 address the deemer
20 balances?

21 A. No.

22 Q. Is including the deemers in this proceeding appropriate?

1 A. No. Not only did the May 2007 Decisions and the 2000 REP Settlement Agreements
2 entered into in the context of the WP-02 rate case not address the deemers, the
3 deemers are a separate contract matter between the affected IOUs and BPA. The
4 Ninth Circuit did not have the deemer contracts before it, and, thus, including them in
5 the resolution of this proceeding is inappropriate. The May 2007 Decisions did not
6 order BPA to fix all past problems, just those associated with the WP-02 rates and the
7 Settlement Agreements.

8 Q. Is the resolution of the deemer issue cut and dried?

9 A. No. In fact, BPA recognizes that the affected IOUs dispute the deemer balances.
10 WP-07-E-BPA-44, p. 208. In addition, there is nothing in Section 5 of the Northwest
11 Power Act that authorizes BPA to create deemer accounts or that authorizes BPA to
12 exchange when an IOU's ASC is less than the PF Exchange rate.

13 Q. How are the deemer balances reflected in BPA's case?

14 A. The deemers are recorded for each affected IOU by state.

15 Q. Does this present a problem with regard to Idaho Power's deemer?

16 A. Yes. Idaho Power's deemer indicates a separate balance for Idaho, Oregon, and
17 Nevada. In 2001, Idaho Power sold its Nevada operations to Raft River Rural Electric
18 Cooperative to comply with Nevada's electric restructuring law. The IPUC order
19 approving the sale is attached as Exhibit WP-07-E-ID-1-AT2. Thus, there is no way
20 to assess the Idaho Power – Nevada deemer balance to Nevada customers. The
21 opportunity to do so has long passed.

22 Q. Are the deemers generally accepted financial obligations of the affected IOUs?

1 A. No, not from an accounting standpoint. According to BPA's response to Data
2 Request PU-BPA-5, the deemers have never been recorded in BPA's books and
3 accounts. *See* WP-07-E-ID-1-AT3. A review of the Annual Reports and Form 10-K
4 filings made by Avista and Idaho Power since 2001 indicates that neither utility
5 recorded the deemer obligation on their books either.

6 Q. Is this the normal accounting treatment for an obligation established by contract?

7 A. No. BPA and the IOUs use generally accepted accounting principles for recording
8 financial transactions in their books. BPA's and the IOUs' financial statements are
9 audited annually by nationally recognized accounting firms that attest to the fact that
10 BPA and the IOUs use generally accepting accounting principles implemented
11 through current accounting and financial standards.

12 The normal treatment for recording this type of obligation would be the creation
13 of a regulatory asset, or other appropriate deferral, in BPA's books and a
14 corresponding regulatory liability, or other appropriate deferral, on the affected IOUs'
15 books to reflect the deemer obligation. Regulatory assets and liabilities, or other
16 similar deferral, are normally amortized over the life of the obligation. However, this
17 never happened.

18 Q. Why were the deemer balances not recorded in the books of BPA and the affected
19 IOUs?

20 A. The answer lies in the Workpapers BPA provided in this proceeding. In the Record of
21 Decision for the 1983 rate case, BPA decided that, if the deemed IOUs' loads and
22 resources were included in the Cost of Service Analysis, then the accounting

1 obligation did not have to be recorded. The passage below explains this accounting
2 interpretation.

3 For ratemaking purposes BPA treats the exchange as a resource transaction.
4 The exclusion of loads and resources of utilities projected to be in a 'deemed
5 equal' status from BPA's COSA load/resource balance would be equivalent to
6 treating the deemed exchange as an 'accounting' transaction, and the
7 nondeemed exchange as a 'resource' transaction.
8

9 1983 Rate Proposal Record of Decision (Ch. 5 Cost of Service Analysis) p. 169 (Issue
10 #1).

11 Obviously, BPA chose the alternative described above to achieve other
12 objectives in determining rates and REP benefits within the region over the time
13 period since 1981.

14 Q. From an accounting standpoint, are the deemers a legitimate obligation?

15 A. No. Allowing the recovery in rates of off-the-books transactions is inconsistent with
16 generally accepted ratemaking principles. Ratemaking is based on the ability to
17 assess the legitimate costs of a utility by examining its books and records. If a
18 financial transaction is not recorded on a utility's books, then it is not a transaction
19 recoverable in rates. Frankly, if a state commission determined that a utility were
20 conducting transactions off the books, the commission would take drastic measures to
21 stop the activity and insist that it be recorded in the utility's books and be subject to
22 the same regulatory scrutiny as other utility activities.

