Bonneville Power Administration
Power Business Line

2003 Safety-Net Cost Recovery Adjustment Clause Final Proposal

Administrator's Final Record of Decision

SN-03-A-02

June 2003

BONNEVILLE
POWER ADMINISTRATION

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COMMONLY USED ACRONYMS

AER	Actual Energy Regulation
AFUDC	Allowance for Funds Used During Construction
ANR	Accumulated Net Revenues
AOP	Assured Operating Plan
ASC	Average System Cost
BART	Bay Area Rapid Transit
BiOp	Biological Opinion
BPA	Bonneville Power Administration
Bureau	US Bureau of Reclamation
C&RD	Conservation and Renewables Discount
CBFWA	Columbia Basin Fish and Wildlife Authority
CCCT	Combined-Cycle Combustion Turbines
CGS	Columbia Generating Station
Coalition Customer	Coalition Customers (ICNU, Alcoa, PNGC, Benton, Canby)
ConAug	Conservation Augmentation
Corps	U.S. Army Corps of Engineers
Council	Northwest Power Planning Council
CPP	Creditor Payment Probability
CRAC	Cost Recovery Adjustment Clause
CRITFC	Columbia River Inter-Tribal Fish Commission and Yakama Nation
DDC	Dividend Distribution Clause
DOE	Department of Energy
DSI	Direct Service Industrial Customers
ECC	Energy Content Curve
ENW	Energy Northwest
EPBA	Eastern Power Business Area
ESA	Endangered Species Act
EWEB	Eugene Water and Electric Board
FAS	Federal Accounting Standard
FASB	Federal Accounting Standards Board
FB	Financial-Based
FCCF	Fish Cost Contingency Fund
FCRPS	Federal Columbia River Power System
FELCC	Firm Energy Load Carrying Capability
FERC	Federal Energy Regulatory Commission
FRN	Federal Register Notice
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
G&A	General and Administrative

GPU	Generating Public Utilities (Benton, Cowlitz, Franklin, Grays Harbor, Pend Oreille, Grant, Seattle, Eugene)
GRSPs	General Rate Schedule Provisions
GSP	Generation System Peak
GTA	General Transfer Agreements
HLH	Heavy Load Hour Energy
HOSS	Hourly Operating and Scheduling Simulator
HydroSim	Hydro Regulation Simulator
IDC	Interest During Construction
IOU	Investor-Owned Utilities
IP	Industrial Firm Power
IPTAC	IP Targeted Adjustment Charge
ISO/PX	California Independent System Operator/Power Exchange
ISRP	Independent Scientific Review Panel
Joint Customers	Joint Customers (Alcoa, Golden NW, Idaho, ICNU, NRU, PNGC, PPC)
JCG	Joint Customer Group
LB	Load-Based
LDD	Low Density Discount
LLH	Light Load Hour Energy
maf	Million Acre-Feet
MOA	Memorandum of Agreement
MW-Mo	MW-Months
NAGPRA	Native American Graves Protection and Repatriation Act
NEPA	National Environmental Policy Act
NGPRM	Natural Gas Price Risk Model
NOAA Fisheries	National Marine Fisheries Service (previously NMFS)
NORM	Non-Operating Risk Model
Northwest Power Act	Pacific Northwest Electric Power Planning and Conservation Act
NRU	Northwest Requirements Utilities
NUG	Non-Utility Generators
NWPPC	Northwest Power Planning Council
O&M	Operations and Maintenance
OY	Operating Year
PBL	Power Business Line
PDP	Proportional Draft Points
PF	Priority Firm
PF TAC	PF Targeted Adjustment Charge
PNCA	Pacific Northwest Coordination Agreement
PNGC	Pacific Northwest Generating Cooperative

PNRR	Planned Net Revenues for Risk
PNW	Pacific Northwest
PPC	Public Power Council
PSW	Pacific Southwest
PUD	Public Utility District
Puget	Puget Sound Energy
RAM	Rate Analysis Model
Reclamation	Bureau of Reclamation
RL	Residential Load
ROD	Record of Decision
RTO	Regional Transmission Organization
SCE	Southern California Edison
SN	Safety-Net
SOR EIS	System Operations Review Environmental Impact Statement
SOS	Save our Wild Salmon and NW Energy Coalition
SUB	Springfield Utility Board
TBL	Transmission Business Line
TPP	Treasury Payment Probability
TRP	Treasury Recovery Probability
USFWS	U.S. Fish and Wildlife Service
WECC	Western Electric Coordinating Council
WPAG	Western Public Agencies Group (Snohomish, Clallam, Clark, Kittitas, Lewis County, etc.)
WPBA	Western Power Business Area
WPRDS	Wholesale Power Rate Development Study
WSCC	Western Systems Coordinating Council
WY	Water Year

1.0 INTRODUCTION

This Record of Decision (ROD) contains the decisions of the Bonneville Power Administration (BPA), based on the record compiled to date, with respect to the adoption of the Safety-Net Cost Recovery Adjustment Clause (SN CRAC) which is to be effective October 1, 2003. The adoption of the SN CRAC is the implementation of risk mitigation mechanisms developed to assure sufficient cost recovery.

This ROD follows a full evidentiary hearing, briefing, and oral argument before the BPA Administrator. Chapters 2 and 3 present the issues raised by parties in this proceeding, the parties' positions, BPA's position on the issues, BPA's evaluation of the positions, and the Administrator decisions.

1.1 Background

On July 2, 2002, BPA sent a letter to rate case parties and other interested entities in the region announcing the beginning of the Financial Choices public comment process. The Financial Choices process examined a variety of financial and program options for addressing PBL's FY 2003-2006 financial challenges. In this process, BPA described the financial challenges, the actions BPA already had taken to address the problem, and the financial outlook for the remainder of the rate period. Additionally, BPA identified a variety of potential financial alternatives that, separately or in combination, could form the basis of a solution to PBL's financial situation.

During the course of the process, BPA held ten public meetings and workshops with customers, public interest groups, tribes, and other interested persons to explain the nature of the problem, and to show program level costs and the potential effects of cost reductions. BPA also solicited suggestions to address its growing financial problem. The public comment period for the Financial Choices process closed on September 30, 2002. As a result of the Financial Choices process, BPA made decisions to cut, eliminate, or defer certain costs and expenses. BPA issued a Financial Choices close-out letter to the region on November 22, 2002, outlining BPA's plan, in part, for meeting the agency's financial challenges. The plan took into consideration extensive public input BPA received during the Financial Choices public process. The BPA actions described in the Financial Choices close-out letter included $350 million in expense savings, expense deferrals, and other actions for the FY 2003-2006 period. These were reflected in the program levels in BPA's initial proposal.

While BPA did not trigger the SN CRAC in November, by January 2003, worsening water conditions and a refined secondary revenue forecast increased the net revenue gap for the 2002-2006 rate period to $920 million. In February 2003, a SN CRAC adjustment became necessary to ensure that rates and revenues would be sufficient to recover costs with a high degree of certainty over the remainder of the rate period.

On February 7, 2003, the BPA Administrator determined that the SN CRAC triggered based upon a forecast of a 50 percent or greater chance of missing a payment to the U.S. Treasury or

another creditor during this fiscal year. The triggering of the SN CRAC initiates an expedited hearing under section 7(i) of the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act), 16 U.S.C. § 839e(i). The prohibition on *ex parte* communication went into effect on February 7, 2003. Prior to the release of its initial SN-03 rate proposal, BPA sponsored six workshops in order to address a variety of issues related to its ratemaking. The workshops covered topics such as financial issues and proposed rate designs. The workshops held between BPA and interested parties were to develop a common understanding of the issues, to generate ideas, and to propose alternative solutions to issues in specific areas when possible.

1.1.1 Procedural History of the SN-03 Rate Proceeding

Section 7(i) of the Northwest Power Act, 16 U.S.C. § 839e(i), requires that BPA's wholesale power and transmission rates be established according to certain procedures. These procedures include, among other things, issuance of a Federal Register Notice (FRN) announcing the proposed rates; one or more hearings; the opportunity to submit written views, supporting information, questions, and arguments; and a decision by the Administrator based on the record. This proceeding is governed by the *Procedures Governing Bonneville Power Administration Rate Hearings*, 51 Fed. Reg. 7611 (1986) (hereinafter BPA Procedures). These BPA Procedures implement the statutory section 7(i) requirements.

On March 13, 2003, BPA published a Federal Register Notice of "Proposed Safety-Net Cost Recovery Adjustment Clause Adjustment to 2002 Wholesale Power Rates," 68 Fed. Reg. 12048 (2003). BPA's SN-03 proceeding began with a prehearing conference held on March 31, 2003. At the prehearing conference, the Hearing Officer issued orders concerning procedural matters and established the schedule for this rate proceeding. On April 4, the Hearing Officer granted parties' petitions to intervene and adopted the service list for BPA's SN-03 proceeding.

BPA's SN-03 proposal, filed on March 31, was supported by prefiled written testimony and studies sponsored by approximately 30 witnesses. Oral clarification of BPA's initial proposal occurred on April 2 followed by written discovery. The parties filed direct testimony on April 18. Clarification of the parties' direct testimony occurred on April 22 followed by written testimony. On May 5, litigants to the proceeding filed testimony in rebuttal to the parties' direct cases. The parties filed their prehearing briefs two days later. Clarification on the litigants' rebuttal testimony occurred on May 7 followed by written testimony. BPA responded to 105 data requests concerning its initial SN CRAC proposal and its rebuttal testimony.

Cross-examination took place on May 16. The parties submitted initial briefs on May 23, and oral argument before the Administrator was held on May 29. The draft ROD was issued and distributed to parties on June 16, 2003. The parties submitted briefs on exception on June 20, 2003.

For interested persons who do not wish to become parties to the formal evidentiary hearings, BPA's Procedures provide opportunities to participate in the ratemaking process by submitting oral and written comment. *See* Section 1010.5 of BPA's Procedures. BPA received oral and written comments at a transcribed filed hearing conducted on April 16, 2003, in Portland, Oregon. BPA received and considered 3,803 written comments submitted during the participant

comment period, which officially ended on May 1. BPA also received several written comments after the end of the official comment period through the issuance of this ROD. The transcribed field hearing and the comments from these rate case participants are part of the record upon which the Administrator bases his decisions.

1.1.2 Waiver of Issues by Failure to Raise in Briefs

While the parties have raised many issues in this proceeding in their briefs, there are a number of issues raised by the parties during the hearing that were not raised in the parties' briefs. Pursuant to section 1010.13(b) of BPA's Procedures, arguments not raised in parties' briefs are deemed to be waived. Such issues will be implemented based on BPA's stated position in the record.

1.2 Legal Guidelines Governing Establishment of Rates

1.2.1 Statutory Guidelines

Section 6 of the Bonneville Project Act of 1937 (Project Act), 16 U.S.C. § 832e, requires that the Administrator prepare schedules of rates and charges for electric energy sold to purchasers. Under the Project Act, rate schedules become effective upon confirmation and approval by the Federal Power Commission, now succeeded by the FERC. Section 6 of the Project Act directs the Administrator to establish rates with a view to encouraging the widest possible diversified use of electric energy. Section 7 provides that rate schedules are to be established having regard to the recovery of the cost of producing and transmitting electric energy, including amortization of the capital investment over a reasonable period of years. *See* 16 U.S.C. § 832f.

The Flood Control Act of 1944 contains ratemaking requirements similar to the Project Act. Section 5 of the Flood Control Act directs that rate schedules should encourage the most widespread use of power at the lowest possible rates to consumers consistent with sound business principles. *See* 16 U.S.C. § 825s. Section 5 also provides that rate schedules should be drawn having regard to the recovery of the cost of producing and transmitting electric energy, including the amortization of the Federal investment over a reasonable number of years. *Id.*

The Federal Columbia River Transmission System Act of 1974, 16 U.S.C. § 838 (Transmission System Act), contains requirements similar to those of the Project Act and the Flood Control Act of 1944. Section 9 of the Transmission System Act, 16 U.S.C. § 838g, provides that rates shall be established: (1) with a view to encouraging the widest possible diversified use of electric power at the lowest possible rates consistent with sound business principles; (2) with regard to the recovery of the cost of producing and transmitting electric power, including amortization of the capital investment allocated to power over a reasonable period of years; and (3) at levels that produce such additional revenues as may be required to pay when due the principal, premiums, discounts, expenses, and interest in connection with bonds issued under the Transmission System Act. Section 10 of the Transmission System Act, 16 U.S.C. § 838h, allows for uniform rates and specifies that the costs of the Federal transmission system be equitably allocated between Federal and non-Federal power utilizing the system.

In addition to the Bonneville Project Act, the Flood Control Act, and the Transmission System Act, the Northwest Power Act establishes numerous rate directives. Section 7(a)(1) of the Northwest Power Act directs the Administrator to establish, and periodically review and revise, rates for the sale and disposition of electric energy and capacity and for the transmission of non-Federal power. *See* 16 U.S.C. § 839e(a)(1). Rates are to be set to recover, in accordance with sound business principles, the costs associated with the acquisition, conservation, and transmission of electric power, including the amortization of the Federal investment in the FCRPS (including irrigation costs required to be repaid by power revenues) over a reasonable period of years. *Id.* Section 7 also contains rate directives describing how rates for individual customer groups are derived.

1.2.2 The Broad Ratemaking Discretion Vested in the Administrator

The Administrator has broad discretion to interpret and implement statutory standards applicable to ratemaking. These standards focus on cost recovery and do not restrict the Administrator to any particular rate design methodology or theory. *See Pacific Power & Light v. Duncan,* 499 F. Supp. 672 (D.C. Or. 1980); *accord City of Santa Clara v. Andrus*, 572 F. 2d 660, 668 (9th Circuit 1978) ("widest possible use" standard is so broad as to permit "the exercise of the widest administrative discretion"); *ElectriCities of North Carolina v. Southeastern Power Admin.*, 774 F. 2d 1262, 1266 (4th Circuit 1985).

The United States Courts of Appeals for the Ninth Circuit has also recognized the Administrator's ratemaking discretion. *Central Lincoln Peoples' Utility District v. Johnson*, 735 F. 2d 1101, 1120-29 (9th Circuit 1984) ("[b]ecause BPA helped draft and must administer the Northwest Power Act, we give substantial deference to BPA's statutory interpretation"); *PacifiCorp v. F.E.R.C.*, 795 F. 2d 816, 821 (9th Circuit 1986) ("BPA's interpretation is entitled to great deference and must be upheld unless it is unreasonable"); *Atlantic Richfield Co. v. Bonneville Power Admin.*, 818 F. 2d 701, 705 (9th Circuit 1987) (BPA's rate determination upheld as a "reasonable decision in light of economic realities"); *Aluminum Company of America v. Central Lincoln Peoples' Utility District*, 467 U.S. 380, 389 (1984) ("The Administrator's interpretation of the Regional Act is to be given great weight"); *Department of Water and Power of the City of Los Angeles v. Bonneville Power Admin.*, 759 F. 2d 684, 690 (9th Circuit 1985) ("Insofar as agency action is the result of its interpretation of its organic statutes, the agency's interpretation is to be given great weight").

1.2.3 Federal Energy Regulatory Commission Confirmation and Approval of Rates

BPA's rates become effective upon confirmation and approval by FERC. 16 U.S.C. § 839e(a)(2). FERC's review is appellate in nature, based on the record developed by the Administrator. *United States Department of Energy--Bonneville Power Admin.*, 13 F.E.R.C. ¶ 61,157, 61,339 (1980). The Commission may not modify rates proposed by the Administrator, but may only confirm, reject, or remand them. *United States Department of Energy--Bonneville Power Admin.*, 23 F.E.R.C. ¶ 61,378, 61,801 (1983). Pursuant to Section 7(i)(6) of the Northwest Power Act, 16 U.S.C. §839e(i)(6), FERC has promulgated rules establishing procedures for the approval of BPA rates. 18 C.F.R. Part 300 (1997).

With respect to rates, FERC determines whether: (1) rates are sufficient to assure repayment of the Federal investment in the FCRPS over a reasonable number of years after first meeting BPA's other costs; (2) rates are based on BPA's total system costs; and (3) transmission rates equitably allocate the cost of the Federal transmission system between Federal and non-Federal power using the system. 16 U.S.C. §839e(a)(2). *See United States Department of Energy--Bonneville Power Admin*, 39 F.E.R.C. ¶ 61,078, 61,206 (1987). The limited FERC review of rates permits the Administrator substantial discretion in the design of rates and the allocation of power costs, neither of which are subject to FERC jurisdiction. *Central Lincoln Peoples' Utility District v. Johnson,* 735 F. 2d 1101, 1115 (9th Circuit 1984).

1.2.4 Standard of Judicial Review

Section 9(e)(5) of the Northwest Power Act states that suits challenging a BPA final action are subject to Ninth Circuit review. 16 U.S.C. § 839f(e)(5). A rate determination is specifically identified as a final action, 16 U.S.C. § 839f(e)(1)(G), and is deemed final upon confirmation and approval by FERC, 16 U.S.C. § 839f(e)(4)(D). "Thus, judicial review of disputes over a rate or the implementation of a rate are placed within our exclusive jurisdiction." *Puget Sound Energy, Inc. v. U.S.*, 310 F.3d 613, 617 (9th Circuit 2002).

Section 9(e)(2) of the Northwest Power Act provides that "final determinations regarding rates under Section 7 shall be supported by substantial evidence in the rulemaking record required by Section 7(i) considered as a whole." 16 U.S.C. § 839f(e)(2). In describing the applicable standards of judicial review, the Ninth Circuit has stated that "[t]his court must affirm the rates if 'substantial evidence in the rulemaking record' supports BPA's determination . . .. We must also affirm the agency's action unless it is arbitrary, capricious, an abuse of discretion or in excess of statutory authority." *Alcoa v. Bonneville Power Administration*, 891 F. 2d 748, 752 (9th Circuit 1990). *See also Southern California Edison Co. v. Jura*, 909 F. 2d 339, 342 (9th Circuit 1990); *Central Lincoln Peoples' Utility District, et al., v. Johnson*, 735 F. 2d 1101, 1115 (9th Circuit 1984).

2.0 SN CRAC ISSUES

2.1 Overview and Management Direction

2.1.1 Causes of BPA's Financial Condition

BPA's PBL's net revenue condition is different from what BPA expected when completing its Supplemental Proposal in June 2001. Keep, *et al*., SN-03-E-BPA-04, at 5. On June 29, 2001, BPA filed a Supplemental Proposal with FERC, and received interim approval on September 28, 2001. *Id*. In that filing, PBL predicted higher net revenues than in BPA's May 2000 Final Proposal. Net revenues are defined as revenues minus (or net of) expenses. *Id*. BPA expected both higher revenues and lower expenses than it subsequently experienced. *Id*. Two primary reasons drove BPA's expected increased revenues: secondary sales and fish credits. *Id*. BPA's secondary sales are a function of both market prices and available surplus hydro generation. *Id.* Secondary sales were forecasted to provide higher revenues due to BPA's expectation through FY 2002 of high market prices. *Id*. At the time, the West Coast was experiencing very high electrical demand relative to supply. *Id.* The development of new resources, which BPA expected would eventually help bring market prices down, was anticipated to take up to two years. *Id.* BPA believed high market prices would continue until these new resources came on line. *Id.* However, lower-than-forecasted revenues for BPA in FY 2002 resulted from an unanticipated and rapid decline in market prices. *Id.* A number of factors contributed to this decline, including lower demand as a result of a downturn in the economy. *Id.*

A variable in secondary sales revenues is the amount of water in the hydro system available to generate hydroelectricity in any given year. *Id.* In BPA's Supplemental Proposal, BPA expected an average amount of hydro production for all years of the rate period. *Id.* However, actual hydro production in FY 2002 was lower than expected. *Id.* Although the hydro conditions appeared to be about normal over the January-July 2002 period, it was necessary to store a significant amount of water to partially replenish the low reservoirs resulting from the 2001 drought. *Id.* at 5 -6. This storage resulted in less 2002 hydro production than forecasted in BPA's Supplemental Proposal. *Id*. at 6. Hydro conditions in FY 2003 were expected to be below average, thereby also contributing to the decline in BPA's revenues. *Id.* at 5. The net result of these two factors (lower than expected prices and less than expected hydro production) resulted in BPA selling less energy and at lower prices than forecasted in the Supplemental Proposal. *Id.* at 6.

The second source of expected increased revenues in BPA's Supplemental Proposal consisted of credits toward BPA's Treasury payments based on fish-related costs and impacts on operations (fish credits). *Id.* These credits were expected to contribute significantly to BPA's total revenues, in part due to high market prices. *Id.* Fish credits contribute to BPA's overall revenues through a credit against BPA's payment to the U.S. Treasury. *Id.* However, these credits are now expected to be substantially lower over the rate period than previously forecasted. *Id.* The reasons include a reallocation of project purposes at Grand Coulee, lower wholesale power prices, and, finally, reduced availability of Fish Cost Contingency Fund (FCCF) credits that were all but exhausted at the end of 2001 because of the severe drought. *Id.*

PBL cost increases of approximately $1.5 billion in total over the rate period have also contributed to BPA's eroding financial condition (not including offsetting increases in revenue due to the increase in expenses and the risk to certain expense categories embedded in the NORM assessment). *Id.* These increases include PBL Internal Operations, Corporate Overhead, Residential Exchange Settlement Agreements, Power Generation, Renewable projects, Transmission Acquisition, Civil Service Retirement Payments, Terminated Projects, Fish and Wildlife, Conservation and Renewable Discount, Other Public Benefits, Non-Federal Debt Service, Depreciation, Amortization, and Net Interest (not included are Power Purchases and Augmentation). *Id.* Associated with these expense items are approximately $500 million in offsetting revenues over the rate period, such as increased generation from the hydro system and Columbia Generating Station, and approximately $120 million over the rate period from non-operating risks. *Id.* at 6-7.