23 Q. What bearing does BPA's decision to flow REP benefits to Avista and Idaho Power
24 have on the legitimacy of the deemers?

1 A. Because the RPSA contracts state that REP benefits will not be resumed until the
2 deemer balances are satisfied, a party could argue that the deemers no longer existed
3 when BPA provided REP benefits to Avista and Idaho Power . Moreover, Avista and
4 Idaho Power terminated their RPSAs in 1993, yet the deemer balances continued to
5 grow. WP-07-E-BPA-57 at p. 3, ll. 21-22.

6 Q. Are there other accounting guidelines that BPA follows?

7 A. Yes. BPA follows the U.S. Department of Energy's (DOE's) accounting order RA
8 6120.2, entitled "Power Marketing Administration Financial Reporting." FERC
9 references this accounting order in its order granting interim approval of the WP-07
10 rates. Section 6.a. of RA 6120.2 provides DOE's policy on financial reporting:

11 It is DOE policy to encourage sound businesslike financial management and
12 accounting practices in routine accounting and the preparation of power system
13 financial statements. Power system financial statements will be prepared in
14 accordance with generally accepted accounting principles as prescribed by the
15 American Institute of Certified Public Accountants, the Financial Accounting
16 Standards Board, the General Accounting Office, and the Office of Management
17 and Budget, as appropriate. To the extent practicable, the PMAs will maintain
18 their accounts in accordance with the Uniform System of Accounts prescribed
19 by the Federal Energy Regulatory Commission for public utilities.

20
21 This DOE policy statement on financial reporting for the federal power marketing
22 agencies, including BPA, reaffirms the point that BPA follows DOE accounting order
23 RA 6120.2, which states as a matter of policy that BPA will follow generally accepted
24 accounting principles.

25 Q. What does BPA's 2007 Annual Report say about "Regulatory Assets and Liabilities"?

26 A. On page 58 of the Annual Report, "Regulatory Assets and Liabilities" are described
27 as follows:

1 BPA defers costs as regulatory assets such that costs will be recovered through
2 rates during the periods when the costs are scheduled to be repaid. Amortization
3 is computed using the straight-line method based upon either the estimated
4 service lives or the periods the costs are included in rates; or based upon specific
5 amounts included in rates each year. BPA does not earn a rate of return on its
6 regulatory assets. BPA defers credits as regulatory liabilities in connection with
7 the rate setting process.
8

9 Q. What conclusions can be drawn from DOE accounting order RA 6120.2 and from
10 BPA's description of Regulatory Assets and Liabilities in its 2007 Annual Report?

11 A. Under generally accepted accounting principles, affirmed by RA 6120.2 and
12 described in BPA's own 2007 Annual Report, there are no exceptions noted or
13 contemplated for recording legitimate regulatory assets on BPA's books. Neither
14 generally accepted accounting principles nor RA 6120.2 provide for "off-the-books"
15 transactions. I also reviewed BPA's annual reports for the past ten years and found
16 the same silent treatment on the matter of the deemers. BPA cannot have the deemers
17 both ways. As indicated above, BPA chose to keep the deemers out of its official
18 books. Either the deemers are a contractual obligation creating a regulatory asset that
19 appears on BPA's books, or the unrecorded deemers do not represent a regulatory
20 obligation.

21 Q. In addition to the principal balance of the deemers, has BPA charged interest on the
22 deemers?

23 A. Yes. In reviewing the deemer contracts, BPA acknowledges that Avista paid simple
24 interest on its deemer balance but Idaho Power (and Northwest) paid compound
25 interest. This distinction is significant. As BPA explained, Avista's interest "is
26 calculated only on the initial deemer balance (or remaining balance thereof) and not

1 on the interest that has accrued.” WP-07-E-BPA-44, p. 196, ll. 15-17. Idaho Power’s
2 agreement specifies that interest compounds, in other words, interest is calculated on
3 both the initial deemer balance and interest. *Id.* at ll. 15-26.