BPA also experienced additional increases in expenses. Because of the energy crisis in 2001, BPA is still owed about $90 million by the California Independent System Operator and Power Exchange. *Id*. at 7. Of this amount, BPA made an accounting adjustment to PBL's net revenues in 2002 of about $30 million [revised in final study to $24 million] to reflect the risk that BPA may never be paid this amount. *Id.* Additionally, BPA has take-or-pay contracts that obligate the DSIs to pay damages for IP power that is not purchased (curtailed). *Id.* This event has occurred and BPA has had to sell the curtailed amount in the surplus market when the market value is less than the IP value. *Id.* The DSIs are obligated to pay BPA the difference under those circumstances so that BPA is made whole. *Id.* BPA is at risk of not being paid about $30 million of FY 2002 damages due to DSI bankruptcies or other financial difficulties. *Id.* So far, the portion of money at risk is $58 million [revised in final study to $54 million], which is reflected as a Bad Debt Expense in BPA's income statement. *Id.*

BPA began this section 7(i) SN-03 CRAC rate hearing in poor financial shape. BPA's prognosis was for further deteriorating financial health. The record of this proceeding reflects the several causes for BPA's weak financial condition. Keep, *et al*., SN-03-E-BPA-04, at 5-7. In order to regain its financial health, BPA's initial proposal set a prospective rate level of 15.6 percent (average expected value rate level for FY 2004–2006 above the total average rate level for FY 2003). The implications of such a large rate increase for a fragile Northwest economy were of great concern, but so were the long-term implications if BPA failed to recover its costs through its rates. Fortunately for BPA and the parties, over the course of months during which this hearing has taken place, the prognosis has changed for the better. Tr. at 40-42. It is therefore reasonable, based on improvements in PBL's financial condition that are on the record, for the Administrator to bring the average expected value of FY 2004-2006 rates down to about 5 percent above the total rate level for FY 2003. These improvements are due to aggressive cost cutting resulting in over $80 million in net expense reductions, more favorable water conditions, higher market prices, and cash benefits from debt optimization, among other things. Moreover, based on the structure of the SN-03 CRAC rate design, further improvements in FY 2003 secondary revenues could further reduce these rates. In light of these improvements to BPA's financial health, the Administrator reconsidered the need to adopt two addition financial standards as initially proposed (TRP and zero net PBL Revenues in addition to TPP). It is no longer necessary to adopt these two additional standards, and BPA will instead return to relying

on a single financial standard, requiring that the three-year TPP be at least 80 percent. *See* Rate Design, Chapter 2.7, *infra.*

Issue 1

Whether BPA's financial situation is largely self-created.

Parties' Positions

ICNU/ALCOA argue that BPA's financial situation is largely self-created. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 5. ICNU/ALCOA contend that it is erroneous that the draft ROD refused to acknowledge the role BPA played in its current financial condition because much of BPA's "controllable" costs were foreseeable and BPA should have either included these costs in rates or not incurred them. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 11. ICNU/ALCOA state that BPA's actual and forecasted costs have dramatically exceeded, and continue to exceed, the amount included in BPA's rates. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 5. They argue that the primary causes of all of BPA's cost increases include: (1) BPA's failure to anticipate load reductions; (2) BPA's commitment to purchase expensive power and five year buydowns at the height of the 2000-2001 market price spike; (3) the "litigation settlement" or "Poison Pill" agreement; (4) BPA's failures in the secondary sales market; (5) the lack of a timely response by BPA to its financial problems; and (6) BPA's failure to make any overall cost cuts. *Id*. at 6. They suggest that the majority of the cost increases regarding controllable costs were not caused by unforeseen or extraordinary events, but by exceeding the budgets approved in the May 2000 rate case. *Id*. at 6. ICNU/ALCOA also argue that BPA cannot now distance itself from its recent rate case filings by characterizing the costs in rates as "aggressive targets" simply because it did not take the actions necessary to ensure that costs remained within rate case levels. *Id*. at 7.

BPA's Position

BPA's spending was a direct result of the increasing complexity of the market, the load obligations placed on BPA by its customers, the service-level expectation of BPA's stakeholders, the required functional split between the Power and Transmission Business Lines, and compliance with FERC standards of conduct and other requirements. Keep, *et al*., SN-03-E-BPA-11, at 7. In addition, BPA experienced lower revenues than forecasted in the Supplemental Proposal, and lower than expected fish credits, which are due to conditions beyond BPA's control (lower than expected market prices and less than expected hydro production). Keep, *et al*., SN-03-E-BPA-04, at 6. BPA's May 2000 and June 2001 rate cases anticipated that there were risks associated with the cost levels included in the revenue requirement, which is why BPA included planned net revenues for risks associated with operating and non-operating costs. Keep, *et al*., SN-03-E-BPA-11, at 15. Also, BPA's budgets are not approved in rate cases. *Id*. at 13.

Evaluation of Positions

The purpose of a rate case is to establish rates that recover costs consistent with applicable provisions of law. While program and budget issues are not the subject of a rate case, a great deal of concern has been expressed that rates should be used as a last resort to cure a problem that parties assert is of BPA's own making. BPA takes the opportunity to address the policy issue here.

ICNU/ALCOA argue that BPA's actual and forecasted costs have dramatically exceeded, and continue to exceed, the amount included in BPA's rates. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 5. ICNU/ALCOA argue the expense forecasts in BPA's 2003 SN CRAC initial proposal, GRSPs, and direct testimony were about $669 million per year higher than its May 2000 rates for FY 2004 to FY 2006. *Id*. Total spending levels over the same period were forecast to be nearly $2 billion over its May 2000 rates. *Id*. at 5-6. ICNU/ALCOA argue that the vast majority of the more difficult-to-control costs related to augmentation power purchases, investor-owned utility buy backs, and load reduction costs that are already recovered in the LB CRAC and FB CRAC. *Id.* at 6. ICNU/ALCOA conclude that BPA's current FY 2003-2006 cost forecasts for "controllable" cost categories, primarily related to internal programs, corporate overhead, U.S. Army Corps of Engineers and U.S. Bureau of Reclamation ("Corps and Bureau"), fish, wildlife, and conservation programs, and generation costs, including ENW, account for nearly half of BPA's spending increase, or approximately $732 million over May 2000 rates. *Id*.

First, identifying certain costs as "more controllable" is flawed when compared to BPA's May 2000 forecast. Keep, *et al*., SN-03-E-BPA-11, at 14. For instance, internal operations costs (costs associated with the Power Business Line, Corporate G&A, and Shared Services) are a direct result of the dramatic change in the fundamental relationship between BPA and its customers when compared with the assumptions made when developing the May 2000 forecast, which assumed simple contracts and rate structures (*e.g.*, today BPA has a variety of complex contracts, varied rate mechanisms that change every 6 months, customer service requirements, etc.). *Id*. Further, the increased complexity of the electricity market due to deregulation, which required increases in staffing and operations expenses was not embedded as a fundamental assumption in the May 2000 forecasts. *Id*. at 15. Another example is the increase in security costs associated with BPA's internal operations, the Corps, Reclamation, and ENW due to September 11, 2001. *Id*. Finally, the increased costs associated with maintaining a safe, reliable, and aging hydro system and nuclear plant; increased regulatory requirements; the reallocation of project purposes at Grand Coulee dam by Reclamation; and the embedded expenses associated with implementing the Biological Opinion (in the Corps, Reclamation, and internal operations line expense items) were not contemplated in BPA's May 2000 forecast. *Id*.

Second, the comparison argued by ICNU/ALCOA above ignores the risk analysis for non-operating costs (called NORM), included in BPA's May 2000 and June 2001 rate filings, which included an expected value of increased operations costs that was about $121 million more than the base case costs in the revenue requirement study. *Id*. at 15. The risk analysis was done to recognize the difficulty of meeting those aggressive cost targets in light of the risks

associated with the future that the Cost Review had assumed when making its recommendations. *Id*.

Further, the Cost Review identified substantial risks associated with its recommendations (which are associated with expense forecast levels in the May 2000 forecast). *Id*. For instance, regarding internal operations costs, the Cost Review notes "a greatly reduced staff may not be able to respond to the many upcoming changes in the power business such as new market flexibilities, scheduling protocols, and new independent system operators (ISOs). Complex and highly tailored products and support services would not be offered." *Id*. It also notes that "some market analyses, particularly for purposes of managing river operations in relation to both fish and excess power, may need to increase, not decrease, depending on how overall industry restructuring affects operations of the FCRPS. It is anticipated that fewer analysts will be required in the future for this function, but this is very tentative." *Id*. at 15-16. Regarding ENW, the Cost Review notes "[t]here is some risk that WNP-2 will face significant unplanned costs, either from failure of major pieces of equipment or from increased regulatory requirements." *Id*. at 16.

Furthermore, the analysis done by the Joint Customers does not recognize the increases in revenue associated with several of the expense categories. *Id*. For instance, in the PBL Internal Operations category, several expenses are paid for by other parties (such as Market Development and Slice) or have offsetting revenues due to increases in generation or more efficient use of the hydro system (such as PBL Efficiencies Projects). *Id*. Similarly, generation output from ENW and the hydro projects is greater than it otherwise would have been, which offsets some of the expense increases. *Id*.

ICNU/ALCOA argue that the majority of the cost increases regarding controllable costs were not caused by unforeseen or extraordinary events, but by exceeding the budgets approved in the May 2000 rate case. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 6. ICNU/ALCOA claim that all of these costs are foreseeable and were included or should have been included in BPA's May 2000 rates. *Id*. at 7. ICNU/ALCOA contend, "BPA has simply not justified why these costs should exceed budgeted amounts." *Id*. ICNU/ALCOA note, for example, BPA's initial proposal forecasted spending an average additional $171 million per year for FY 2003-2006 on CGS, the Corps and Reclamation, BPA's Power Business Line, Shared Services, Corporate, and administrative departments. *Id*. at 6. ICNU/ALCOA note BPA also claims that its costs have increased because of electric deregulation, maintenance of the aging hydro system, biological opinion costs, the functional split between power and transmission operations, FERC regulatory requirements, and staffing and development related to the Northwest Regional Transmission Organization. *Id*. at 6-7. ICNU/ALCOA argue all of these costs are foreseeable and were included or should have been included in BPA's May 2000 rates. *Id*. at 7.

ICNU/ALCOA state that BPA "obfuscates" its cost increase problem by comparing its current and forecasted costs to its 2001 actuals rather than the May 2000 rate case costs. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 7. ICNU/ALCOA argue that BPA distances the agency from its May 2000 rates by claiming that they were based on "aggressive targets" recommended by the 1998 Cost Review. *Id*. ICNU/ALCOA argue BPA fails to recognize that it set rates and submitted rates to FERC in June 2001 based on the claim that those costs would cover BPA's

total system costs. *Id.* ICNU/ALCOA argue BPA cannot now distance itself from its recent filings by characterizing the costs in rates as "aggressive targets" simply because it did not take the actions necessary to ensure that costs remained within rate case levels." *Id.*

ICNU/ALCOA is wrong to suggest there is no basis to raise rates. BPA's budgets are not subject to BPA's rate hearing process, only BPA's rates. Keep, *et al*., SN-03-E-BPA-11, at 13. Moreover, while BPA's May 2000 rates reflected earlier budget levels, the actual costs incurred since then were unforeseeable and thus could not have been included in the May 2000 rates. This is why BPA established the three CRACs in the supplemental rate proposal—to handle cost uncertainties and risk. BPA disagrees that all of these costs were foreseeable and therefore should have been included in the May 2000 rates. There is nothing on the record that implies these costs were foreseeable. While BPA must recover its costs, whatever the case, these expenditures also were prudent at the time they were made. Most important, however, is the fact that certain costs not being included in BPA's May base rates does not relieve BPA of its legal obligation to set rates sufficient to recover its costs.

BPA disagrees with the assertion that BPA failed to take steps to achieve the Cost Review recommendations. BPA adopted the overall cost reduction target recommended by the Cost Review. Keep, *et al*., SN-03-E-BPA-11, at 2. Both BPA and the Cost Review acknowledged that there were challenges to achieving all the cost reductions. *Id.* Nevertheless, considerable effort and planning took place from 1997 through 2000 within BPA to achieve the overall cost reductions defined in the Cost Review, though with a somewhat different mix of actions than specified in the Cost Review. *Id.* Additionally, BPA targeted cost increases that were associated with offsetting revenue increases as consistent with the cost reduction goal, even though gross costs were higher. *Id.* Below is a non-exhaustive list of examples of BPA's efforts and planning.

First, BPA established a staffing plan in 1999 which anticipated that the fundamental relationship between BPA and its long-term power customers would change substantially. *Id.* It assumed that many traditional customer support services no longer would be provided and Power Marketing would focus on maximizing the value from the seasonal and monthly changes in the hydro system. *Id.* This staffing plan assumed customers would not exercise their statutory rights to obligate BPA to provide new resources and expanded services, and assumed power rates would be established and remain in place for many years at a time. *Id.* at 2-3. Further, the staffing plan was predicated on greatly simplified billing, scheduling, and inventory systems, and an assumption that complex and highly tailored products and support services would not be offered. *Id.* at 3.

Second, BPA developed plans to work with retail utilities and states to secure funding for conservation market transformation through state public purpose funds, as recommended by the Cost Review. *Id.*

Third, BPA transformed its approach to conservation, moving to a market-oriented approach that involved drastic reductions in staffing and funding. *Id.*

Fourth, BPA established plans to fund renewable resource projects up to a maximum of $15 million in any one year above the revenues obtainable from those renewable resource projects, and has managed renewable resource costs within this limit ever since. *Id.*

Fifth, BPA developed a major program to automate many aspects of its system planning, scheduling, and billing to reduce staff requirements and increase revenues. *Id.* Collectively, these efforts are called the Efficiencies Project. *Id.*

Sixth, a Joint Operating Committee was established, and continues today, which is composed of the Corps, Reclamation, and BPA, to facilitate the development and implementation of a consolidated, integrated capital/asset management strategy directed at maximizing value, including both financial returns and public benefits of the Federal Columbia River Power System (FCRPS). *Id.* This is referred to as the Asset Management Strategy. Performance measures have been explicitly developed and are reported publicly. *Id.* Accountabilities have been established and incentives have been created to ensure the asset management success of the FCRPS. *Id.* O&M aspects of the FCRPS assets have been benchmarked against industry practices. *Id.*

Finally, BPA performed a shared services review and adopted a corporate and shared service organizational structure, which redesigned financial, information, procurement, human resource management, and other processes. *Id.* at 2-3. BPA also performed benchmarking techniques and implemented private sector-based "best practices" in the "shared services" area. *Id.* at 4. Additionally, BPA secured and implemented "enterprise software." *Id.*

BPA acknowledges that ENW, the Corps, and Reclamation did not commit to [the Cost Review] cost targets and budget levels. *Id.* However, BPA has worked extensively with ENW, Corps, and Reclamation on their expense forecasts included in this rate proceeding. *Id.* BPA works very closely with the Corps and Reclamation, through the Joint Operating Committee, to set and manage to budgets. *Id.* Through this process, BPA is confident that the three agencies will stay within budgets, absent *force majeure*-type events. *Id.* ENW has expressed its intent to keep its costs for Columbia Generating Station as low as it can, consistent with safe and reliable operation of the plant. *Id.*

ICNU/ALCOA suggest BPA did not respond in a timely manner to its escalating cost problem. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 7. They argue that by October 2001, BPA had lost over $1 billion before accounting for fish credits. *Id.* They argue BPA lost an additional $437 million by October 2002 before fish credits. *Id.* They argue that despite these losses, BPA only began to cut the growth in future budgets in the spring and fall of 2002. *Id.* Meetings with internal managers regarding the adoption of "hard" spending limits did not occur until December 2002 and January 2003. *Id.* ICNU/ALCOA argue that BPA's high starting reserves at the beginning of the current rate period provided BPA with easy access to cash and led to overspending. *Id.* at 8. The large accumulation of cash reserves allowed BPA to avoid dealing with its financial problems and cost overruns until its expenses dramatically exceeded its revenues. *Id.*

BPA disagrees with the parties' suggestion that BPA failed to respond in a timely manner to its FY 2001 financial problems. Keep, *et al.*, SN-03-E-BPA-11, at 6. First, it is inappropriate to exclude "fish credits" (credits from the Fish Cost Contingency Fund and section 4(h)(10(C) of the Northwest Power Act) when evaluating the Power Business Line's financial results, given that the primary driver of PBL's financial losses stem from the severe drought in 2001 which "fish credits" are intended to mitigate. *Id.* Even so, the Power Business Line's financial losses were driven by power purchase expenses (power purchases and conservation load reduction expenses), which exceeded $2.2 billion, while "fish credits" only mitigated just over 25 percent of this expense ($601 million). *Id.*

Second, BPA disagrees with the parties' assertion that BPA was increasing spending in the face of the largest loss in agency history, which has the implication that this spending was controllable and imprudent. *Id.* at 6-7. As previously noted, BPA's spending was a direct result of the increasing complexity of the market, the load obligations placed on BPA by its customers, the service-level expectation of BPA's stakeholders, the required functional split between the Power and Transmission Business Lines, and compliance with FERC standards of conduct and other requirements. *Id.* at 7. Additionally, deregulation and restructuring along with the West Coast power crisis in 2000-2001 required expense increases in order to respond to the increase in complexity of the electricity market, scheduling protocols, congressional and FERC inquiries, etc. *Id.* Also, conservation and renewable resource development was required in the face of West Coast supply deficits revealed during the 2000-2001 drought. *Id.*

Despite these major increases in demands, BPA's internal operations costs for the FY 2003-2006 period have been brought down to within one percent of actual spending in 2001, with no allowance for inflation and no allowance for offsetting revenues. *Id.* Increases in costs for operating the hydro system and nuclear plant have occurred, but have been necessary to maintain the reliability and efficiency of the system. *Id.* Further, the expense increases during FY 2001 were driven by power purchase expenses (power purchases and conservation load reduction expenses), which exceeded $2.2 billion. *Id.*

ICNU/ALCOA argue BPA only began to cut the growth in future budgets in the spring and fall of 2002. The record refutes this statement. BPA began to make significant expense reductions in winter 2001-2002. *Id.* at 8. Those efforts early in the year are clearly summarized in the letter from Paul Norman, Senior Vice-President of the Power Business Line, to BPA customers, tribes, constituents, and interested parties dated May 2, 2002. *Id.* at 8-9. As the letter indicates, BPA established a multi-faceted management plan to reduce approximately $100 million from expenses and take actions to improve BPA's overall financial health. *Id.* at 9.

By the spring of 2002, excluding the costs of augmentation purchases, BPA brought expense budgets for 2002 down to the aggressive targets in the rate case, which were based on the 1998 Cost Review, through net reductions of $102 million relative to the start-of-year estimates for FY 2002. *Id.* During this time, BPA put interim financial controls in place to limit new financial commitments, both capital and expense. *Id.* BPA reduced internal operations expenses in the areas of travel, training, overtime, labor and non-labor contracts, and other expense categories. *Id.* BPA also began actively seeking opportunities within its contractual rights to reduce the costs of the higher-priced individual purchases in BPA's augmentation portfolio. *Id.*

Additionally, BPA focused on maximizing revenues from secondary sales, and optimizing river operations within the various non-power constraints to make power available during the highest-value periods. *Id.* BPA continued to stand firm on its take-or-pay obligations and began encouraging its IOU and public agency customers to reach a settlement of litigation challenging the IOUs' Residential Exchange Program settlement agreements. *Id.* As a part of its overall cost management plan, PBL has established informal monthly meetings with customers, customer representatives, and constituents to review current year actual and forecast expense levels for both program and internal operations expenses charged to power rates. *Id.* at 37. In these forums, the PBL also reports on changes to expense levels including reductions taken to date. *Id*. While not part of this rate proceeding, in order to respond to further requests by customers and other stakeholders, BPA will participate in more formal and frequent financial review meetings with customers and other interested parties and stakeholders. BPA is currently working cooperatively to define the nature of these review meetings.

BPA notes that the increasing risks and revenue opportunities in the power market have required increased effort to manage those risks and maximize surplus revenues, and to manage increases in spending on automated systems to manage business and operational functions. Keep, *et al.*, SN-03-E-BPA-11, at 50. Conservation and renewable resource development was required in the face of West Coast supply deficits revealed during the 2000-2001 drought and energy crisis. *Id*. A constant flow of regional policy issues has required ongoing staffing, as has RTO development and administration of the Asset Management Strategy with the Corps and Reclamation. *Id*. The split of Power and Transmission Business Lines and compliance with Federal Energy Regulatory Commission (FERC) standards of conduct and other requirements have increased costs and staff demands. *Id*.

Despite these increased demands and effort, BPA's overall internal operations costs are being held to within one percent of FY 2001 actual levels, with no allowance for inflation or offsetting revenues. Keep, *et al*., SN-03-E-BPA-11, at 4-6. It would not be prudent to assume further cost reductions unless and until those cost reductions can be specifically identified. BPA will continue to seek further cost reductions.

Decision 1

While BPA takes responsibility for past management of its costs, BPA's financial situation is not largely self-created.

Issue 2

Whether it is appropriate to exclude certain costs from collection through the SN CRAC.

Parties' Positions

ICNU/ALCOA argue the SN CRAC was designed only to recover extraordinary costs, and it is inappropriate to use the SN CRAC to recover controllable and foreseeable cost increases. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 4; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-02, at 7. They argue the SN CRAC was not designed to recover amounts BPA should already have been recovering in its current rates, including the FB and LB CRACs. *Id*. They argue the

SN CRAC was intended to provide BPA with a tool to address true "emergency conditions" or a series of catastrophic events. *Id*. They conclude BPA's current FY 2003-2006 cost forecasts for "controllable" cost categories account for nearly half of BPA's spending increase, or approximately $732 million over May 2000 rates, and therefore BPA improperly seeks to recover these costs through the SN CRAC. *Id*. at 5-6. They also argue the SN CRAC was not intended to allow BPA to increase rates "based on its failure to manage its controllable costs and speculation in the energy markets." *Id*. at 5; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-02, at 7.

BPA's Position

BPA must set rates to recover its costs and there are no limits as to the types of BPA costs the SN CRAC can recover. Keep, *et al.*, SN-03-E-BPA-11, at 8, 38.

Evaluation of Positions

ICNU/ALCOA argue the SN CRAC is not intended to address the same concerns as the Load-Based CRAC, *i.e.*, augmentation costs, or the Financial-Based CRAC, *i.e.*, normal risks such as water conditions, load changes, Columbia Generating Station outages, and cost overruns. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 4-5. They further argue the SN CRAC is intended to cover BPA for extraordinary or catastrophic events such as an extended outage at CGS, the removal of the Snake River dams, or a significant constraint to the power system due to fish mitigation measures. *Id*. at 5.

BPA agrees that the SN CRAC was intended to be a tool of last resort. Keep, *et al*., SN-03-E-BPA-11, at 38. However, there are no limits as to the type of BPA costs that the SN CRAC can recover. *Id*. Such costs are not limited to "extraordinary or catastrophic events." *Id*. Specifically, when the LB CRAC was designed during BPA's Supplemental rate case, the methodology explicitly provided for augmentation costs to be excluded from recovery using the LB CRAC when BPA had acquired more augmentation power than was needed to meet augmentation needs. *Id*. at 38-39. When augmentation power is excluded from the LB CRAC, it is remarketed by BPA's trading floor. *Id*. at 39. Revenues from this remarketing, as well as the gross cost of the excluded augmentation power, are included in BPA's overall financial results. *Id*. If the remarketing revenues fall short of the costs of these excluded augmentation megawatts, the FB or SN CRACs may recover the cost shortfall. *Id*.

BPA's position is supported by the brief filed by the Joint Customer Group (JCG) in BPA's WP-02 proceeding. They stated that:

> [I]t is conceivable that events will occur during the rate period that will pose financial risks to BPA that are not encompassed by the LB and FB CRACs. To address this risk, the JCG proposed, and BPA included in its Supplemental Proposal, the Safety Net CRAC ("SN CRAC"). The SN CRAC permits BPA to initiate a process to revise the FB CRAC parameters if it has missed, or has forecast a high likelihood of missing, a payment to a creditor or the Treasury during the rate period. There are not specified limits on the amount of additional revenues that BPA can collect under the SN CRAC.

JCG Brief, WP-02-B-JCG-01, at 12. They further stated:

> [I]n essence, the SN CRAC allows BPA to truncate the five-year rate period and make an adjustment to the FB CRAC parameters when it is clear that the LB and FB CRACs are inadequate to ensure timely payment to the Treasury. It also requires that no such change to the FB CRAC parameters will be suggested to review by the FERC, which will ensure that any such change satisfies the cost recovery requirement of section 7(a) of the Regional Act. The SN CRAC is the ultimate demonstration that the region is committed to providing BPA with the tools necessary to fulfill its obligations to the Treasury regardless of what may transpire during the rate period.

ICNU/ALCOA argue the SN CRAC was not intended to allow BPA to increase rates based on its "failure" to manage its controllable costs or "speculation in energy markets." ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 5. As stated above, BPA has not "failed" to manage its costs. Further, BPA does not "speculate" in energy markets. Keep, *et al.*, SN-03-E-BPA-11, at 39. Rather, BPA must manage the risk associated with a highly uncertain hydroelectric system and volatile market prices, which requires it to take positions in the market without complete certainty. *Id.* ICNU/ALCOA's statement that there are categories of costs that should be excluded from the SN CRAC is without foundation. There are no limits on the categories of costs that the SN CRAC can recover. *Id*. In fact, BPA is required by law to set rates sufficient to recover its costs. Keep, *et al.*, SN-03-E-BPA-04, at 13.

ICNU/ALCOA argue the SN CRAC was designed to protect BPA from actual "extraordinary or catastrophic events." ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 5. In support of this argument, they state "[t]he Administrator agreed that the purpose and function of the SN CRAC was to allow BPA to raise 'additional revenues under emergency conditions.'" *Id.* (emphasis in original) However, the quotation from the 2002 Supplemental ROD was taken out of context. The statement is "[a]lthough not referred to as a 'Safety-Net' CRAC in the February 2000 initial briefs (since there was only a single CRAC component in the May Proposal), the [NWEC/SOS, CRITFC, and the Oregon Public Utility Commission's proposed] design clearly has the same purpose and function, allowing BPA to collect potentially very large amounts of additional revenues under emergency conditions." 2002 Supplemental ROD, WP-02-A-09, at 4-24. Taken in context, the phrase "under emergency conditions" meant that under emergency conditions, the alternative design proposed by the parties was similar to BPA's proposal, which allowed BPA to collect "potentially very large amounts of additional revenues," not that the SN CRAC was only available under emergency conditions. The SN CRAC GRSPs specify the conditions for the SN CRAC to trigger.

Decision 2

It is not appropriate to exclude certain costs from collection through the SN CRAC.

Issue 3

Whether BPA should assume all cost cuts identified as a result of Financial Choices in the Revenue Recovery chapter of the final study.

Parties' Positions

ICNU/ALCOA argue BPA is too conservative in its cost reduction estimates. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 12. They argue BPA's statutory obligations and the GRSPs require BPA to include all reasonably achievable cost reductions and/or revenue increases in the SN CRAC calculation. *Id.* PPC and IEA argue BPA should assume all other cost cuts, besides those specifically listed in their brief identified as a result of Financial Choices. PPC/IEA Brief, SN-03-B-PP-01, at 9.

CRITFC argues that BPA should not include in its revenue requirement the $580 million in cost cuts proposed by the Joint Customers, as identified in Financial Choices. CRITFC Brief, SN-03-B-CR/YA-01, at 31.

BPA's Position

As stated above, program and budget levels are not subjects of BPA rate cases. However, BPA takes the opportunity to respond to the policy issues raised by parties. BPA continues to pursue additional savings, but will not reflect them in the SN CRAC proposal unless there is a high degree of certainty they will be achieved. Keep, *et al.*, SN-03-E-BPA-04, at 10. BPA is aggressively pursuing cost reductions both internally and with its generating partners (*i.e.*, Corps, Reclamation, and ENW). Keep, *et al.*, SN-03-E-BPA-11, at 52. BPA stated in rebuttal testimony that it will incorporate all cost reductions that have been identified with a high level of certainty by the time of development of the final proposal. *Id.* That has been done. The GRSPs state that, in developing BPA's initial proposal, BPA will give priority to *prudent* cost management and other options that enhance TPP while minimizing rate increases. *Id.* at 62.

Evaluation of Positions

As stated above, program and budget levels are not the subject of BPA rate cases. BPA takes the opportunity to respond to policy issues raised by parties.

ICNU/ALCOA and PPC/IEA rely on the Joint Customers' testimony to identify cost cuts in the Financial Choices process. *See* Bliven, *et al.*, SN-03-E-JC, at 12-13. These costs fall into three categories. The first category is cost reductions associated with BPA's internal operating expenses and charged to power rates in the Financial Choices process of approximately $20 million, which were inadvertently omitted but will be reflected in the final proposal. Keep, *et al.*, SN-03-E-BPA-04, at 9. BPA agrees with the parties and these costs are included in the final study.

The second area of cost reductions identified by the Joint Customers was the suggestion of an additional $24 million in cost cuts that would be "necessary to achieve the 2001 commitment." BPA includes in the final studies a total of $36.2 million in reductions in PBL Internal Operations, Corporate G&A, and Shared Services expenses from the SN CRAC initial proposal. Of this $36.2 million, approximately $20 million were the cuts inadvertently omitted in the SN CRAC initial proposal and mentioned above. The new forecast therefore reflects $16.2 million in additional, new cost reductions (again, from the SN CRAC initial proposal). At this time, it is not prudent for BPA to assume the full $24 million in cost cuts suggested by the

parties because those additional actions cannot be backed by a sustainable plan. However, BPA continues to pursue additional cost reductions for the remainder of the rate period. The current total FY 2003-2006 delta above FY 2001 actual expenditures on a forecasted basis is $6.6 million.

The third area of Financial Choices cost cuts totaled about $580 million. These were identified at a BPA workshop held on March 7, 2003, and submitted as Attachment F to the Joint Customers' testimony. Bliven, *et al.*, SN-03-E-JC-01. One of those cost reductions was "Power Resource Cost Reduction" of $30 million. The Power Resource Cost Reduction item referred to power purchase augmentation agreements BPA has with Enron. Keep, *et al*., SN-03-E-BPA-11, at 18. BPA and Enron reached a settlement on those agreements. Under the settlement BPA agreed to pay $99 million to terminate a series of contracts with Enron. *Id*. Those savings are reflected in BPA's final studies. Another area of identified cost reduction is the discussions between the public agency customers and the IOUs to reach a settlement of the IOU Residential Exchange Program settlement agreements. *Id*. BPA has described elsewhere in this ROD how that cost reduction will be dealt with in BPA's rates, if that settlement is reached. *See* section 2.7.

There are a number of reasons why BPA did not include the other possible cost reductions in its initial proposal and does not believe it is prudent to include them in the final. First, because these cost reductions were not certain, BPA believes that to include them in the rate calculation would not be financially prudent. McCoy, *et al*., SN-03-E-BPA-17, at 16; s*ee also* Keep, *et al*., SN-03-E-BPA-11, at 52.

Second, including these cost reductions would have introduced a source of risk that BPA would have needed to model. BPA did not model probabilities of specific costs being higher or lower than the point forecasts, as it did through NORM in BPA's 2002 power rate proposal. Keep, *et al*., SN-03-E-BPA-04, at 10. Modeling these uncertainties would have required the introduction of additional planned net revenues for risk.

Third, ICNU/ALCOA argue that BPA's actual and forecasted costs have dramatically exceeded, and continue to exceed, the amount included in BPA's rates, and that these cost increases were foreseeable and therefore should not be allowed to be recovered in the SN CRAC. ICNU/ALCOA and PPC/IEA now ask BPA to do the same thing – include cost reductions that BPA does not yet have in hand, thereby setting rates lower than BPA needs to in order to recover its costs.

Finally, it is not necessary for the final studies to include uncertain cost reductions. BPA is proposing a contingent SN CRAC design that allows for resetting the SN CRAC parameters in August 2003, based on cost savings found in specific categories. Specifically, to the extent relevant events occur and cost savings have been identified with some certainty for the FY 2004-2006 period, reductions in the following categories will be reflected in recalibrated SN CRAC Thresholds, Caps, and revenue amounts: BPA Internal Operations Costs (the sum of PBL Internal Operations and Corporate Internal Services), Corps and Reclamation O&M, CGS O&M, BPA's Fish and Wildlife Integrated Program O&M, and any IOU settlement. Keep, *et al*., SN-03-E-BPA-11, at 52. In addition, FY 2003 secondary revenues will be updated, and the re-calibration of the SN CRAC Caps and the SN CRAC Thresholds will capture these changes.

McCoy, *et al.*, SN-03-E-BPA-17, at 9. In addition, FB CRAC Thresholds will be modified to be the same as the thresholds for the SN CRAC. *Id.* at 24. To the extent savings are realized each year, the variable component of the proposed SN CRAC will capture those savings.

Although CRITFC framed the issue as one involving the uncertainty surrounding BPA's internal operating costs, CRITFC also objects to BPA adopting the Joint Customer proposal to assume an additional $580 million in cost reductions in this proceeding. *See* CRITFC Brief, SN-03-B-CR/YA-01, at 31. BPA agrees with CRITFC that it would be imprudent to assume the $580 million in possible other cost cuts identified in the Financial Choices process because, as described above, these cost cuts are not certain and therefore it would be imprudent to assume them in the final study revenue requirement. *See* Section 2.7 of this ROD for a discussion of how the variable and contingent feature of the SN CRAC design will allow for future cost reductions to be captured in the SN CRAC rate level.

In its Brief on Exceptions, PNGC argues that to contend that the Northwest Power Act's rate directive to recover its system costs prevents BPA from setting rates in anticipation of reducing its controllable costs is to misapply and abuse that directive. PNGC Ex. Brief, SN-03-R-PN-01, at 9. PNGC states "the (draft) ROD persists in laying at the doorstep of the customers the risk that BPA will fail or refuse to control its internal spending. Unless cost cuts are identified 'with a high level of certainty,' BPA plans to use the SN CRAC to charge customers for these costs regardless of whether savings are realized." *Id*. citing SN-03-A-01, at 2.1-14.

BPA disagrees with PNGC's contention that it is a misapplication and abuse of statute for BPA to recover costs that are based on cost cuts that have a high level of certainty. To do otherwise is illogical. As stated, it is imprudent to assume cost cuts that are not certain. Assume, *arguendo*, that BPA set rates based on all assumed cost cuts regardless of certainty and then failed to achieve such cuts. The result would be added costs that would need to be recovered. Although the initial rate might be low—the risk that BPA might not achieve the cost cuts must be accounted for by either increasing the rates to account for the risk or by including a rate adjustment mechanism.

Decision 3

BPA has incorporated in the final study all cost reductions from Financial Choices that have been identified with a high level of certainty. Additional cost cuts, which are not yet certain, are not incorporated in the Revenue Recovery chapter of the final study.

Issue 4

Whether BPA must reduce costs to the levels described in its May 2000 and June 2001 rates before it should consider increasing rates.

Parties' Positions

ICNU/ALCOA argue that any final proposal adopted by the Administrator in this proceeding must recognize that BPA has contributed to its current financial circumstances. ICNU/ALCOA

Brief, SN-03-B-IN/AL-01, at 8. ICNU/ALCOA argue BPA must reduce costs to the levels described in its May 2000 and June 2001 rates before it should consider increasing rates. *Id*.; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 12. PNGC argues BPA must reduce its controllable spending to well below FY 2001 actual levels. PNGC Brief, SN-03-B-PN-01, at 3-5. ICNU/ALCOA argue BPA must gain control over certain spending that heretofore has been considered, as a practical matter, uncontrollable. *Id*. PPC/IEA argue BPA should cut costs and use cash tools before it imposes an SN CRAC rate increase. PPC/IEA Brief, SN-03-B-PP-01, at 8.

BPA's Position

BPA must set rates to recover its costs. Keep, *et al*., SN-03-E-BPA-04, at 13. The 2002 GRSPs state that BPA must consider "prudent" cost management in the SN CRAC proposal, but do not require a specific level. Keep, *et al*., SN-03-E-BPA-11, at 62. BPA has created an extensive record explaining both the reasons for the cost increases (and why it would be imprudent to cut costs to the May 2000 levels) and the extensive cost cutting BPA is doing to prudently mitigate the size of the SN CRAC. *See* Keep, *et al.*, SN-03-E-BPA-04, at 3-12; Keep, *et al*., SN-03-E-BPA-11, at 2-17 and 49-55. The SN CRAC is one of three Cost Recovery Adjustment Clauses (CRACs) that are part of BPA's June 2001 power rate design. Keep, *et al*., SN-03-E-BPA-04, at 2. The SN CRAC is designed to provide a "safety net" in case BPA's financial situation continues to deteriorate, despite implementing the Load-Based and Financial-Based CRACs. *Id.* Together, these CRACs allowed BPA to adopt a general approach of keeping base rates low and addressing financial shortfalls as needed through implementation of the CRACs. *Id.*

Evaluation of Positions

PNGC argues that imposing an SN CRAC under current economic circumstances is simply wrong. PNGC Brief, SN-03-B-PN-01, at 3-5. PNGC argues BPA represented to its customers, the region, and FERC that the rates set in the WP-02 proceeding were adequate to cover its costs. *Id.* PNGC notes the supplemental proceedings in WP-02 were the subject of a settlement agreement. *Id*. It states that the settlement was predicated on cost levels used in the WP-02 rate proceedings to develop base rates. *Id.* PNGC states the customers recognized the future was uncertain and offered their support to BPA by agreeing to modify rates to include LB CRAC, FB CRAC, and SN CRAC provisions. *Id.*

At the time, BPA's May and Supplemental proposals fully demonstrated cost recovery. 2000 Supplemental ROD WP-02-A-09, at 2-7. As stated in BPA's direct case for the SN CRAC, the PBL's net revenues (revenues minus expenses) that actually occurred in FY 2001 and FY 2002 were lower than expected. Keep, *et al*., SN-03-E-BPA-04, at 5. However, as the parties acknowledge, the WP-02 rate proceeding included three cost recovery adjustment provisions. It was the package of rate mitigation tools, including all three CRACs, which let BPA set its base rates as low as they are, while still providing a sufficiently high TPP. Keep, *et al*., SN-03-E-BPA-11, at 48. In BPA's rate filings, costs and revenues are taken into account. In addition, BPA's risk analysis for the expense forecasts in the May 2000 and June 2001 rate filings included an expected value of increased operations costs that was about $121 million

more than the base case costs in the revenue requirement study. *Id*. at 15. The risk analysis was done to recognize the difficulty of meeting cost targets in light of the risks associated with the future that the Cost Review had assumed when making its recommendations. *Id.* Unfortunately for BPA and its customers, neither side of this equation (neither costs nor revenues) performed as expected. Potential uncertainties such as these were one of the reasons BPA proposed the SN CRAC.

PNGC states BPA raised rates to cover forecasted augmentation costs, including costs that BPA "unlawfully incurred for service to DSI customers at rates subsidized by preference and priority customers." PNGC Brief, SN-03-B-PN-01, at 4; PNGC Ex. Brief, SN-03-B-PN-01, at 7. Certainly BPA incurred augmentation costs to meet its firm contract obligations. PNGC's allegation that BPA unlawfully incurred costs to serve DSI customers, however, is unfounded. There is nothing on the record to support this statement, nor is this an issue within the scope of this SN CRAC section 7(i) proceeding. BPA's decision to serve the DSIs is a final action taken well before this proceeding.

PNGC states that BPA, while incurring enormous losses in market transactions that should have been seen as a major warning sign of cost recovery problems, made ill-considered decisions, like the litigation penalty payments to PacifiCorp and Puget Sound Energy, and substantially increased its spending program. PNGC Brief, SN-03-B-PN-01, at 3-4. BPA is confused by PNGC's reference to "enormous losses in market transactions" since there is no evidence cited to support its statement. BPA assumes PNGC is referring to expected secondary sales revenues that were less than expected. Also, PNGC mischaracterizes BPA's settlement agreements with PacifiCorp and Puget. These decisions were not "ill-considered," as explained in the RODs for such agreements. *See* "Financial Settlement Agreement and Amendment to Residential Exchange Program Settlement Agreement with PacifiCorp, Record of Decision," May 23, 2001, and Amended Residential Exchange Program Settlement Agreement with Puget Sound Energy, Record of Decision," June 6, 2001. Furthermore, there are no "litigation penalty" payments in the agreements. Litigation challenging the settlement agreements had been filed well before the agreements were executed. Instead, PacifiCorp and Puget agreed to specified benefits with BPA in the 2001 agreements. PacifiCorp and Puget were unwilling to negotiate five-year load reduction deals with BPA at a discount to the then-current market prices because they continued to face litigation over their underlying settlement agreements. BPA and the utilities negotiated two prices for the 2003-2006 period; a market price if the litigation continued, and a price that reflected a reduction of risk discount if the litigation were resolved by the public agencies and IOUs. This is not a "litigation penalty." In any event, these agreements are separate final actions and are not subject to review in this proceeding.

There is an indisputable reason why BPA offered its regional customers load buy-down and load reduction agreements — avoidance of potentially significant rate increases. Keep, *et al*., SN-03-E-BPA-11, at 8. Regional customer loads were being placed on BPA during a period of historically high power costs in the West. *Id.* The design of the SN CRAC allows BPA to recover augmentation costs that the LB CRAC and FB CRAC do not recover. *Id*. There are no limits to the types of BPA costs that the SN CRAC can recover. *Id.* The SN CRAC is allowed to recover these types of costs, otherwise it does not provide the "safety-net" it was intended to be. However, if public agency customers and IOUs reach a settlement of litigation challenging

the IOUs' Residential Exchange Program settlements, BPA's costs will be greatly reduced which could reduce the level of BPA's rates. *Id.*

The five-year buydown agreements with Puget and PacifiCorp included specific provisions to ensure that those loads would share in the SN CRAC, if one were to be put in place. *Id.* Thus, those loads continue to help share in BPA's costs. *Id.*

ICNU/ALCOA contend that BPA must reduce costs to the levels described in its May 2000 and June 2001 rates before it should consider increasing rates. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 8; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 12. They argue the Administrator can accomplish this goal by implementing aggressive spending caps and cost reductions. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 8. They argue the Administrator should also avoid relying upon mechanisms like open-ended CRACs and high reserves that provide BPA with disincentives to control its costs. *Id.* at 9. They note BPA's response to its current financial problems contrasts dramatically with actions taken in the mid-1990s when BPA's rates were above market and BPA was losing load. *Id.* at 8. ICNU/ALCOA contend that the DROD misconstrues their argument: mid-1990's cost reduction efforts were more successful because BPA did not have take-or-pay contracts or automatic adjustment clauses. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 13.