4 Q. Does the accrual of interest have a significant effect on the deemer balances?

5 A. Yes. The results are staggering in terms of the penalty imposed on both Avista and
6 Idaho Power for actions taken in the 1980s all in the name of fairly distributing REP
7 benefits. In the Lookback workpapers accompanying BPA’s case in this proceeding,
8 BPA indicates that Avista’s deemer balance is \$99,320,467 as of October 2007, the
9 sum of \$69,042,017 for Washington and \$30,278,450 for Idaho. The workpapers
10 indicate that Avista’s deemer balance in January 1987 was \$27,336,185 for
11 Washington and \$11,988,313 for Idaho, or a total of \$39,324,498. The application of
12 simple interest from 1987 to 2007 has increased Avista’s deemer balance 2.5 times.
13 For Idaho Power, the situation is even worse because BPA used compound, rather
14 than simple, interest on the deemer balance. The Lookback workpapers indicate that
15 Idaho Power’s deemer balance is \$245,362,811 as of October 2007, the sum of
16 \$223,210,742 for Idaho; \$19,244,784 for Oregon; and \$2,907,285 for Nevada. The
17 workpapers indicate that Idaho Power’s deemer balance in January 1987 was
18 \$52,903,825 for Idaho; \$4,561,262 for Oregon; and \$689,064 for Nevada, or a total of
19 \$58,154,151. The application of compound interest from 1987 to 2007 has increased
20 Idaho Power’s deemer balance 4.2 times.

21 Q. Does the interest have a punitive effect?

1 A. Yes. The result of applying interest over such a long period of time to Avista's and
2 Idaho Power's deemer balances constitutes the application of a severe penalty to the
3 REP benefits of both companies' ratepayers. Additionally, there is no justification for
4 the inequity created by applying simple interest to Avista's deemer balance and
5 compound interest to Idaho Power's deemer balance. Although BPA believes that
6 interest should accrue on both the Lookback and the deemers to reflect the time value
7 of money, the application essentially amounts to a penalty – in the case of the
8 deemers, an insurmountable penalty for Idaho Power and for Avista a significant
9 reduction in REP benefits forward.

10 Q. Are the arguments you made previously concerning the negative aspects of the
11 Lookback Analysis as a form of retroactive ratemaking also applicable to the
12 deemers?

13 A. Yes, even more so. The deemers sprang from the unanticipated consequence of the
14 Northwest Power Act not addressing the situation where an IOU's ASC fell below the
15 PF exchange rate. The deemers were used in the loads and resources of BPA cost-of-
16 service studies for years and were characterized as resource, not accounting,
17 transactions. Although the deemers have their roots in RPSAs, the contractual
18 obligation was never recorded as a regulatory asset or other deferral or amortized on
19 BPA's books. The RPSA contracts Avista and Idaho Power entered into in 1981
20 expired in 1993 without the deemer balances being addressed. Both Avista and Idaho
21 Power received REP benefits from BPA after entering into the 1981 RESAs, in spite
22 of the prohibition of receiving future REP benefits until the deemer balances were

1 repaid. Any resolution of the deemer issue in 2008 will create an extreme example of
2 inter-generational subsidies of Avista's and Idaho Power's ratepayers. Finally, the
3 deemers are a contractual issue separate and apart from the rate case in this
4 proceeding and should not be included in any calculation of REP benefits on a
5 lookback or going-forward basis. The lack of accounting treatment of the deemer
6 balances in BPA's books over the past 27 years – not to mention the absence of any
7 authority in Section 5 of the NPA – challenges the legitimacy of the repayment
8 obligations that BPA has proposed. I recommend that the deemer balances not be
9 included in the resolution of this rate proceeding.

10 Q. Does BPA's proposed treatment of Idaho Power's deemer balance undermine any
11 other BPA goals?

12 A. By including the deemer balance and continuing to accrue interest, BPA will not
13 achieve its goal of maintaining a reasonable level of REP payments balanced against
14 repaying the Lookback amounts in 20 years or less. Given the inability of BPA and
15 Idaho Power to address the deemer balances, Idaho Power's ratepayers are severely
16 disadvantaged. In essence, Idaho Power ratepayers are penalized for BPA's and
17 Idaho Power's inability to resolve or address the deemer balance account. The IPUC
18 strongly encourages Idaho Power and BPA to settle their deemer dispute.

19 **Section 5: ASC Methodology**

20 Q. Do you have a recommendation concerning what BPA should do if it insists on
21 calculating the Lookback amounts and in establishing new preference rates?

1 A. Yes. BPA is developing a new ASCM in a concurrent rulemaking proceeding and
2 intends to apply the results of that rulemaking to the rates in this case. The facts that
3 the 1984 ASCM has never been fully litigated because of the RESAs and that the
4 electric utility industry has changed substantially since 1984 in terms of resource
5 development and options, market operations, and load growth in the Northwest – all
6 point to the need to use an updated ASCM. As proposed in the ASCM rulemaking, it
7 would be transparent by relying on readily available data from FERC Form No. 1
8 reports, would be easy to update on an annual basis, and would be sustainable going
9 forward. I recommend that BPA include the results of the ASCM rulemaking in
10 determining final rates in this proceeding.

11 Q. Does this conclude your testimony?

12 A. Yes.
13
14
15
16
17
18
19
20
21
22