As described above, there are no limits as to the types of BPA cost categories that the SN CRAC can recover. BPA disagrees with the contention that BPA must reduce costs to levels described in its May 2000 and June 2001 rates before it should consider increasing rates. First, the determination of SN CRAC itself contains no such requirement. Keep, *et al.*, SN-03-E-BPA-11, at 38-46. Second, BPA's testimony is replete with evidence as to the causes for BPA's cost increases. *Id.* at 2-17; Keep *et al.*, SN-03-E-BPA-04, at 3-8. Third, the SN CRAC proposal rate design includes cap features. McCoy, *et al.*, SN-03-E-BPA-10, at 4. BPA also disputes the allegation that when open-ended CRACs are available, they create a disincentive to the Administrator to control spending. An automatic adjustment clause mechanism and a contingent mechanism do not reduce BPA's incentive to control costs or increase the risks that contributed to BPA's financial problems. Keep, *et al.*, SN-03-E-BPA-11, at 53. BPA is going through significant cost cutting efforts, both internally and with its cost partners. *Id.* BPA proposed, and customers agreed, through the rate case settlement in BPA's 2002 Supplemental rate case, that BPA faced many large uncertainties, most of which were beyond BPA's control. *Id.* Without the ability to implement the CRACs, BPA would have had to set very high base rates. *Id.* The automatic nature of the CRACs allows them to rise and fall as the risks they are designed to cover result in greater or lesser costs to BPA. *Id.*

The current automatic adjustment mechanisms were not established to create an incentive to relax cost controls; rather they were established to deal with risks of all types, including cost uncertainties. *Id.* The fact that these risks have proved real and BPA now needs to raise its rates to deal with these materialized risks is not a function of the rate design or lack of control effort on BPA's part relative to the demands and expectations placed on it. *Id.* at 54. The rate design allowed BPA to set a lower base rate initially and only raise rates if the need arose. *Id.* The ability to raise rates did not drive the rate increase. *Id.* The risks the variable rate was designed to cover drove the rate increase. *Id.*

In testimony, BPA states that the comparison between today's cost-reduction efforts and those in the mid-1990s is flawed. *Id*. The competitive situation in the mid-1990s is different than today's situation. Regardless of the take-or-pay nature and cost recovery adjustment clause in the Subscription power sales contracts, the mid-1990's posed a different kind of challenge to BPA than the financial challenge BPA faces today. BPA's relationship with its customers has evolved since the mid-1990s and the electricity market is very different as well. *Id*. BPA's overall expense structure reflects the load obligations placed on BPA by its customers, the service-level expectation of BPA's stakeholders, and the required functional split between the Power and Transmission Business Lines. *Id*. Additionally, managing and implementing Subscription contracts, implementing the CRAC-rates structure, and acquiring and managing BPA's augmentation portfolio have placed upward pressure on costs. *Id*. Further, deregulation and restructuring, along with the West Coast power crisis in 2000-2001, required expense increases in order to respond to the increase in complexity of the electricity market, scheduling protocols, congressional and FERC inquiries, etc. *Id*. Additionally, the increasing risks and revenue opportunities in the power market have dictated increases in expenses to manage those risks and maximize surplus revenues, and increases in spending on automated systems to manage business and operational functions. *Id*. at 55. Conservation and renewable resource development was required in the face of West Coast supply deficits revealed during the 2000-2001 drought. *Id*. at 54-55. Further, a constant flow of regional policy issues has required ongoing staffing, as has RTO development and administration of the Asset Management Strategy with the Corps and Reclamation. *Id*. at 55. The split of Power and Transmission Business Lines and compliance with FERC standards of conduct and other requirements have increased costs and staff demands. *Id*. All of these factors differentiate the cost-cutting environment of the mid-1990s from today. *Id*.

ICNU/ALCOA argue that BPA's SN CRAC proposal does not recognize that its financial problems are largely a result of BPA exceeding the costs contained in its May 2000 rates. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 4; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 12. They argue that the SN CRAC proposal also fails to implement responsible, prudent remedies for BPA's failure to control its costs. *Id*.

As described above, BPA continues to pursue additional cost cuts. BPA has included substantial cost cuts (net reductions total over $80 million) that BPA is confident can be achieved with a high degree of certainty. However, the GRSPs specify the conditions for the SN CRAC to trigger. ICNU/ALCOA incorrectly assume that a benchmark exists that ties BPA's right to implement the SN CRAC to the May 2000 rates. No such benchmark exists. The 2002 GRSPs state that BPA must consider "prudent" cost management in the SN CRAC initial proposal, but do not require a specific level. Keep, *et al*., SN-03-E-BPA-11, at 62. The record is extensive in developing an explanation for both the reasons for the cost increases (and why it would be imprudent to cut costs to the May 2000 levels) and the extensive cost cutting BPA is doing to prudently mitigate the size of the SN CRAC. Keep, *et al.*, SN-03-E-BPA-04, at 3-12; Keep, *et al*., SN-03-E-BPA-11, at 2-17 and 49-55. ICNU/ALCOA suggest prudent remedies ought to apply if BPA cannot control costs. BPA's rate directives require that BPA's total system costs be recovered in rates established in accordance with section 7 of the Northwest Power Act. Any remedy, presumably a financial one, must ultimately be borne by BPA's customers.

As a part of its overall cost management plan, the PBL has established informal monthly meetings with customers, customer representatives and constituents to review current year actual and forecast expense levels for both program and internal operations expenses charged to power rates. In these forums, the PBL also reports on changes to expense levels including reductions taken to date. Keep, *et al*., SN-03-E-BPA-11, at 37. Additionally, the parties have requested that BPA provide a more formal opportunity to review BPA's finances and spending levels. While not part of the rate case process, in response, and in addition, to the formal public workshops for the SN CRAC described in the GRSPs, BPA has committed to provide an ongoing process of cost disclosure by BPA and opportunities for customers and others to review costs and provide input to BPA.

Decision 4

BPA is not required to reduce costs to the levels described in its May 2000 and June 2001 rates before it considers increasing rates.

Issue 5

Whether BPA's proposal should include the assumption that additional financial liquidity tools will be used to lower rates and raise TPP.

Parties' Positions

ICNU/ALCOA argue that BPA can prudently use more liquidity tools than it used in its initial proposal, and should do so to reduce the SN CRAC. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 17-18. They contend BPA can rely upon prudent financial tools and liquidity options as measures of last resort to avoid a rate increase. *Id*. at 23; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 14.

ICNU/ALCOA believe that BPA's utility and end-use customers are willing to risk potential cost increases related to the use of the financial liquidity tools in order to reduce or eliminate an SN CRAC rate increase. *Id*.

NRU states the rate case record gives the Administrator specific tools that can be used to substantially mitigate, if not outright eliminate, an SN CRAC Adjustment in 2004. NRU Brief, SN-03-B-NR-01, at 5. NRU argues that though they are not proposing use of these tools in lieu of the proposed SN CRAC, or as a direct means to lower the size of any SN CRAC identified at this point in time, with a tilted SN CRAC, the agency will have sufficient time to analyze some of the tools and potentially use them if necessary to increase reserve levels to help manage the size of any SN CRAC that may be needed for FY 2005-2006. NRU Ex. Brief, SN-03-R-NR-01, at 9.

PNGC argues BPA should employ available liquidity tools to avoid imposing an SN CRAC rate increase. PNGC Brief, SN-03-B-PN-01, at 5. PNGC believes that BPA has, among other things, retreated materially from its initial proposal, and wasted the customers' time and resources initiating extensive discussions and generating information concerning the use of additional

available cash tools, which it now refuses to employ to avoid a rate increase. PNGC Ex. Brief, SN-03-R-PN-01, at 3-4.

SUB argues BPA should reflect the use of cash tools in the ToolKit model when developing the SN CRAC to minimize SN CRAC thresholds and limits. SUB Brief, SN-03-B-SP-01, at 19. SUB's proposal would only assume (but not require) the use of the $250 million Treasury note for 2006, giving BPA the ability to recover any shortfall and repay Treasury in 2007 (in the following rate period). SUB Ex. Brief, SN-03-R-SP-01, at 10.

GPU contends BPA has several financial mechanisms to further reduce its need for the SN CRAC rate increase, and must use all financial mechanisms at its disposal to avoid the SN CRAC rate increase. GPU Brief, SN-03-B-GP-01, at 4-5.

PPC/IEA argue BPA should employ whatever means it has, including use of cash tools, before resorting to another rate increase and BPA should use its available cash tools to obtain a higher TPP. PPC/IEA Brief, SN-03-B-PP-01, at 8-9.

WPAG calls for BPA to take extraordinary actions in all areas, including utilizing cash tools, to eliminate the need for a wholesale power rate increase in FY 2004. WPAG Brief, SN-03-B-WA-01, at 2. Using no cash management tools is an overly conservative approach, and limited use of one or more of the numerous cash tools to provide rate relief to the region is both necessary and appropriate under current conditions. WPAG Ex. Brief, SN-03-R-WA-01, at 13.

Canby argues that the draft ROD does not adequately make the case for the SN CRAC, because BPA's financial condition has improved, and BPA has not availed itself of the financial tools that would make an SN CRAC unnecessary. Canby Ex. Brief, SN-03-R-CA-01, at 2.

BPA's Position

BPA's initial proposal reflected cost reductions and cash tools, including the use of borrowing for long-lived assets where appropriate. Keep, *et al*., SN-03-E-BPA-11, at 45. BPA considered the potential use of ENW debt extension proceeds to minimize rate adjustments, although BPA determined this latter option was imprudent. *Id.*

BPA should not assume use of the Treasury note to lower rates or raise TPP. Keep, *et al*., SN-03-E-BPA-11, at 60. To date, Treasury has made it clear that they do not view payments in prior years as available to satisfy current year obligations. *Id*. at 43. BPA has no evidence that it can rely on previous payments of accelerated amortization to fulfill payments for current year Treasury obligations. *Id*.

BPA intends to keep the option of using cash tools for short-term liquidity needs, but does not intend to employ them further to reduce rates. Keep, *et al*., SN-03-E-BPA-11, at 45-46. There is no requirement that BPA must use all its financial tools in lieu of a rate increase. *Id*. at 41. BPA's intention on a planning basis is to conform to the Debt Optimization Program. *Id*, at 62.

Evaluation of Positions

ICNU, ALCOA, NRU, SUB, Canby, and PNGC argue generally that BPA should use cash tools to reduce or eliminate an SN CRAC rate increase. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 17-18; INCU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 14; NRU Brief, SN-03-B-NR-01, at 5; SUB Brief, SN-03-B-SP-01, at 9; PNGC Brief, SN-03-B-PN-01, at 5; Canby Ex. Brief, SN-03-R-CA-01, at 2. However, in their oral argument, NRU stated that as a result of new facts, NRU no longer sees the need to propose the use of creative financial tools to achieve sufficient TPP in FY 2003 and FY 2004; but these tools should be analyzed and ready should conditions deteriorate later in the rate period. Oral Argument Tr. at 100.

Several parties suggested or recommended use of specific cash tools. GPU contends BPA has several financial mechanisms to further reduce its need for the SN CRAC rate increase, including obtaining recognition from the Treasury that accelerated amortization repayments by BPA can be used to offset future payment obligations, recovery by Energy Northwest of abandoned bearer bonds, and use of the existing $250 million short-term Treasury note. GPU Brief, SN-03-B-GP-01, at 4.

PPC argues BPA's SN CRAC analysis should assume recovery of ENW bearer bonds, and BPA should use its available cash tools to obtain a higher TPP. PPC/IEA Brief, SN-03-B-PP-01, at 9. Specifically, they point to the $250 million Treasury note. *Id.* In addition, they argue BPA could use a portion of the ENW refinancing proceeds as a reserve of last resort to ensure Treasury repayment with repayment of these funds during the current rate period, although they believe BPA can avoid an SN CRAC without recourse to this tool. *Id.*

WPAG argues it is crucial that BPA take actions to eliminate an SN CRAC rate increase, including: (1) renewing efforts to obtain credit from the Treasury for accelerated repayments made during this rate period; (2) retaining a portion of the proceeds from the Energy Northwest refinancing activities undertaken this year to provide an interim reserve of last resort to ensure Treasury payments are made; and (3) reflecting the recovery of Energy Northwest bearer bonds. WPAG Brief, SN-03-B-WA-01, at 3.

While these parties recommend BPA use cash tools, and in some cases chastise BPA for not using them, in fact BPA is using cash tools to minimize the level of the SN CRAC. Keep, *et al.*, SN-03-E-BPA-11, at 45. BPA has not refused to use financial tools in the context of this SN CRAC proposal, but does not agree with these parties on the obligation nor magnitude of use of such tools. Despite WPAG's claim that BPA "fail(ed) to use even one of the twelve cash management tools that have been identified in this proceeding (*See* WPAG Ex. Brief, SN-03-R-WA-01, at 5-6), BPA's proposal reflects the following actions, which all serve to reduce the level of an SN CRAC rate increase:

> (a) As recommended by several parties (GPU Brief, SN-03-B-SG-01, at 4; WPAG Brief, SN-03-B-WA-01, at 3; PPC/IEA Brief, SN-03-B-PP-01, at 9), BPA's final proposal recognizes ENW's $22 million payment to BPA related to a settlement with Bank of America on BPA-backed bearer bonds. Keep, *et al.*, SN-03-E-BPA-11, at 50.

(b) BPA requested and ENW implemented a process to release bond reserve funds by purchasing surety bonds. Keep, *et al*., SN-03-E-BPA-11, at 45. These reserve fund free-ups added $60 million in cash to BPA's FY 2003 cash flow. SN CRAC Study, SN-03-E-BPA-01, at 7-15. Another $68 million will be released during ENW's FY 2004, lowering the amount BPA needs to recover through rates. McCoy, *et al.*, SN-03-E-BPA-10, at 16.

(c) In FY 2002, ENW proposed, and BPA agreed, to start issuing debt for new capital investments. Keep, *et al.*, SN-03-E-BPA-11, at 45-46. This change reversed historical practice and reversed the accounting and revenue financing that had occurred in prior years for the Independent Spent Fuel Storage Installation at CGS. *Id*. ENW and BPA are in the process of issuing bonds for this capital project and other anticipated projects for FY 2004. *Id*. Contrary to the ENW standard of levelized debt service, the ENW board has agreed to schedule principal payments to start in FY 2007. *Id*.

(d) In keeping with the spirit of parties' proposals to delay cash payments until later in the rate period, BPA has shaped the payments to Treasury for the Judgment Fund associated with the Enron settlement. Keep, *et al.*, SN-03-E-BPA-11, at 45. Payments will remain within the original term of the Enron contracts, but are heavily weighted toward the end of the rate period. *Id*. In its Brief on Exceptions, WPAG argues that the following actions from BPA result in an unnecessary SN CRAC rate increase in FY 2004:

- Collecting the costs of the Enron settlement in advance of the actual payment obligation
- Electing not to make use of the ability to defer the Enron settlement payment obligation until 2010
- Failing to use even one of the twelve cash management tools that have been identified in this proceeding

WPAG Ex. Brief, SN-03-R-WA-01, at 5-6. This argument is flawed in several ways. First, addressing the third bullet, BPA has not failed to use cash management tools. WPAG's list of cash management tools includes "Use the timing flexibility in the repayment of the Enron settlement costs." *Id*. at 13. As described above, BPA has done exactly that, by accessing the Department of Justice Judgment Fund to decrease significantly BPA's FY 2004 cash payment relating to the Enron settlement.

Second, WPAG criticizes BPA for "raising the SN CRAC rate level" by "collecting . . . in advance of the actual payment obligation." *Id.* This argument appears to be addressing the way the expenses related to the settlement are accounted for. There are two issues here. The first is the reason for the accounting treatment. BPA is recognizing the expenses related to the settlement by prorating them based on the expenses associated with the original Enron contracts, rather than based on the cash repayments to the Judgment Fund. The payments to the Judgment Fund are, in essence, repayment of a loan. BPA believes the correct accounting treatment according to the GRSPs is to record the expense of the Enron settlement in the same time period as the original contracts with Enron and prorate the same as the original payments to Enron.

The second issue is the impact of this treatment. Contrary to WPAG's claim, this treatment does not increase the SN CRAC. Any impact of the accounting treatment is only to the LB CRAC. BPA believes the accounting treatment is correct, and the LB CRAC will be lower than it would have been in FY 2004 absent the settlement. Additionally, the use of the Judgment Fund results in higher ending reserve levels in FY 2003 and 2004 than BPA would otherwise have, which raises TPP and results in a lower SN CRAC rate, not a higher one.

Third, WPAG also argues that BPA should have moved all payments to the Judgment Fund out to 2010. BPA is planning to keep the payments within the original term of the Enron contracts, Keep, *et al.*, SN-03-E-BPA-11, at 45, thus BPA is following the principle of collecting from those who get the benefits. BPA has maintained some cash flexibility by having a possibility of deferring payment out to 2010, but intends to make the payments within the original contract term.

Several parties recommend assuming use of the $250 million Treasury note. SUB Ex. Brief, SN-03-R-SP-01, at 10; GPU Brief, SN-03-B-GP-01, at 4; PPC/IEA Brief, SN-03-B-PP-01, at 9; ICNU/Alcoa Ex. Brief, SN-03-R-IC/AL-01, at 14. BPA views use of the Treasury note as a tool that is available for short-term liquidity purposes, if necessary. However, planning to use it, and lowering rates with the expectation that it will be used, is not a position BPA is willing to take, given that it exacerbates longer-term financial impacts and would be viewed negatively by rating agencies. Keep, *et al.*, SN-03-E-BPA-11, at 60.

Several parties recommend that BPA reduce any SN CRAC rate increase by obtaining, or renewing efforts to obtain, recognition from Treasury that advanced amortization payments to the Treasury, related to the ENW Debt Optimization Program, be used to offset future payment obligations. GPU Brief, SN-03-B-GP-01, at 4; WPAG Brief, SN-03-B-WA-01, at 3. BPA has proposed to Treasury that it be allowed to credit advance payments against later payments that would otherwise be missed, and intends to continue such discussions. However, to date, Treasury has made it clear that they do not view payments in prior years as available to satisfy current year obligations. Keep, *et al.*, SN-03-E-BPA-11, at 43. There is no basis on which to assume that BPA would obtain Treasury's concurrence. *Id.* at 60. Thus, BPA cannot prudently assume such recognition in the final proposal, given the current lack of acceptance from Treasury. BPA believes that if it were to assume such treatment, Treasury and others in the Administration would view this as a BPA deferral of Treasury payment, and serious political repercussions could result. *Id.* at 44. *See also* this ROD, at chapter 3. Additionally, the Debt Optimization Program has the primary purpose of restoring and extending BPA borrowing authority. SN-03 Study, SN-03-E-BPA-01, at 3-11. Using the advanced amortization payments as "prepayments" in inconsistent with the Debt Optimization Program. BPA believes the program provides value to the region, and planning to use the proceeds for purposes other than as envisioned by the program puts the program at risk. Keep, *et al.*, SN-03-E-BPA-11, at 57. Therefore, even if Treasury did agree to recognition of prior payments, BPA would not want to use them to avoid an SN CRAC rate increase.

BPA will have $315 million from extending ENW principal due this year into the 2013-2018 period. Keep, *et al*., SN-03-E-BPA-11, at 56. Several parties recommend using some or all of these funds to increase reserves, thus reducing the need for an SN CRAC rate

adjustment. BPA intends to make payments on higher-interest Treasury debt with these funds, consistent with the Debt Optimization Program. *Id.* This entails repaying the same amount of combined Federal and non-Federal debt that was planned in the May 2000 rate proposal, using proceeds from extending ENW debt to repay an equivalent amount of higher-interest Federal debt. *Id*. at 62. As with the previous issue of recognizing prior year advance amortization payments as payment for current year obligations, BPA believes planning to use the proceeds for purposes other than paying Federal debt puts the program at risk. *Id*. at 57. The Debt Optimization Program has the primary purpose of restoring and extending BPA's borrowing authority, and is expected to result in lower interest expense overall as well. SN-03 Study, SN-03-E-BPA-01, at 3-11. Since BPA believes the program provides value to the region, Keep, *et al.,* SN-03-E-BPA-11, at 57, BPA will not plan on holding ENW debt extension proceeds to lower the SN CRAC rate. Keep, *et al*., SN-03-E-BPA-11, at 57-58.

BPA acknowledges that these funds could be applied in other ways. *Id*. at 56. Just as the Administrator stated in the letter cited in the Coalition Customers' testimony, "extraordinary cash tools, such as use of ENW refinancing proceeds or the Treasury note, are BPA's last line of financial defense." *Id.* "Using $100 million of ENW debt extension proceeds to avoid an SN CRAC means that the last line of defense is that much smaller." *Id.* In other words, using these proceeds to decrease rates (or avoid increasing them) means they are unavailable for other purposes. *Id*. BPA recognizes that these funds may be necessary for short-term liquidity purposes, such as making the scheduled year-end Treasury payment or for cash flow in October or November. *Id*. Because of this, and because other actions and factors are acting to decrease the proposed expected rate increase, BPA does not plan to use these tools in rate setting. *Id.*

BPA recognizes ENW's reduced debt service costs for what they are, an extension of bond principal, which would otherwise have been paid off at maturity. *Id.* at 41. That principal extension, on its own, is pushing a significant amount of debt into future years. *Id.* Without planning for the corresponding payment of Treasury debt, the act of extending the ENW debt would be financially imprudent. *Id.* In order to be effective and justifiable, the Debt Optimization Program is a two-part transaction extending ENW principal and paying down Treasury debt. *Id.* This is consistent with the intent of the SN CRAC. *Id.*

The following are reasons for continuing the Debt Optimization Program as originally intended:

- BPA has already employed several financial tools that it considers prudent as described elsewhere in this ROD;
- Use of the proceeds as proposed by the customers will jeopardize the future of the program, which BPA believes provides value to the region. The understanding with ENW does not envision a long-term use of these funds, even under serious financial conditions;
- Use of the proceeds as proposed will jeopardize bond ratings on BPA-backed bonds. Recently issued bond Official Statements state that "[t]he possible financial tools Bonneville may rely on to meet cash flow needs in early fiscal year 2004 include among other items: (i) deferring all or a portion of planned early repayments and amortization of about $315 million in bonds issued by Bonneville to the United States Treasury and

> appropriations repayment obligations by Bonneville to the United States Treasury at the end of fiscal year 2003 in great part under the Debt Optimization Proposal, (ii) seeking access to short-term borrowing with the United States Treasury under Bonneville's existing borrowing authority, or (iii) deferring scheduled interest and/or principal payments to the United States Treasury, meaning planned payments to the United States Treasury as scheduled under applicable repayment criteria in contrast to the advance amortization payments described in clause (i)."

Keep, *et al.,* SN-03-E-BPA-11, at 57-58. Standard and Poor's has said "rating concerns that could prompt a downgrade include: the use of any debt restructuring savings to offset current operating expenses which would constitute a deferral of the cost recovery needed into future years." *Id.* at 59-60, citing the SN-03 Study, SN-03-E-BPA-01, Attachment 1-1. While BPA believes the Official Statements give BPA some flexibility with regard to use of the proceeds, *Id*. at 57-58, it is imprudent to depart from the plan except in the most dire of financial emergencies.

BPA is also very concerned about moving costs into the next rate period. Keep, *et al*., SN-03-E-BPA-11, at 58. Using the ENW debt extension proceeds as a reserve fund in FY 2004 or FY 2005 would require a larger SN CRAC in FY 2006 or a higher rate in the post -2006 period. *Id.* While it could be preferable for short-term impacts to move these repayment costs beyond the current rate period, such actions will be difficult to defend to the financial community and with ENW, and may have a material adverse impact on BPA's Debt Optimization Program. *Id.* BPA's Debt Optimization Program and the rating agencies' perception of BPA's creditworthiness both provide value to BPA's customers and the region. *Id.*

The record does not indicate that it is prudent to rely further on cash tools to reduce an overall rate increase that may now, with other actions taken in and outside of the rate case, be much smaller and possibly nonexistent. BPA intends to keep the option of using additional cash tools for short-term liquidity needs, but does not intend to employ them further to reduce rates. Keep, *et al*., SN-03-E-BPA-11, at 45-46. BPA is considering actions such as pursuing additional reserve fund free-ups and refinancing opportunities, and BPA's proposed variable rate design would allow future refinancings, after they have been completed, to be reflected in the annual calculation of the SN CRAC rate for the subsequent year. Lefler, *et al*., SN-03-E-BPA-13, at 6. Many of the actions GPU proposed in its direct testimony would be imprudent: BPA will not use cash tools to lower the SN CRAC rate, and BPA will not assume that agreements with Treasury not currently in place allow for lowering the SN CRAC rate. McCoy, *et al*., SN-03-E-BPA-17, at 13. As noted above, BPA's final study already reflects the use of cash tools.

Decision 5

BPA will continue to reflect in its modeling only financial tools that already have been accessed. BPA will not assume use of the Treasury note or the ENW proceeds to lower rates or raise TPP. BPA will not assume it can rely on previous payments of accelerated amortization to fulfill payments for current year Treasury obligations.

Issue 6

Whether the SN CRAC should include an explicit limit on expenditures on capital items at a level equal to the sum of Treasury borrowing and appropriations, and a cap on principal payments to Treasury at levels not to exceed the sum of amounts due in the fiscal year, amounts scheduled to be repaid in the May 2000 rate case, and savings available from the refinancing of ENW bonds.

Parties' Positions

WPAG argues that BPA should structure the SN CRAC such that BPA cannot collect revenues through the SN CRAC for amounts spent on revenue-financed capital investments or prepayments. WPAG Brief, SN-03-B-WA-01, at 18. WPAG suggests that if BPA's response is that it has no intention of exceeding the rate case forecasted levels in these areas, it is difficult to understand why BPA is reluctant to agree in writing to forego an action they have no intention of taking. *Id.* at 19.

BPA's Position

It is not BPA's intent to use SN CRAC revenues to directly fund capital programs. Lefler, *et al.*, SN-03-E-BPA-13, at 6-7. Both the May 2000 Proposal and the current proposal reflect BPA's power capital costs being fully funded by Treasury bonds or Congressional appropriations. *Id*. BPA is not proposing to revenue-finance any power-related capital investment. *Id.* BPA has never revenue financed capital investments unless a revenue-financing assumption has been incorporated when setting rates, for instance in the 1995 general rate case, which included $15 million for FY 1996 in each of the power and transmission revenue requirements. *Id.* For these reasons, BPA does not see a need to include limits on revenue financing. *Id.* "We don't want to put anything in any provisions that may be misconstrued in some way and . . . reduce the Administrator's flexibility." Tr. 74.

Evaluation of Positions

WPAG contends that the use of rate revenues to finance capital projects and to prepay Treasury obligations and/or appropriations can increase the likelihood of an SN CRAC rate increase. WPAG Brief, SN-03-B-WA-01, at 18. WPAG argues this is true because reducing the amount of cash that BPA has as financial reserves reduces the TPP and increases the likelihood that the SN CRAC retrigger thresholds will be exceeded. *Id*., citing Saleba, *et al*., SN-03-E-WA-01, at 21-22. WPAG argues that since the amount of rate revenues used to finance capital projects and to repay Treasury obligations and/or appropriations is not limited by any BPA policy or statute and is within the control of BPA, this is another area where actions taken by BPA that diverge from rate case forecasts should not automatically result in a retriggering of the SN CRAC. *Id.*

BPA has never revenue-financed capital investments unless a revenue-financing assumption has been incorporated when setting rates as, for instance, in BPA's 1995 general rate case, which included $15 million for FY 1996 in each of the power and transmission revenue requirements. Lefler, *et al.*, SN-03-E-BPA-13, at 6-7. However, the timing of events is such that BPA never precisely borrows dollar-for-dollar for capital programs in a given year. *Id.* In so doing,

deferred borrowing is created. *Id.* Deferred borrowing refers to capital expenditures that will be funded by borrowing from Treasury, but are temporarily financed with revenues. *Id.* Deferred borrowing is the difference between cumulative capital expenditures and cumulative borrowing for each capital program. *Id.* Although this could be characterized as revenue financing, it is a temporary event. *Id.* In addition, deferred borrowing is part of BPA's financial reserves and is available for risk mitigation. *Id.*

It is not BPA's intent to use SN CRAC revenues to directly fund capital programs. Lefler, *et al*., SN-03-E-BPA-13, at 7. Since this recommendation is intended to prevent an action that BPA does not intend to take, BPA does not see a need to include limits on revenue financing by including the proposed cap. *Id.*

WPAG proposes that principal payments of Federal debt be capped at levels not to exceed the sum of amounts due in the fiscal year, amounts scheduled to be repaid in the May 2000 rate case 50-year repayment study, and savings available from the refinancing of ENW bonds. WPAG Brief, SN-03-B-WA-01 at 18, citing Saleba, *et al.*, SN-03-E-WA-01, at 23.

What WPAG advocates is generally what BPA has been following in the current rate period as well as prior rate periods since getting back on track making amortization payments in the mid-1980s. *Id*. Historically, it is only through the Debt Optimization Program that BPA has previously repaid more power-related Federal principal than the amounts planned in rate filings. *Id*. Otherwise, annual payments have only exceeded the rate filing plan in minor ways, such as when end-of-year adjustments for over-payment of appropriations interest are applied to amortization or when the payment of a whole bond cause the actual payment to exceed the plan (*e.g.*, scheduled payment is $148 million but three $50 million bonds are repaid, thus resulting in $2 million payment above the scheduled amount). *Id.* BPA does not see a need to include the proposed cap. *Id.*

On both these issues, the recommendations are intended to prevent actions that BPA does not intend to take. However, unintended and unforeseen consequences and complications could result from crafting language without having time to fully and carefully consider potential consequences and appropriate restrictions.

Decision 6

While BPA does not plan to revenue-finance capital items, and does not expect that annual payments to Treasury will exceed the rate filing plan other than in minor ways, the SN CRAC will not include an explicit limit on expenditures on capital items at a level equal to the sum of Treasury borrowing and appropriations, and will not explicitly cap principal payments of Federal debt.

2.1.2 Regional Economy

BPA began this section 7(i) SN-03 CRAC rate hearing in poor financial shape. BPA's prognosis was for further deteriorating financial health. The record of this proceeding reflects the several causes for BPA's weak financial condition. *See* Keep, *et al*., SN-03-E-BPA-04, at 5-7. In order

to regain its financial health, BPA's initial proposal set a prospective rate level of 15.6 percent (average expected value rate level for 2004-2006 above total rate level for 2003). The near-term implications of such a rate increase for a fragile Northwest economy were of great concern, but so were the long-term implications if BPA failed to recover its costs through its rates. Fortunately for BPA and the parties, over the course of months during which this hearing has taken place, BPA's prognosis has changed for the better. *See* Tr. at 40-42. Some parties have even described a "March Miracle." Oral Argument Tr. at 15. Based on improvements in BPA's financial condition that are on the record, including substantial cost reductions of more than $80 million, more favorable hydro conditions and market prices, as well as improvements in cash, it is therefore reasonable for the Administrator to bring the average expected value of 2004-2006 rates down to about 5 percent above the total rate level for 2003. Issues raised by parties during this hearing regarding the region's economic condition and potential rate impacts are addressed below.

Issue 1

Whether BPA's SN CRAC proposal comports with the statutory requirement to adopt the lowest possible rates consistent with sound business principles.

Parties' Positions

GPU contends that BPA's current proposal does not achieve the ratemaking standard to adopt rates that are as low as possible, consistent with sound business principles. GPU Brief, SN-03-B-SG-01, at 3. GPU cites *Central Lincoln PUD v. Johnson*, 735 F.2d 1101 (9th Cir. 1984); Northwest Power Act section 7(a)(1), 16 U.S.C. § 839e(a)(1); Flood Control Act of 1944 section 5, 16 U.S.C. § 825s; and Federal Columbia River Transmission System Act sections 9 and 10, 16 U.S.C. §§ 838g and 838h.

BPA's Position

BPA's SN CRAC proposal is consistent with BPA's statutory obligation to adopt the lowest possible rates consistent with sound principles. *See* 68 Fed. Reg. 12049 (March 13, 2003). BPA is taking steps to reduce or eliminate the proposed SN CRAC, and is seeking to set rates as low as possible sufficient to recover its costs in accordance with sound business principles. Keep, *et al.*, SN-03-E-BPA-11, at 18.

Evaluation of Positions

GPU contends that BPA's need for a SN CRAC has changed significantly from the time of BPA's initial proposal—BPA's financial condition has greatly improved due to projected secondary revenues, the Enron settlement, the Bank of America settlement, and other factors. GPU Brief, SN-03-B-SG-01, at 3. GPU argues that BPA has several financial mechanisms to further reduce its need for the SN CRAC rate increase; *Id*. at 4, and that if BPA implemented these mechanisms, and given the recent improved financial conditions, BPA could avoid imposing any SN CRAC rate increase in FY04. *Id*. at 5. Given the dire conditions of the Pacific Northwest economy and BPA's statutory obligation to minimize its rate impacts on its

customers, GPU argues BPA must use all financial mechanisms at its disposal to avoid the SN CRAC rate increase. *Id*.

BPA is taking all reasonable steps to reduce or eliminate the proposed SN CRAC and is seeking to set rates as low as possible sufficient to recover its costs in accordance with sound business principles. Keep, *et al.*, SN-03-E-BPA-11, at 18. To that end, BPA has lowered the TPP standard as low as BPA feels it can, to accommodate the concerns raised by BPA's power customers. *Id*. At the same time, BPA is cognizant of its statutory obligation to recover its costs, as provided in section 7(a)(1) of the Northwest Power Act. BPA cannot disregard its paramount statutory directive to recover its costs, even during tough economic times.

BPA must also review such suggestions in the context of BPA's obligation to recover its costs. *Id*. at 19. As stated in BPA's direct testimony, "BPA is concerned about the impact of any rate increase on the economy of the Pacific Northwest, so direction was given to staff that the rate design should mitigate the level of any rate increase, to the extent possible." Keep, *et al*., SN-03-E-BPA-04, at 13. BPA continues to look for ways to limit the size of any rate increase by controlling and cutting costs, within the bounds of setting rates to recover costs. *Id*. BPA must set rates to recover its costs. *Id*. Without such a determination, BPA cannot set an arbitrary limit such as no total rate increase compared to FY 2003 total rate levels, as suggested above, to establish the level of the SN CRAC.

Decision 1

BPA's SN CRAC proposal comports with the statutory requirement to adopt the lowest possible rates consistent with sound business principles.

Issue 2

Whether BPA properly considered the potential impact an SN CRAC might have on its customers and their consumers given the present economic state of the regional economy.

Parties' Positions

Several parties note the poor state of the Northwest economy. Golden Northwest Brief, SN-03-B-GN-01, at 13; ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 12; NRU Brief, SN-03-B-NR-01, at 4; PNGC Brief, SN-03-B-PN-01, at 3; PPC/IEA Brief, SN-03-B-PP-01, at 10; WPAG Brief, SN-03-B-WA-01, at 2. Parties express concern over the potential impact an SN CRAC might have on the Northwest economy. "[T]estimony from numerous parties confirms that the economy in the Pacific Northwest is mired in the worst recession in the Nation." Golden Northwest Brief, SN-03-B-GN-01, at 13. "Many customers emphasized the stagnant economy and the harm that a further BPA rate increase would impose on the Region." ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 12. "BPA's customers have shown that, at both the utility and end use customer level, another rate increase would further harm an already poor economy." NRU Brief, SN-03-B-NR-01, at 4. "Numerous regional utility customers of BPA and of [sic] some of their major retail customers have submitted testimony that shows that the Region cannot afford an SN CRAC charge without placing at risk many, many jobs in the

Region." PNGC Brief, SN-03-B-PN-01, at 3. "[A] rate increase would be very harmful to the economy." PPC/IEA Brief, SN-03-B-PP-01, at 10. "When BPA commenced this proceeding, the economy of the Northwest was gripped by a severe economic recession. . . . These circumstances have not improved during the intervening three months." WPAG Brief, SN-03-B-WA-01, at 2.

BPA's Position

BPA is concerned about the impact of any rate increase on the economy of the Pacific Northwest, so direction was given to staff that the rate design should mitigate the level of any rate increase, to the extent possible. Keep, *et al*., SN-03-E-BPA-04, at 13.

Evaluation of Positions

PNGC acknowledges that BPA staff's rebuttal testimony assures the customers that BPA is sensitive to these concerns, although PNGC alleges that BPA's rate design favors BPA's financial condition. PNGC Brief, SN-03-B-PN-01, at 3. NRU does not believe that an SN CRAC is necessary to protect the agency financially in 2004. NRU Brief, SN-03-B-NR-01, at 4. Nevertheless, if the Administrator determines to proceed with the adjustment NRU urges the Administrator to mitigate the effect of such an adjustment. *Id*. NRU contends that it and other parties have demonstrated the negative impact of further rate increases on the Northwest economy. *Id*.

PNGC states that in the draft ROD BPA says that it is concerned about the welfare of the Pacific Northwest and its economy. PNGC Ex. Brief, SN-03-R-PN-01, at 5. PNGC contends that throughout the draft ROD BPA "employs its familiar rhetoric about the inarguable, *viz*., its obligations to recover its costs, pay Treasury on time, and make 'prudent' and 'businesslike' decisions, to bury any suggestion that it might decide to do something really helpful to retail customers who need the rate relief now." *Id*. NRU contends that BPA is not recognizing the fragile health of the Northwest economy and appears to believe that "mere acknowledgement of the testimony is adequate consideration of the problems faced by Northwest industry." NRU Ex. Brief, SN-03-R-NR-01, at 3. ICNU/ALCOA argue that despite BPA's alleged concern for the regional economy the draft ROD rejects the customers' requests and makes little effort to account for the impact the SN CRAC rate increase would have on its customers and the regional economy. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 7. ICNU/ALCOA argue that the Administrator avoids responsibility for BPA's role in the regional economy by "inappropriately placing the burden on end-use customers to reduce 'all other costs' to absorb BPA's higher power costs. *Id*. citing draft ROD at 2.1-27 to 2.1-32. ICNU/ALCOA argue that BPA concludes that if customers take extreme measures, such as significantly reducing their labor costs, then these customers should be able to "operate economically with higher power costs." *Id.* PPC/IEA argue that BPA fails to acknowledge the continued dismal state of the regional economy. PPC/IEA Ex. Brief, SN-03-R-PP-01, at 5.

Allegations continue that BPA has not considered or acknowledged the state of the region's economy. Some parties have come to the conclusion that a decision by BPA that involves any rate increase is a failure to consider the region's economy. BPA disagrees. On the one hand,

BPA seeks to mitigate any rate impact. BPA is reducing costs and considering other factors to improve its financial health in an effort to mitigate the level of any rate increase. *See* Keep, *et al*., SN-03-E-BPA-04, at 13. On the other hand, BPA cannot disregard its statutory obligations to recover its costs. BPA is making every prudent effort to minimize the rate increase because of the state of the regional economy.

ICNU/ALCOA incorrectly conclude that the Administrator is inappropriately placing the burden on end-use customers to reduce all other costs to absorb BPA's higher power costs. BPA makes no such conclusion. These parties misconstrue the quotes cited in their Brief on Exceptions which pertain to aluminum smelting specifically, not end-use customers generally.

BPA is very concerned about the financial situation that these parties describe. Keep, *et al.*, SN-03-E-BPA-11, at 22. That is why BPA's proposal lowered the TPP standard for this rate case. *Id*. BPA does not dispute the parties' contentions about the state of the Pacific Northwest economy and the loss of manufacturing jobs. *Id*. at 25. Indeed, BPA's proposal does reflect the economic concerns of BPA customers and the economic condition of the Northwest. Keep, *et al.*, SN-03-E-BPA-11, at 24.

As delineated in BPA's initial proposal, management instructed staff to meet three standards in the design of the SN CRAC: resulting PBL net revenues that are at least zero over the rate period; a reduced TPP standard for this rate period to a 50 percent probability that BPA can make all of its Treasury payments in the FY 2004-2006 three-year rate period; and a new Treasury repayment standard, which is the probability that BPA will be able to make all of its FY 2006 payments to the U.S. Treasury, including repayment of any amounts it might miss in FY 2003-2005. *See* Keep, *et al.*, SN-03-E-BPA-04, at 13-15. Additionally, BPA is using agency reserves to calculate the TPP and TRP, temporarily departing from BPA's standard of a PBL-only TPP. Keep, *et al.*, SN-03-E-BPA-11, at 24. Using agency reserves allows BPA to set the SN CRAC to minimize the effect on ratepayers overall while ensuring an adequate probability of making all payments, including Treasury payments, for the entire agency. *Id*. The three standards taken together, in addition to the modification of using BPA agency reserves to calculate TPP, addresses BPA's obligation to set rates to recover costs as well as minimize, to the extent possible, the impact of a BPA rate increase on the Northwest economy and BPA's customers. *Id*. As discussed in section 2.7 of this Record of Decision, with the substantial improvement of its revenues, BPA is now resorting to a TPP-only approach that allows BPA to keep rates low while reasonably assuring cost recovery in the circumstances the region now finds itself.

ICNU/ALCOA contend that BPA's proposed standards and rate design do not equitably balance BPA's real financial needs with the needs of the regional economy. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 12. To illustrate the recession gripping the economy, these parties note Oregon and Washington's high unemployment rates, the worsening economy, loss of manufacturing jobs, Kimberly-Clark's Everett mill power costs, and Alcoa's power cost. *Id*. at 12-13. ICNU and ALCOA contend that BPA failed to consider impacts of a rate increase to end-use customers of BPA's customers. *Id*. at 15. ICNU/ALCOA reference BPA data response IN/BPA-015 to support its contention. IN/AL-015 includes references to data responses CR&YA/BPA: 95 and 115.

BPA rejects the contention that it failed to consider regional economic impacts because the record is full of evidence that BPA, even before proposing the SN CRAC, has monitored the economic condition of the Pacific Northwest. A more thorough "analysis" of the two referenced BPA data responses (CR&YA/BPA: 95 and 115) supports BPA's consideration of the concerns expressed by both BPA's power customers and rate case parties.

> BPA, however, is aware of reports regarding these effects and has received many letters from Pacific Northwest citizens, businesses and local governments describing the authors' expected effects of such a rate increase on the economy. BPA also received public comments in workshops for the Financial Choices process and workshops for the SN CRAC rate case regarding the state of the regional economy . . . From a societal standpoint, BPA is concerned with the welfare of the residents and businesses in the region, and is therefore cognizant of the financial hardships rate increases may have on the economy, in general. As such, BPA seeks to keep rate increases as low as possible consistent with prudent financial practices.

(CR&YA/BPA: 95), ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 15, citing SN-03-E-CC-01R. ICNU/ALCOA argue that BPA has an alleged obligation to consider impacts on end-use customers of BPA's utility customers, and that BPA failed to meet this obligation because BPA did not analyze price elasticity effects. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 15-16 (citing Keep, *et al.*, SN-03-E-11, at 32.) In a related vein, PNGC states that the region is suffering with the nation's worst regional economy and the highest unemployment, caused in part by previous BPA rate increases. PNGC Brief, SN-03-B-PN-01, at 9. WPAG claims that the combination of current BPA rate increases of nearly 50 percent combined with a severe economic recession have made paying electric bills impossible for many and have put employers out of business. WPAG Ex. Brief, SN-03-R-WA-01, at 5. Golden Northwest also argues that BPA refuses even to examine the question of load loss from rate increases. Golden Northwest Brief, SN-03-B-GN-01, at 14. BPA disagrees. BPA witnesses testified that "BPA is obligated to set rates to recover its costs consistent with sound business principles." Keep, *et al.*, SN-03-E-11, at 31. This obligation is expressed in section 7(a) of the Northwest Power Act, 16 U.S.C. § 839e(a)(1). BPA witnesses explained that "[m]eeting this obligation entails the consideration of many factors, including impacts to end use consumers of BPA's utility customers." Keep, *et al.*, SN-03-E-11, at 32. Consideration of multiple factors in setting rates provides BPA the ability to deal with ever-changing landscapes, ranging from the weather to the environment and the economy. "The major drivers of load and the subsequent load risk are weather and the economy, . . ." Hirsch, *et al.*, SN-03-E-BPA-12, at 3. BPA data response CR&YA/BPA:115 describes BPA's consideration of factors related to load and rates.

> There are several reasons why BPA decided to not analyze price elasticity effects. First, only about 2,200 aMW of BPA firm sales are provided by contracts under which the load that BPA serves would decline if the utility load declines. The remainder is sold as take-or-pay Blocks, Slice or pre-Subscription contracts. The Block and Slice sales will remain constant regardless of the elasticity effects experienced by the serving utility. The pre-subscription sales would not be expected to experience any price elasticity effects because they are not subject to

> the SN CRAC rate increase. Second, any power that is freed up due to elasticity effects will be sold in the market as surplus. Therefore the additional revenue will be the difference between market and PF times the MWh freed up, not market times MWh. Third, price elasticity effects are dependent upon the retail rates, not the wholesale power costs. BPA has no way of knowing the extent to which its rate increases will be passed through to the retail rates. Some utilities may use reserves or other tools to forestall or moderate a retail rate increase. Fourth, for FY2002 actual sales for the load following Public Agencies exceeded weather adjusted forecasts by 1.2%. This was during a time when LB CRACs of 46.22 percent and 39.08 percent, for Oct 2001-Mar2002 and April 2002-Sep2001, respectively, were in place. This suggests very little, if any, price elasticity. An additional rate increase would, therefore, not be expected to produce much of a load response. Fifth, the forecasts for utilities served by the Western Power Business Area used FY2002 as the base year to which growth rates were applied. To the extent that loads in this year were lower due to rate increases than they would otherwise have been price elasticity responses have been implicitly incorporated. Sixth, loads can vary for a variety of reasons, including weather, economic activity, price, available substitutes, income levels and others. Attempting to isolate the price elasticity effects would require controlling for these other factors. Obtaining data at county or sub-county levels, if possible at all, would be costly and resource consuming. BPA subjectively determined that the price elasticity effects would be of insufficient value to warrant the cost of extensive data collection and modeling efforts.

ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 15, citing SN-03-E-CC-01S. In its rebuttal testimony BPA witnesses testified that utilities often design rates towards certain desired outcomes. Keep, *et al*., SN-03-E-BPA-11, at 25. For example, BPA has designed rates with time-of-day and seasonal shapes to encourage customers to shape their purchases from BPA away from periods of high cost (for BPA). *Id*. Retail utilities can set rates to the advantage of industrial users. *Id*. In specific regard to the Kimberly-Clark Everett mill, without any supporting documentation, BPA has no way of knowing whether the industrial power rates of the other Kimberly-Clark mills benefit from such retail rate designs. *Id*. It may be that Snohomish PUD, because its rates were so low in the past, did not need to develop beneficial industrial rates, and so does not have those types of industrial rates. *Id*. In addition, the Coalition Customers were not responsive to BPA's data requests BPA-CC-005 and BPA-CC-008, which sought information pertaining to the 82 percent rate increase experienced at the Kimberly-Clark mill. *Id*. BPA notes that Snohomish Public Utility District (PUD) is not supplied solely with Federal power marketed by BPA. *Id*. BPA understands that Snohomish PUD executed several power purchase contracts with various suppliers during the height of the energy crisis that far exceed the cost at which it pays for power marketed to it by BPA. *Id*. BPA also is aware that Snohomish is currently in legal proceedings to seek relief from those contracts. *Id*. Therefore, BPA believes the rate increases noted in the Coalition Customers' testimony are likely a result of independent decisions that Snohomish PUD made with respect to meetings its own loads, in addition to cost increases from BPA. *Id*.

Further, BPA is cognizant of the price of power and its relationship to smelting aluminum--price of power is only one of an aluminum smelter's costs. Keep, *et al*., SN-03-E-BPA-11, at 26. At any given time, the competitiveness of an aluminum smelter depends on its overall cost structure and the world aluminum price. *Id*. The cost structure is driven by an individual smelter's production efficiency and its cost components. For Pacific Northwest smelters the cost of power is one of three major cost components. The other two are labor and raw materials (alumina, carbon, and miscellaneous materials). If a smelter is able to sufficiently lower all other costs then it can operate economically with higher power costs. *Id*.

ICNU/ALCOA further contend that BPA did not consider the impact of a BPA rate increase on a customer's bond rating or on its ability to pay. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 16 (citing SN-03-E-CC-01, at 11; SN-03-E-CC-01V). This is incorrect. Bond rating agencies consider a number of factors when evaluating an entity for creditworthiness. Keep, *et al*., SN-03-E-BPA-11, at 28. Among the factors are quality and expertise of management, adequacy of financial and risk management policies, operating performance as measured by financial ratios, the local economic situation, and, in the case of distribution utilities, cost of wholesale power. *Id*. BPA has virtually no control over most of those factors as they relate to its customer utilities and, as is the case of many of its rated customers, has only partial responsibility for the cost of wholesale power. *Id*. In addition, each utility customer manages the impact of BPA's rates uniquely. *Id*. Since BPA influences so few of the rating factors and no formula seems to exist for isolating and evaluating the effects of BPA's actions on all customers, BPA does not specifically include impacts of the bond ratings of its utility customers and consumers in ratesetting. *Id*.

PNGC argues that imposing an SN CRAC now is contrary to BPA's statutory obligations. PNGC Brief, SN-03-B-PN-01, at 4. The obligation PNGC appears to reference is the purpose stated in section 2(2) of the Northwest Power Act, "to assure the Pacific Northwest of an adequate, efficient, economical, and reliable power supply." PNGC argues that "the agency has pushed ratepayers to their limits, economic harm is already widespread, and further increases are extremely risky to the economy." *Id*. BPA does not dispute the parties' contentions about the state of the Pacific Northwest economy. Keep, *et al*., SN-03-E-BPA-11, at 22. However, BPA does not agree that imposition of a SN CRAC now is contrary to statute. To the contrary, BPA's statutes expressly provide that BPA shall recover its costs in accordance with sound business principles. S*ee* 16 U.S.C. § 839e(a)(1). Over time this assures the Pacific Northwest of an adequate, efficient, economical, and reliable power supply. That purpose is one of many overarching purposes enunciated in section 2 of the Act. Another purpose enunciated is that "customers of the Bonneville Power Administration and their consumers continue to pay all costs necessary to produce, transmit, and conserve resources to meet the region's electric power requirements, including the amortization on a current basis of the Federal investment in the Federal Columbia River Power System." 16 U.S.C. § 839(4). It is inappropriate to confuse an economical power supply with a power supply priced at the lowest possible rates consistent with sound business principles. BPA cannot disregard its paramount statutory directive to recover its costs, even during tough economic times. This should come as no surprise to BPA's power customers since the standard power sale contract with BPA includes within the definition of the term "Uncontrollable Force" that neither the unavailability of funds or financing, nor conditions of national or local economies or markets shall be considered an uncontrollable force. Thus,

given BPA's substantive statutory obligation to establish rates to recover its costs, direction was given to staff that the rate design should mitigate the level of any rate increase, to the extent possible, because BPA is concerned about the impact of any rate increase on the economy of the Pacific Northwest. Keep, *et al*., SN-03-E-BPA-04, at 13.

Decision 2

BPA has appropriately taken into account the potential impact an SN CRAC might have on its customers and their consumers given the present economic state of the regional economy.

Issue 3

Whether BPA's SN CRAC proposal appropriately balances the economic impacts with BPA's fish and wildlife obligations.

Parties' Positions

CRITFC contends that BPA has balanced near-term achievement of the Fish and Wildlife Funding Principles with its concerns about economic impact to the region's economy, but in order to minimize the SN CRAC rate increase BPA will reduce its ability to meet fish and wildlife and other costs and repay the Treasury. CR&YA Brief, SN-03-B-CR/YA-01, at 53.

BPA's Position

The design features of BPA's SN CRAC proposal will meet its fish and wildlife, tribal trust and environmental obligations. McNary, *et al*., SN-03-E-BPA-18, at 1. The variable nature of the SN CRAC allows adjustment in future years if there is a deterioration of BPA's financial position. *Id*.

Evaluation of Positions

CRITFC contends that the record shows that BPA has not done any analysis of the economic impacts of raising rates, nor has BPA analyzed the economic impacts of reducing fish and wildlife recovery activities on local communities and economies. CR&YA Brief, SN-03-B-CR/YA-01, at 53. In its Brief on Exceptions, CRITFC argues that if BPA had conducted such analysis "it is likely that the studies would have shown that economic benefits from habitat restoration activities in rural communities would far outweigh any adverse effects of the associated rate impact." CR&YA Ex. Brief, SN-03-R-CR/YA-01, at 8. CRITFC further contends that it is also likely the study would show that BPA's customers have received billions of dollars of benefit while tribal economies and cultures dependent on fishing have been decimated. *Id*.

While no formal price elasticity studies were performed, BPA did consider the effect of rates on its sales. For the reasons stated in BPA data responses CR&YA/BPA: 95 and 115, BPA determined no adjustment for price elasticity was necessary. Hirsch, *et al.*, SN-03-E-BPA-12, at 3. CRITFC argues that because of the "prominent role that economic considerations play in the decisions that went into the Proposal, Bonneville should have conducted analysis, provided

testimony, and these issues should have been subject to review by the Parties in this rate case." CR&YA Brief, SN-03-B-CR/YA-01, at 53. BPA's consideration of economic impacts has been subject to this hearing, which is evident from the parties' testimony and briefs on this issue. It is not necessary, however, to conduct a public process to analyze BPA's economic considerations prior to proposing rates. Further, BPA conducted the Financial Choices public process to examine BPA's financial and program options for PBL's FY 2003-2006 financial challenges. Keep, *et al*., SN-03-E-BPA-04, at 8. CRITFC's statements about what the "likely" results produced by a hypothetical economic study are speculative and have no basis in the record. BPA rejects such statements. The real issue here is that CRITFC does not believe BPA is spending what it believes is necessary to address its fish and wildlife, tribal trust and environmental obligations. As the Administrator explained in the Federal Register Notice, the expense levels for these matters are being addressed in other forums and as a consequence are outside the scope of this proceeding. McNary, *et al*., SN-03-E-BPA-18, at 1-2. BPA believes the levels contained in this proposal are reasonable and fulfill BPA fish and wildlife obligations. *Id.*

BPA is obligated to set rates to recover its costs consistent with sound business principles. Meeting this obligation entails the consideration of many factors, including impacts to end-use consumers of BPA's utility customers. BPA assumes that such end-use consumers include the local communities and economies referenced in CRITFC's brief and testimony. Keep, *et al*., SN-03-E-BPA-11, at 31-32. While BPA considers potential impacts of rate increases on load, it does not necessarily follow that BPA would need to consider the impacts on communities and economies as they relate to fish and wildlife activities. Congress has not directed BPA to provide cultural or economic mitigation to Indian or rural peoples. McNary, *et al*., SN-03-E-BPA-18, at 10. BPA is, of course, well aware of the benefits the tribes and communities receive through BPA fish and wildlife mitigation funding. *Id*. BPA's 2002 GRSPs specifically provide that "BPA will propose changes to the FB CRAC parameters that will, *to the extent market and other risk factors allow*, achieve a high probability that the remainder of Treasury payments during the FY 2002-2006 rate period will be made in full." 2002 GRSPs, section II.F.3 (emphasis added). BPA has, with its proposal, tried to balance its concern with the current state of the Pacific Northwest economy with the need to set rates sufficient to recover its costs. *Id*.

CRITFC calculated that the proposal results in a rate increase of approximately $4.50 for the average residential consumer served by BPA wholesale power. CR&YA Brief, SN-03-B-CR/YA-01, at 54. CRITFC argues that while no one likes rate increases, "this level is far from the huge rate increase that Bonneville describes." *Id*. citing SN-03-E-CR/YA-01C. In its Brief on Exceptions, CRITFC seeks to correct its citation in order to support its rate calculation; CRITFC states its calculations were based on SN-03-E-CR-CR-01VV. CR&YA Ex. Brief, SN-03-R-CR/YA-01, at 9. CRITFC's brief did not cite this document to support its argument. While CRITFC now points to analysis it included as an attachment to its testimony to support the dollar figure it posited, such analysis remains lacking and is unpersuasive. CRITFC's analysis fails to account for variables that would need to be considered, such as the impact on commercial, industrial, and other loads that are already facing very difficult economic circumstances. CRITFC also assumes a faulty premise: if one can set a rate at some percentage below market, then there is no economic impact. That logic misses the point of BPA's

consideration of economic impacts to the region given the current recession and BPA's need to meet its fish and wildlife obligations. McNary, *et al*., SN-03-E-BPA-18, at 1.

Decision 3

BPA's SN CRAC proposal appropriately balances the economic impacts with BPA's fish and wildlife obligations.

2.1.3 Sound Business Principles

Issue 1

Whether BPA's SN CRAC proposal is consistent with sound business principles.

Parties' Positions

SOS/NWEC argue BPA should not be allowed to disregard sound business principles by setting rates so low as to put it at extraordinary risk of not being able to deal with its many "foreseeable, but unpredictable costs." SOS/NWEC Brief, SN-03-B-SA-01, at 4; SOS/NWEC Ex. Brief, SN-03-R-SA-01, at 7.

BPA's Position

In regard to the current rate period, BPA has accounted for its costs and uncertainties in this SN CRAC rate proposal, while setting rates that are competitive, cover its costs, and provide sufficient assurance that BPA will have made all its payments to the U.S. Treasury by the end of the rate period. Conger, *et al*., SN-03-E-BPA-16, at 2.

Evaluation of Positions

SOS/NWEC contend that BPA is obliged not to ignore foreseeable costs; it is not sound business practice to deliberately ignore information on future costs nor to tie one's hands to act on such information. SOS/NWEC Brief, SN-03-B-SA-01, at 4. Their concern is that BPA is deliberately tying its hands by limiting its contingent SN CRAC's ability to react to future events, especially during the one-year gap before the 7(i) SN CRAC could start collecting money. SOS/NWEC Ex. Brief, SN-03-R-SA-01, at 7. SOS/NWEC contends that BPA sidesteps this point. *Id*.

BPA is not ignoring foreseeable costs or tying its hands to act in the future if needed. The statutes governing BPA's operations are permeated with references to the "sound business principles" Congress desired the Administrator to use in discharging his duties. *Ass'n of Pub. Agency Customers v. Bonneville Power Admin.*, 126 F.3d 1158, 1171 (9th Cir.) ("APAC"). *See* 16 U.S.C. §§ 825s, 838g, 839e(a)(1); *see also Department of Water & Power of the City of Los Angeles v. Bonneville Power Admin., 759 F.2d 684, 693* (9th Cir. 1985) ("To the extent that [BPA's challenged transmission allocation policy] is designed to mitigate projected deficits, [it] is not only statutorily authorized but statutorily mandated."). Thus, although Congress did not prescribe the parameters of the Administrator's authority, it granted BPA an unusually expansive

mandate to operate with a business-oriented philosophy. APAC, 126 F.3d at 1171. Clearly, issues of the condition of the current regional economy and keeping costs as low as possible are appropriate considerations, among others, for judging costs related to activities outside the rate case as a matter of policy. SOS/NWEC's claim that BPA is ignoring issues of risk and uncertainty are unfounded.

In its Brief on Exceptions, SOS/NWEC states that BPA can argue, and it does, that it does not think anything can go wrong, that it is very sure that the budget control it has put in place will work. SOS/NWEC Ex. Brief, SN-03-R-SA-01, at 7. SOS/NWEC then queries: what if it does not rain very much one year and BPA has to start the next year with low reservoirs? *Id*. SOS/NWEC then asks, "[w]hy not have the contingent SN CRAC adjustment take that information into account when it sets rates for the second year? *Id*. They argue that this is what a business following sound business practices would do. *Id*.

BPA has already addressed the concerns expressed by SOS/NWEC. The flexibility provided by the FB CRAC and SN CRAC rate design in the WP-02 rate case allow BPA to modify its rates depending on its financial condition. *See* Conger, *et al*., SN-03-E-BPA-16, at 1. BPA has addressed in its Risk Analysis and its various other studies, documentation, and testimony its costs and uncertainties in this SN CRAC proposal, while also setting rates that are competitive and provide sufficient assurance that BPA will have made all its payments to the U.S. Treasury by the end of the rate period. *Id*. at 1-2. *See also* SN-03 Study, SN-03-A-01, at 2.6-1, and SN-03 Study, SN-03-E-BPA-01, Chapter 6.

The decisions made by the Administrator outside the rate case to cut costs constitute fundamental management decisions as to how best to conduct BPA's multiple affairs in light of the current and foreseeable financial, political, and operational situation of BPA and the region. These budgetary decisions are all matters of judgment that call into play implementing the Northwest Power Act in a sound and businesslike manner. However, these budget decisions cannot be said to constitute matters of "establishing rates" under section 7(i) or as defined in the scope of the Federal Register Notice, 68 Fed. Reg. 12048-12055 (March 13, 2003). BPA's ratesetting takes budgets as a given. In addition, BPA's variable and contingent SN CRAC design allow the rate to correspond the cost levels and programs established outside of the rate case process.

BPA adheres to sound business principles when it sets rates. *See* 16 U.S.C. § 839e(a)(1). In accordance with sound business principles, BPA considers multiple factors in setting rates, which provides BPA the ability to deal with ever-changing landscapes, ranging from the weather to the environment and the economy. In this section 7(i) hearing BPA must strike a balance among many statutory directives--providing reliable, economic power, working to assure the survival of fish stocks, promoting conservation, and delivering other benefits to the region. BPA believes that its SN CRAC rate proposal represents a reasonable balance. Conger, *et al*., SN-03-E-BPA-16, at 2-3. BPA's ability to meet potentially higher costs in the future is substantial. *Id*. at 3. The majority of BPA's firm load is covered by 10-year contracts, extending though FY 2011, which provide a very sound financial base for BPA. *Id*. at 3.

Decision 1

BPA's SN CRAC proposal is based on budget decisions that were reasonably made outside the rate case and is consistent with sound business principles.

Issue 2

Whether BPA is proposing an SN CRAC that recovers BPA's costs.

Parties' Positions

Bonneville's proposed rates must recover all of its foreseeable costs. SOS/NWEC Brief, SN-03-B-SA-01, at 5.

BPA's Position

BPA's rates are set to recover all costs that are legally mandated.

Evaluation of Positions

SOS/NWEC contend that the mandatory duty to allocate costs and benefits within rates assumes that the costs will actually be included in rates to allow recoupment of such costs. SOS/NWEC Brief, SN-03-B-SA-01, at 5. They argue reasonable rates include fair treatment of all such costs and expenditures. *Id*. at 6. They further contend that to adopt rates which fail to capture all costs is unlawful, and to provide mechanisms which do not adequately assure compliance with all statutory duties is arbitrary and capricious. *Id*.

BPA is setting its rates to recover its costs. Costs must be reasonably likely to occur, otherwise rates would not be set as low as reasonably possible consistent with sound business principles. Rate designs, such as CRACs or net revenues for risk, can then address the possibility that costs may actually be higher or lower. The variable and contingent SN CRAC design reasonably allows BPA to recover uncontrollable costs.

Decision 2

BPA is proposing an SN CRAC that recovers BPA's costs.

2.1.4 Section 7(b)(2) Rate Test

Introduction to Section 7(b)(2). Section 7 of the Northwest Power Act contains directives for the development of BPA's wholesale power rates. 16 U.S.C. § 839e. Among these directives is section 7(b)(2). 16 U.S.C. § 839e(b)(2). Section 7(b)(2) of the Northwest Power Act directs BPA to conduct, after July 1, 1985, a comparison of the projected amounts to be charged its preference and Federal agency customers for their general requirements with the costs of power (hereafter called rates) to those customers if certain assumptions are made. *Id*. The effect of this rate test is to protect BPA's preference and Federal agency customers' wholesale firm power

rates from certain specified costs resulting from the provisions of the Northwest Power Act. 2002 Final Power Rate Proposal, Administrator's ROD, WP-02-A-02, at 13-1 to 13-63. The rate test can result in a reallocation of costs from the general requirements loads of preference and Federal agency customers to other BPA loads. *Id.*

In determining public body and cooperative customers' power costs for any rate period after July 1, 1985, and the ensuing 4 years, the following assumptions are made:

- the public body and cooperative customers' general requirements had included during such five-year period the DSI loads which are: (1) served by the Administrator; and (2) located within or adjacent to the geographic service boundaries of such public bodies and cooperatives;

- public body, cooperative, and Federal agency customers were served, during such five-year period, with FBS resources not obligated to other entities under contracts existing as of the effective date of this Northwest Power Act (during the remaining term of such contracts), excluding obligations to DSI loads included in this paragraph;

- no purchases or sales by the Administrator as provided in section 5(c) were made during such five-year period;

- all resources that would have been required, during such five-year period, to meet remaining general requirements of the public body, cooperative, and Federal agency customers (other than requirements met by the available FBS resources determined under this paragraph) were: (1) purchased from such customers by the Administrator pursuant to section 6, or (2) not committed to load pursuant to section 5(b), and were the least expensive resources owned or purchased by public bodies or cooperatives; and any additional resources were obtained at the average cost of all other new resources acquired by the Administrator; and

- the quantifiable monetary savings, during such five-year period, to public body, cooperative, and Federal agency customers resulting from: (1) reduced public body and cooperative financing costs as applied to the total amount of resources, other than FBS resources, identified under this paragraph; and (2) reserve benefits as a result of the Administrator's actions under this Northwest Power Act were not achieved.

Id. The rate test, as implemented by BPA since its inception, involves the projection and comparison of two sets of wholesale power rates for the general requirements of BPA's public body, cooperative, and Federal agency customers (7(b)(2) customers). *Id.* The two sets of rates are: (1) a set for the test period and ensuing 4 years, assuming that section 7(b)(2) is not in effect (Program Case rates); and (2) a set for the same period taking into account the five assumptions listed in section 7(b)(2) (7(b)(2) Case rates). *Id.* Certain specified costs allocated pursuant to section 7(g) of the Northwest Power Act are subtracted from the Program Case rates. *Id.* Next, each nominal rate is discounted to the test year of the relevant rate case. *Id.* The discounted Program Case rates are averaged, as are the 7(b)(2) Case rates. *Id.* Both averages are rounded to the nearest tenth of a mill for comparison. *Id.* If the average Program Case rate is greater than

the average 7(b)(2) Case rate, the rate test triggers. *Id*. Based on the extent to which the test triggers, the amount to be reallocated in the rate test period is calculated. *Id*.

The methodology to implement section 7(b)(2) was developed in a section 7(i) proceeding that preceded BPA's 1985 rate case. *Id*. The section 7(i) process culminated in the Section 7(b)(2) Implementation Methodology ROD (Implementation ROD), b-2-84-F-02. Issues regarding interpretation of the statute were resolved in the Legal Interpretation for Section 7(b)(2), b-2-84-FR-03, 49 Fed. Reg. 23,998 (1984); SN-03-E-sp-01K.

Proceedings Leading To The SN-03 SN CRAC Rate Proceeding. BPA developed proposed power rates in BPA's initial WP-02 rate proceeding. These rates included BPA's PF-02, RL-02, NR-02, IP-02, and NF-02 rates. In developing BPA's proposed rates, BPA conducted a rate test required by section 7(b)(2) of the Northwest Power Act. 16 U.S.C. § 839e(b)(2); 2002 Final Power Rate Proposal, Administrator's ROD, WP-02-A-02, at 13-1 to 13-63. All issues regarding the section 7(b)(2) rate test were decided by BPA in the WP-02 proceeding. *Id*. On July 6, 2000, BPA filed its proposed 2002 wholesale power rates with the Federal Energy Regulatory Commission (FERC) for confirmation and approval. 16 U.S.C. § 839e(a)(2).

BPA later conducted a supplemental rate hearing under section 7(i) of the Northwest Power Act. 16 § U.S.C. § 839e(i). BPA's supplemental proposal included three specific risk mitigation tools in BPA's GRSPs: the LB CRAC, the FB CRAC, and the SN CRAC. During the proceeding, a diverse group of parties, comprising nearly all of BPA's customers and four regional utility commissions, filed joint testimony and briefs as the "Joint Customers" (Avista, PacifiCorp, Portland General Electric Company, Idaho Power Company, Puget Sound Energy, Public Generating Pool, Market Access Coalition, Northwest Requirements Utilities, Pacific Northwest Generating Cooperative, Public Power Council, Western Public Agencies Group, and the State utility commissions of Idaho, Montana, Washington, and Oregon). As discussed in greater detail below, this extremely broad coalition of parties argued that BPA's previous "inclusion of . . . contingent rate adjustment clauses in the GRSPs has never required a second performance of the section 7(b)(2) rate test . . . ." Joint Customer Brief, WP-02-B-JC-01, at 6. The Joint Customers also stated that BPA had already subjected its base rates to the section 7(b)(2) rate test and "since it is only the contingent cost recovery clauses contained in the GRSPs, and not the base rates contained in the rate schedules, that are being modified in the second phase of this proceeding, there is no legal requirement that these rate tests be performed a second time." *Id*. at 5. The Joint Customers also stated that the Northwest Power Act "does not require that these contingent rate mechanisms individually be evaluated on the basis of the section 7(b)(2) . . . rate test." *Id*. at 6.

The Joint Customers, through a settlement agreement, also supported holding a subsequent section 7(i) hearing for implementing the SN CRAC, which would receive FERC review. *Id.* at 12. The Joint Customers advocated a section 7(i) hearing to provide greater procedural protection and in order that "any such change to the FB CRAC parameters will be subjected to review by the FERC, which will ensure that any such change satisfies the cost recovery requirement of section 7(a) of the Regional Act." *Id*.

On June 20, 2001, the Administrator issued the ROD in the supplemental rate case. *See* Supplemental Power Rate Proposal, Administrator's Record of Decision, WP-02-A-09. In the ROD, the Administrator agreed with virtually all of BPA's customers that BPA was not required to conduct the section 7(b)(2) rate test a second time for the LB, FB, and SN CRACs. *Id*. at 6-1 to 6-15. BPA's SN CRAC was established in section II.F of the GRSPs. Section II.F.3 of the GRSPs provides:

> The SN CRAC will be available if the Administrator determines that, after implementation of the FB CRAC and any Augmentation True-Ups, either of the following conditions exist:
>
> > BPA forecasts a 50 percent or greater probability that it will nonetheless miss its next payment to Treasury or other creditor, or
> >
> > BPA has missed a payment to Treasury or has satisfied its obligation to Treasury but has missed a payment to any other creditor.

The Administrator agreed, however, to conduct an additional section 7(i) hearing for the SN CRAC in order to ensure cost recovery. Joint Customer Brief, WP-02-B-JC-01, at 12. BPA's GRSPs, including the SN CRAC, accompanied the ROD. BPA's GRSPs do not require BPA to conduct the section 7(b)(2) rate test when implementing these adjustment clauses. *See* 2002 GRSPs, Section 2.F.

BPA filed its supplemental rate proposal with FERC on June 29, 2001. On September 28, 2001, FERC granted interim approval to BPA's proposed 2002 power rates. *U.S. Department of Energy – Bonneville Power Admin.*, 96 FERC ¶ 61,360 (2001).

The SN-03 SN CRAC Rate Proceeding. On March 13, 2003, BPA published notice of the instant proceeding in the Federal Register, entitled "Bonneville Power Administration's Proposed Safety-Net Cost Recovery Adjustment Clause, Adjustment to 2002 Wholesale Power Rates, BPA File No: SN-03," 68 Fed. Reg.12,048 (2003). The notice established the scope of this proceeding. The notice states:

> *Pursuant to section 1010.3(f) of BPA's Procedures, the Administrator directs the Hearing Officer to exclude from the record any material attempted to be submitted or arguments attempted to be made in the hearing which seek to in any way visit the appropriateness or reasonableness of BPA's decisions in the WP-02 rate hearing.*

Id. at 12,051. Because BPA already decided all issues regarding the section 7(b)(2) rate test in BPA's WP-02 rate hearing, and because the SN CRAC established in the WP-02 proceeding does not require BPA to conduct the section 7(b)(2) rate test, BPA moved to strike the Springfield Utility Board's (SUB) testimony regarding section 7(b)(2). In its motion to strike, BPA noted, among other things, that it conducted the section 7(b)(2) rate test when BPA developed its proposed 2002 wholesale power rates; that BPA does not conduct the section 7(b)(2) rate test when it implements adjustment clauses; that only "details" of the

SN CRAC implementation were to be addressed in the section 7(i) hearing, and the section 7(b)(2) rate test was hardly a detail; that the section 7(b)(2) rate test regarded the *allocation* of limited costs, while the SN CRAC dealt with the *recovery* of BPA's total costs; that given the massive nature of conducting the section 7(b)(2) rate test, conducting the test would be inconsistent with the GRSP's requirement to conduct the SN CRAC section 7(i) hearing within 40 days; and that conducting the section 7(b)(2) rate test would be tantamount to performing all the work needed for the development of new base rates for all BPA customers, which is contrary to the purpose of adjustment clauses—namely, to allow electric utilities to adjust rates for particular cost changes instead of requiring the complete redevelopment of base rates. BPA Motion at 1-4. On May 5, 2003, the Hearing Officer, relying on misstatements of fact contained in SUB's response, as discussed below, denied BPA's motion to strike. *See* Order, SN-03-O-12; BPA Response to Motion to Compel, SN-03-M-22.

On May 9, 2003, SUB, the Canby Utility Board, and the PPC filed a motion to compel BPA to conduct the section 7(b)(2) rate test and to include such test in the record of the SN-03 rate proceeding. *See* SN-03-M-19. The hearing officer denied the public agencies' motion as untimely. *See* Order, SN-03-O-15.

Issue 1

Whether BPA should have conducted the section 7(b)(2) rate test in implementing the SN CRAC.

Parties' Positions

SUB, Canby, GPU, ICNU/ALCOA, PPC/IEA, Golden Northwest Aluminum, and PNGC argue that BPA should have conducted the section 7(b)(2) rate test in the SN CRAC proceeding. SUB Brief, SN-03-B-SP-01, at 3-14; SUB Ex. Brief, SN-03-R-SP-01, at 11-20;Canby Brief, SN-03-B-CA-01, at 6-20; Canby Ex. Brief, SN-03-R-CA-01, at 7-13; GPU Brief, SN-03-B-GP-01, at 10-12; GPU Ex. Brief, SN-03-R-GP-01, at 10-14; ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 24-27; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 4-5; PPC/IEA Brief, SN-03-B-PP-01, at 13-14; PPC/IEA Ex. Brief, SN-03-R-PP-01, at 9-10; Golden Northwest Brief, SN-03-B-GN-01, at 14-15; and PNGC Brief, SN-03-B-PN-01, at 10.

The IOUs filed a motion to strike the only direct testimony filed by any party regarding the section 7(b)(2) rate test. IOU Motion, SN-03-M-01. The IOUs argue BPA is not required to conduct the section 7(b)(2) rate test in the SN CRAC proceeding. Oral Tr. at 65; IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 7-10.

BPA's Position

BPA conducted the section 7(b)(2) rate test in developing BPA's 2002 wholesale power rates. Keep, *et al.*, SN-03-E-BPA-11, at 74-78; SN-03-M-22. BPA is not required to run the section 7(b)(2) rate test a second time when implementing an adjustment clause such as the SN CRAC, which does not revisit BPA's established rates. *Id.*

Evaluation of Positions

The Northwest Power Act. Section 7 of the Northwest Power Act contains directives for the development of BPA's wholesale power rates. 16 U.S.C. § 839e. Section 7(b) of the Northwest Power Act regards the establishment of "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) (emphasis added). This rate is called the Priority Firm, or PF rate. Section 7(b)(2) is used in the development of this rate ("the projected amounts to be charged for firm power for the combined general requirements of public body, cooperative, and Federal agency customers."). 16 U.S.C. § 839e(b)(2). Section 7(b)(2) of the Northwest Power Act is one of numerous provisions in section 7 of the Act that provides direction in establishing BPA's wholesale power rates. These provisions, or "rate directives," with one exception, do not regard the specific components of the rates, such as demand charges, energy charges, unauthorized increase charges, adjustment clauses, or other components of BPA's rates. The exception is section 7(e) of the Act, which addresses these component parts of BPA's rates. 16 U.S.C. § 839e(e). Section 7(e), as discussed in greater detail below, grants BPA broad discretion in the design of its rates. The other rate directives, however, address the establishment of BPA's base rates, primarily the PF, NR, and IP rates. This is also true of section 7(b)(2), which establishes a rate test. If the rate test triggers, certain costs must be allocated to all BPA power sales other than those to preference customers. The section 7(b)(2) rate test is thus conducted in the establishment of the base PF rate and the other base rates. Section 7(b)(2) does not refer to adjustment clauses.

The fact that the section 7(b)(2) rate test is conducted in the establishment of the base PF rate is confirmed in the legislative history of section 7(b). The report of the House Committee on Interstate and Foreign Commerce notes that "[s]ection 7(b) establishes the *rates* for power sold to meet the general requirements of public bodies, cooperatives, and Federal agency customers within the Pacific Northwest …. This *rate* will be the Administrator's lowest firm power *rate*." H.R. Rep. No. 96-976, Pt. I, 96th Cong., 2d Sess. 68 (1980) (emphasis added); *see* H.R. Rep. No. 96-976, Pt. II, 96th Cong., 2d Sess. 52 (1980). Section 7(b), including section 7(b)(2), thus refers to the establishment of BPA's PF *rate*. It does not address adjustment clauses.

SUB argues that BPA is incorrect in stating that the legislative history of the Northwest Power Act confirms that the 7(b)(2) rate test is conducted in the establishment of the PF rate and does not address adjustment clauses. SUB Ex. Brief, SN-03-R-SP-01, at 14-15. SUB then quotes passages of legislative history that do not mention adjustment clauses at all. *Id.*

> Section 7(b)—This section establishes a rate or rates for electric power sold to meet the general requirements (defined in this section) of public body cooperative and Federal agency customers and utilities under section 5(b)(2); a rate test to limit the charges that may be recovered by such ***rates*** applicable to public body, cooperative, and Federal agency customers after July 1, 1985; and a supplemental rate charge to recover any costs not recovered as a result of the rate test, to be applied through rates to all other power sales of the Administrator which are not limited by the rate test…" Administrator's Record of Decision, Final Power Rate

> Proposal (May 2000), WP-02-A-02 at 13-5, quoting from S. Rep. No. 272, 96th Cong. 1st Sess. 20 (1979). [emphasis added]
>
> "…Consumers of preference utilities will not suffer any adverse economic consequences as a result of this exchange…" (May 2000), WP-02-A-02 at 13-4, quoting from H. R. Rep. No. 976, Part II, 96th Cong., 2nd Sess. 35 (1980). [emphasis added]

Id. SUB then notes that the "legislative record" is clear that section 7(b)(2) protects preference customers for any rate charged for general requirements service. SUB Ex. Brief, SN-03-R-SP-01, at 15. This is consistent with BPA's citations to legislative history and BPA's conclusion that the 7(b)(2) rate test applies to the development of the PF rate, which is the only rate charged to preference customers for general requirements service. SUB, however, argues that *the SN CRAC* is "a rate charged to preference customers for general requirements service." *Id*. This is incorrect. The SN CRAC is the Safety-Net Cost Recovery *Adjustment Clause*. Section II.F.3 of BPA's 2002 GRSPs states that the SN CRAC is "an upward adjustment *to posted power rates* subject to the FB CRAC." (Emphasis added.) BPA's posted power rates are BPA's PF, NR, RL, IP, and NF rates. The SN CRAC is an *adjustment clause* applied to these rates. A rate can exist without an adjustment clause. An adjustment clause cannot exist without a rate. The rate for the general requirements of BPA's preference customers is the PF rate. The SN CRAC is not the PF rate.

SUB, citing the legislative history, also argues that the SN CRAC increases the cost of power to preference customers, which is an "adverse economic consequence", therefore BPA must conduct the 7(b)(2) rate test. SUB Ex. Brief, SN-03-R-SP-01, at 15. SUB has misread the legislative history. The legislative history cited by SUB provides that ". . . [c]onsumers of preference utilities will not suffer any adverse economic consequences *as a result of this exchange* . . . ." H.R. Rep. No. 96-976, Part II, 96th Cong., 2nd Sess. 34-35 (1980) (emphasis added). The term "exchange" refers to consequences from the "Residential Exchange Program" established in section 5(c) of the Northwest Power Act, not from any adverse economic consequences caused by an adjustment clause. *Id*.

Golden Northwest argues that section 7(a)(1) of the Northwest Power Act requires the Administrator to "establish, and periodically review and revise, rates for the sale and disposition of electric energy and capacity," which "shall be established in accordance with . . . the provisions of this chapter." Golden Northwest Brief, SN-03-B-GN-01, at 14. Golden Northwest argues the "provisions of this chapter" include, among other things, the 7(b)(2) rate test. *Id*. SUB, Canby, ICNU/ALCOA, Golden Northwest, and GPU argue that the section 7(b)(2) rate test is required by the Northwest Power Act, or the Act and its legislative history. SUB Brief, SN-03-B-SP-01, at 8-9; Canby Brief, SN-03-B-CA-01, at 7-9; ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 24-27; Golden Northwest Brief, SN-03-B-GN-01, at 14-15; GPU Brief, SN-03-B-SG-01, at 10. BPA agrees that BPA must conduct the section 7(b)(2) rate test when BPA develops its rate schedules. BPA's current rate schedules are the PF-02 rate, the RL-02 rate, the NR-02 rate, the IP-02 rate, and the NF-02 rate. These are BPA's base rates. The Northwest Power Act, however, does not require BPA to conduct the section 7(b)(2) rate test when BPA implements adjustment clauses that are components of BPA's rate schedules.

The parties' argument that BPA must conduct the section 7(b)(2) rate test when implementing the SN CRAC proves too much. Section 7(b)(2) is only one of many rate directives contained in section 7 of the Northwest Power Act. 16 U.S.C. § 839e. If BPA were required to conduct the section 7(b)(2) rate test when implementing the SN CRAC, then BPA would be required to conduct all of the other rate directives as well. The IOUs note that BPA cannot selectively impose certain rate directives and not impose others. IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 9-10. This would require BPA to perform all the work needed to develop new base rates, which would make adjustment clauses superfluous. Some of these rate directives follow.

Section 7(b)(1) of the Northwest Power Act prescribes the allocation of costs to the rates for requirements sales to BPA's preference customers and for Residential Exchange Program sales to investor-owned utilities. 16 U.S.C. § 839e(b)(1). Section 7(b)(1) of the Act provides:

> 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, and loads of electric utilities under section 839c(c) of this title. Such rate or rates shall recover the costs of that portion of the Federal base system resources needed to supply such loads until such sales exceed the Federal base system resources. Thereafter, such rate or rates shall recover the cost of additional electric power as needed to supply such loads, first from the electric power acquired by the Administrator under section 839c(c) of this title and then from other resources.

16 U.S.C. § 839e(b)(1).

Section 7(c) of the Northwest Power Act establishes rate directives for the establishment of rates for BPA's DSI customers:

> The rate or rates applicable to direct service industrial customers shall be established--
> …
>
> for the period beginning July 1, 1985, at a level which the Administrator determines to be equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial consumers in the region.
>
> The determination under paragraph (1)(B) of this subsection shall be based upon the Administrator's applicable wholesale rates to such public body and cooperative customers and the typical margins included by such public body and cooperative customers in their retail industrial rates but shall take into account--
>
> the comparative size and character of the loads served, the relative costs of electric capacity, energy, transmission, and related delivery

> facilities provided, and other service provisions, and direct and indirect overhead costs,
>
> all as related to the delivery of power to industrial customers, except that the Administrator's rates during such period shall in no event be less than the rates in effect for the contract year ending on June 30, 1985.
>
> The Administrator shall adjust such rates to take into account the value of power system reserves made available to the Administrator through his rights to interrupt or curtail service to such direct service industrial customers.

16 U.S.C. § 839e(c).

Section 7(f) of the Northwest Power Act establishes rate directives for BPA's requirements power sales to BPA's IOU customers and for other firm power sold in the Pacific Northwest:

> Rates for all other firm power sold by the Administrator for use in the Pacific Northwest shall be based upon the cost of the portions of Federal base system resources, purchases of power under section 839c(c) of this title, and additional resources which, in the determination of the Administrator, are applicable to such sales.

16 U.S.C. § 839e(f).

Section 7(g) of the Act prescribes the allocation of certain costs and benefits:

> Except to the extent that the allocation of costs and benefits is governed by provisions of law in effect on December 5, 1980, or by other provisions of this section, the Administrator shall equitably allocate to power rates, in accordance with generally accepted ratemaking principles and the provisions of this chapter, all costs and benefits not otherwise allocated under this section, including, but not limited to, conservation, fish and wildlife measures, uncontrollable events, reserves, the excess costs of experimental resources acquired under section 839d of this title, the cost of credits granted pursuant to section 839d of this title, operating services, and the sale of or inability to sell excess electric power.

16 U.S.C. § 839e(g).

While the parties argue BPA must conduct the section 7(b)(2) rate test in implementing the SN CRAC, section 7(b)(2) is no more or less a part of BPA's statutory rate directives than section 7(b)(1), or section 7(c), or section 7(f), etc. If BPA must conduct the section 7(b)(2) rate test in implementing the SN CRAC, then BPA must implement all of the other rate directives as well. But this makes no sense. The establishment of BPA's base rates is fundamentally different from the establishment or implementation of adjustment clauses. BPA develops its base rates in order to have rates to apply to BPA's power sales to all customers. These rates are developed using all of the rate directives of section 7 of the Northwest Power Act. In implementing the

SN CRAC, however, BPA is only adjusting the parameters of the FB CRAC, which regard cost recovery, not cost allocation or rate design. *See* 2002 GRSPs, Section II.F.3.

In the current proceeding, BPA is not developing base rates, but is implementing an adjustment clause. For example, one of the most fundamental rate directives is that BPA will allocate to preference customers' rates the Federal base system (FBS) resource costs needed to supply preference loads until such sales exceed the FBS resources. 16 U.S.C. § 839e(b)(1). Thereafter, the preference rate(s) recover the cost of additional electric power as needed to supply the preference loads, first from Residential Exchange Program power and then from other resources. *Id*. Yet the SN CRAC proceeding does not address this issue at all. Section 7(b)(1) was implemented in developing BPA's base rates. The same is true for section 7(b)(2).

SUB argues that BPA is not required to comply with section 7 of the Northwest Power Act "when establishing or implementing adjustment clauses which is [sic] not for the general requirements of preference customers." SUB Ex. Brief, SN-03-R-SP-01, at 15. This makes little sense. Section 7(b)(2) is simply one of numerous rate directives in section 7 of the Northwest Power Act. Section 7(b)(2) is not required to be implemented any more than any other rate directive. If BPA is not required to implement other rate directives in establishing or implementing adjustment clauses, then BPA is not required to implement section 7(b)(2). In any event, BPA already conducted the 7(b)(2) rate test when BPA developed its 2002 power rates.

Establishment of Adjustment Clauses. There can be little dispute that BPA has the authority to establish adjustment clauses to its base rates. Section 7(e) of the Northwest Power Act provides that "[n]othing in this Act prohibits the Administrator from establishing, in rate schedules of general application, a uniform rate or rates for sale of peaking capacity or from establishing time-of-day, seasonal rates, *or other rate forms*." 16 U.S.C. § 839e(e). The purpose of adjustment clauses is to provide a mechanism for adjusting rates without having to reestablish base rates. If BPA had to implement all the section 7 rate directives when establishing or implementing adjustment clauses, BPA would never establish adjustment clauses, but would only establish base rates. This is flatly inconsistent with BPA's ratemaking history and the SN CRAC. BPA has established and implemented adjustment clauses for its base rates for many years. For example, BPA's 1987 wholesale power rates had a CRAC. *See* 1987 Wholesale Power and Transmission Rate Schedules. Also, BPA's 1989 wholesale power rates had a CRAC. *See* 1989 Wholesale Power and Transmission Rate Schedules. Also, BPA's 1993 wholesale power rates had an Interim Rate Adjustment (IRA). *See* 1993 Wholesale Power and Transmission Rate Schedules. Implementation of these adjustment clauses did not require a section 7(b)(2) rate test. Parties have never established that BPA lacked authority to develop, or was precluded from developing, adjustment clauses. Indeed, parties have previously advocated adjustment clauses as a means to keep rates low because the adjustment clauses serve as a substitute for the inclusion of higher planned net revenues for risk in rates.

In BPA's response to the public agencies' motion to compel BPA to conduct the 7(b)(2) rate test, BPA stated that it has previously established numerous adjustment clauses and never required itself to conduct a section 7(i) hearing or a section 7(b)(2) rate test when implementing them. Certain parties attempt to distinguish BPA's past adjustment clauses from the SN CRAC. Canby argues that BPA's adjustment clause in 1987 was capped at 10 percent and did not require a

section 7(i) hearing, but here BPA committed to holding a section 7(i) hearing for implementing the SN CRAC. Canby Brief, SN-03-B-CA-01, at 10. As discussed in greater detail below, however, section 7(i) does not require BPA to conduct a section 7(b)(2) rate test. Section 7(i) is procedural, not substantive. Furthermore, also as discussed in greater detail below, the record shows that the section 7(i) hearing for the SN CRAC was not to conduct a section 7(b)(2) rate test or to allocate costs to customer classes, but rather to ensure that BPA recovered its costs.

Canby argues BPA's adjustment clause in 1989 was adopted after a rate case settlement with all parties. Canby Brief, SN-03-B-CA-01, at 10. However, it is unlikely that parties would have agreed to the settlement, which included a CRAC, if the parties believed implementation of the CRAC would be unlawful in the absence of a subsequent section 7(i) hearing or a section 7(b)(2) rate test.

Canby argues that in establishing BPA's adjustment clause in 1993, the Interim Rate Adjustment (IRA), BPA determined that the issue of including the IRA in the rate test was moot because the rate test did not trigger. Canby Brief, SN-03-B-CA-01, at 10. That issue, however, regards whether the section 7(b)(2) rate test must be conducted with an assumption of the implementation of the adjustment clause. The current issue is whether a section 7(i) hearing or the 7(b)(2) rate test must be held when implementing an adjustment clause. The IRA did not require either.

Canby and SUB argue the SN CRAC was open-ended and required a subsequent section 7(i) hearing, while the other adjustment clauses did not. *Id*.; SUB Brief, SN-03-B-SP-01, at 10. All adjustment clauses are open ended in the sense that one does not know the effect of the clause until it is implemented. Also, the SN CRAC is not completely open-ended, although BPA acknowledges that additional elements of the SN CRAC had to be determined in order to implement the SN CRAC. Section II.F.3 of the GRSPs provides that "[t]he SN CRAC will be an upward adjustment to posted power rates subject to the FB CRAC *by modifying the FB CRAC parameters*." (Emphasis added.) Further, "BPA will propose changes to the FB CRAC parameters that will, to the extent market and other risk factors allow, achieve a high probability that the remainder of Treasury payments during the FY 2002-2006 rate period will be made in full." *Id*. In any event, however, the record shows that the requirement of a section 7(i) hearing was to provide parties the procedural protections of a formal hearing and to ensure that BPA would recover its costs under the SN CRAC. Simply because there were details that needed to be determined prior to implementing the SN CRAC does not distinguish the SN CRAC from other adjustment clauses for purposes of conducting the 7(b)(2) rate test.

Section 7(i) Rate Hearings and Base Rates. Some parties have argued the Northwest Power Act requires that whenever BPA conducts a section 7(i) hearing, it must also conduct a section 7(b)(2) rate test. This fundamental premise is flawed. First, section 7(i) of the Northwest Power Act provides that "[i]n establishing rates under this section [7], the Administrator shall use the following procedures …" 16 U.S.C. § 839e(i). BPA established its 2002 wholesale power rates in a section 7(i) hearing after conducting the section 7(b)(2) rate test. BPA established the LB, FB, and SN CRACs in a section 7(i) hearing. Whenever BPA revises any aspect of a rate, BPA conducts a section 7(i) hearing, and BPA is doing so with the SN CRAC. There is no provision in section 7(i), however, which requires BPA to conduct a section 7(b)(2) rate test whenever

BPA conducts a section 7(i) hearing. *Id*. The IOUs also note that the Northwest Power Act does not require BPA to conduct the 7(b)(2) rate test in every section 7(i) hearing. IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 9. This conclusion is supported by BPA's past practice. *Id*.

In contrast to section 7(i) of the Northwest Power Act, which is procedural in nature, section 7(b)(2) of the Act is a rate test that is performed for the development of a new rate "for the combined general requirements of [BPA's] public body, cooperative, and Federal agency customers," that is, a new PF rate. 16 U.S.C. § 839e(b)(2). Therefore, BPA only conducts the section 7(b)(2) rate test when BPA is establishing a new PF rate. BPA only establishes new PF rates in general rate cases where BPA establishes its base rates. The SN CRAC proceeding does not establish a new PF rate. There is no provision in section 7(b)(2) that requires BPA to conduct the section 7(b)(2) rate test whenever BPA conducts a section 7(i) hearing. *Id*.

Canby argues the SN CRAC is not just an adjustment to existing rates, but instead is a new rate because it has a rebate provision, a mechanism for resetting the SN CRAC, and because TPP was used in developing the SN CRAC. Canby Ex. Brief, SN-03-R-CA-01, at 7. This argument is not persuasive. As noted previously, the SN CRAC is a "Safety-Net Cost Recovery *Adjustment Clause*". Section II.F.3 of BPA's 2002 GRSPs state that the SN CRAC is "an upward adjustment *to posted power rates* subject to the FB CRAC." (Emphasis added.) BPA's posted power rates are BPA's PF, NR, RL, IP and NF rates. The SN CRAC is an adjustment clause applied to these rates. A rate can exist without an adjustment clause. An adjustment clause cannot exist without a rate.

ICNU/ALCOA argue that the 7(b)(2) test is not limited to BPA's "base" rates, but reviews the total rates or power costs charged to BPA's public customers. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 25; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 4. Specifically, they argue the language of the Northwest Power Act requires BPA to determine whether the "the projected amounts to be charged for *firm power for the combined general requirements*" of preference customers exceed "*the power costs*" they would pay if BPA was not required to provide power to certain non-preference customers. 16 U.S.C. § 839e(b)(2) (emphasis added). *Id*. ICNU/ALCOA argue this language requires BPA to perform a 7(b)(2) rate test for the total power costs of preference customers and prevents BPA from arbitrarily separating its power costs into base rates and CRACs in order to avoid a 7(b)(2) rate test. *Id*. GPU and SUB also argue that section 7(b)(2) does not distinguish between adjustments to base rates versus surcharges, but applies to all rate adjustments. GPU Brief, SN-03-B-GP-01, at 11; GPU Ex. Brief, SN-03-R-GP-01, at 13; SUB Ex. Brief, SN-03-R-SP-01, at 16. These arguments are not persuasive because they ignore other language of section 7(b) of the Act and the legislative history of the Act, as noted above. In addition, this argument ignores BPA's Section 7(b)(2) Implementation Methodology. While section 7(b)(2) refers to the "projected amounts to be charged" for firm power general requirements sales to BPA's preference customers, and "the power costs" for general requirements of such customers incorporating the five assumptions in section 7(b)(2), these terms are synonymous with rates. The Section 7(b)(2) Implementation Methodology prescribes, and BPA has always implemented these directives as referring to, two sets of rates: Program Case rates and 7(b)(2) Case rates:

> The implementation of section 7(b)(2) in any given BPA rate proceeding requires two distinct steps. The first step is to compare a projection of BPA *rates developed under all the provisions of the Northwest Power Act*, but without considering the effects of section 7(b)(2) (the program case), with a projection of BPA *rates* developed under the assumptions outlined in section 7(b)(2) (the 7(b)(2) case). *Both projections are of rates applicable to public body, cooperative, and Federal agency customers (7(b)(2) customers) and are based on the costs of power required to serve the general requirements of those customers over a five-year period.*
>
> If the projected *rates* in the program case are determined to be higher than those in the 7(b)(2) case, then the second step is required. The *rates* for the 7(b)(2) customers being developed in the BPA rate proceedings must be reduced and the difference allocated to other BPA *rates* pursuant to section 7(b)(3) of the Northwest Power Act. This potential reallocation must be made within the framework of sound ratemaking principles and of BPA's statutory obligations.

Section 7(b)(2) Implementation Methodology, Administrator's ROD, Appendix C, at 37 (emphasis added). Furthermore, section II.5 of the Implementation Methodology defines the 7(b)(2) case as "[t]he entire process of projecting *rates* for the relevant five-year period under the provisions of section 7(b)(2) of the Northwest Power Act, including specific data, assumptions, and results." (Emphasis added.) Similarly, section II.6 of the Implementation Methodology defines the program case as "[t]he entire process of projecting *rates* to be charged in the future under the provisions of the Northwest Power Act other than section 7(b)(2), including specific data, assumptions and results." (Emphasis added.) The section 7(b)(2) rate test must be conducted in the development of base rates. The statute and methodology, however, do not mention adjustment clauses. ICNU/ALCOA argue that because the Northwest Power Act does not refer to base rates or adjustment clauses, Congress intended the 7(b)(2) rate test to apply to total power costs and not base rates. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 4. This does not follow. The Northwest Power Act also does not refer to "rate design", but there is no dispute the Administrator has the authority to design rates. Furthermore, the legislative history of section 7(b) establishes that the 7(b)(2) rate test is for establishing the rate for general requirements service for BPA's preference customers. This is the PF rate, not an adjustment clause. As noted above, section 7(b)(2) is one of many rate directives that BPA must implement when establishing rates. Yet BPA does not implement these rate directives when implementing adjustment clauses. This would require the development of new base rates and render adjustment clauses superfluous. IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 7-10.

Furthermore, even assuming for the sake of argument that there were an ambiguity in section 7(b)(2), BPA's interpretation of the Northwest Power Act is entitled to substantial deference. *Aluminum Company of America v. Central Lincoln Peoples' Utility District*, 467 U.S. 380, 389-90 (1984). In addition, BPA has a longstanding and consistent legal interpretation, which is supported by extensive administrative precedent. Furthermore, ratemaking is rulemaking, and it has long been recognized that an agency's interpretation of its own rule is entitled to deference. *E.g., Sierra Pacific Power Co. v. U.S. Environmental Protection Agency*, 647 F.2d 60, 65 (9th Cir. 1981), citing *Udall v. Tallman*, 380 U.S. 1, 16 (1965). BPA's

interpretation of its GRSPs, which concludes that BPA is not required to implement the section 7(b)(2) rate test when implementing the SN CRAC, as discussed in greater detail below, is eminently reasonable.

SUB argues that BPA's statement that the rate test applies only to base rates and not to adjustment clauses is not supported by the Section 7(b)(2) Legal Interpretation or the section 7(b)(2) Implementation Methodology. SUB Brief, SN-03-B-SP-01, at 10. GPU argues these documents require BPA to conduct the rate test in the SN-03 proceeding. GPU Brief, SN-03-B-SG-01, at 10. SUB claims these documents identify "rate adjustments" and define the "relevant rate case" as:

> The wholesale power rate adjustment proceeding being conducted at the time the projections for section 7(b)(2) are made, and in which any adjustment to rates in accordance with section 7(b)(2) may be reflected.

SUB Brief, SN-03-B-SP-01, at 10; SUB Ex. Brief, SN-03-R-SP-01, at 16. This argument lacks merit. Indeed, the Legal Interpretation and Implementation Methodology do not state that BPA must conduct the rate test in implementing adjustment clauses. Furthermore, despite the length of these two documents, SUB has provided no language supporting its argument. SUB's citation of the definition of "relevant rate case" rebuts SUB's argument rather than supports it. This definition refers to "the wholesale power rate adjustment proceeding being conducted at the time the projections for section 7(b)(2) are made." As BPA has established, the 7(b)(2) rate test is conducted for the purpose of establishing BPA's PF rate. Since the inception of the 7(b)(2) rate test in 1985, BPA has only conducted the rate test in BPA's general rate adjustment proceedings where BPA establishes its base rates, including the PF rate. No projections for section 7(b)(2) have been made for the SN CRAC proceeding, and BPA has never made projections for section 7(b)(2) for an adjustment clause. Instead, this phrase refers to the rate proceeding in which BPA conducts the rate test, which, as reflected in BPA's consistent practice, is BPA's general rate proceeding in which BPA establishes its base rates.

The definition of "relevant rate case" also refers to the proceeding "in which any adjustment to rates in accordance with section 7(b)(2) may be reflected." BPA has only conducted the section 7(b)(2) rate test in general section 7(i) hearings where BPA established all of its wholesale power rates, *i.e.*, base rates. BPA has never conducted the rate test in section 7(i) hearings where BPA did not establish all of its base rates. This is because the rate test, if it triggers, produces costs that are "not charged to public body, cooperative, and Federal agency customers," but which "shall be recovered through supplemental rate charges for all other power sold by the Administrator to all customers." 16 U.S.C. § 839e(b)(3). BPA's general rate cases are where BPA establishes its rates "for all other power sold by the Administrator." In order to comply with section 7(b)(3), BPA can only conduct the 7(b)(2) test in a general rate case where BPA establishes its base rates in order that BPA can allocate the trigger costs to all other power sold by the Administrator through the rates that apply to such sales. Where BPA is establishing a single rate or implementing an adjustment clause in a section 7(i) hearing, BPA is not establishing rates for all of its power sales and BPA may not be able to allocate trigger costs to all of BPA's rates.

Canby cites BPA's Legal Interpretation and argues that BPA's position would render section 7(b)(2) a discretionary request that BPA could follow if BPA classified the rate as a base rate. Canby Brief, SN-03-B-CA-01, at 7-9. In response, however, BPA has not ignored the rate directives. As noted previously, BPA conducted the section 7(b)(2) rate test in developing BPA's 2002 wholesale power rates. Furthermore, Canby's concerns about ignoring ratemaking directives in potential BPA ratemaking actions are speculative. Canby will have a full opportunity to contest BPA's future ratemaking actions in the appropriate forum.

Canby cites BPA's Implementation Methodology and argues that BPA is required to conduct a section 7(b)(2) rate test to reflect changes in loads to reflect elasticity of demand and to adjust DSI loads if the DSIs no longer exist or are no longer served by BPA, and these conditions are cited in SUB's direct testimony. Canby Brief, SN-03-B-CA-01, at 14. Canby argues "[t]he Implementation ROD analyzed, among other things, when BPA was obligated to conduct a new 7(b)(2) rate test and perform a new 7(b)(2) study. Among the factors: changes in BPA loads to reflect elasticity of demand. Implementation ROD at 22-23." *Id.* Canby has mischaracterized the elasticity of demand issue in the Implementation ROD. The issue is not whether a new 7(b)(2) rate test must be conducted if there are changes in loads, but rather whether, in the course of conducting any 7(b)(2) rate test, a new load forecast should be performed for the 7(b)(2) case if the rates in the 7(b)(2) Case and Program Case are significantly different. The Implementation Methodology refers to *how* a 7(b)(2) rate test will be conducted, not *when* it should be conducted. Also, in the case of Canby's DSI load argument, the section of the Implementation ROD cited by Canby, at 41, does not support conducting a new 7(b)(2) rate test when DSI loads change, but rather describes how DSI loads will be treated in any 7(b)(2) rate test.

Canby argues that SUB properly relied on the Implementation ROD in developing its direct testimony. Canby Brief, SN-03-B-CA-01, at 14. Canby argues that until BPA changes the Implementation Methodology, BPA should not carve out exceptions to BPA's long-held practices. *Id*. These arguments are misplaced. When BPA conducted the section 7(b)(2) rate test, BPA reflected all the changes noted in BPA's Implementation Methodology in BPA's proposal. It would be appropriate for the public agencies to raise their concerns in a section 7(i) hearing when BPA is establishing the PF rate. 16 U.S.C. § 839e(b)(2). BPA is not doing so in the SN-03 rate proceeding. As noted previously, BPA has not "carved out exceptions to BPA's long-held practices," but rather acted in a manner consistent with such practices. No changes to the Implementation Methodology are necessary.

BPA's 2002 GRSPs. The section 7(b)(2) rate test was performed in BPA's May 2000 rate proceeding, which addressed all issues regarding the rate test. 2002 Final Power Rate Proposal, Administrator's ROD, WP-02-A-02, at 13-1 to 13-63. That rate proceeding determined the level of BPA's current posted base rates. Keep, *et al.*, SN-03-E-BPA-11, at 74. These base rates remain in effect for the entire rate period, FY 2002-2006, and do not change with the implementation of the SN CRAC. *Id*. Therefore, the section 7(b)(2) rate test is not applicable to the current SN-03 rate proceeding. *Id*. BPA's GRSPs, including the SN CRAC, were established in BPA's supplemental WP-02 rate proceeding.

SUB argues that all issues regarding the 7(b)(2) test were not decided in BPA's WP-02 rate proceeding. SUB Brief, SN-03-B-SP-01, at 7-8. First, SUB argues the GRSPs are silent on the

issue of the 7(b)(2) test when conducting a 7(b)(2) test for the SN CRAC. In response, however, the fact that the GRSPs do not *expressly* mention the 7(b)(2) rate test does not mean the GRSPs provide no insight with regard to the rate test. First, the absence of an explicit prohibition of an action does not mean a particular action is appropriate, and is not a sufficient reason to take that action. Keep, *et al*., SN-03-E-BPA-11, at 75. For example, the GRSPs also do not expressly prohibit BPA from developing new base rates when implementing the SN CRAC, but doing so would be absurd because the purpose of the SN CRAC is to avoid establishing new base rates. *Id*. Furthermore, while the GRSPs do not explicitly preclude BPA from conducting the section 7(b)(2) rate test during the SN CRAC section 7(i) proceeding, the GRSPs implicitly include such a prohibition. *Id*. It was BPA's intent that BPA would not conduct the section 7(b)(2) rate test in the SN CRAC process. *Id*. This intent is confirmed by specific language that indicates conducting the rate test is inappropriate when implementing the SN CRAC. *Id*.

Section II.F.3 of the GRSPs, regarding the SN CRAC, provides that "[t]he SN CRAC will be an upward adjustment to posted power rates subject to the FB CRAC *by modifying the FB CRAC parameters*. BPA will propose changes to the FB CRAC parameters that will, to the extent market and other risk factors allow, achieve a high probability that the remainder of Treasury payments during the FY 2002-2006 rate period will be made in full." (Emphasis added.) The GRSPs therefore limit the SN CRAC to adjustments to the FB CRAC parameters. The FB CRAC parameters regard only BPA's cost recovery, not the allocation of costs or rate design. The section 7(b)(2) rate test, in contrast, does not adjust the FB CRAC parameters. The rate test regards the allocation of certain costs among customers, not the recovery of BPA's total costs or establishment of a high probability of making Treasury payments. The GRSPs therefore do not contemplate conducting the section 7(b)(2) rate test in the SN-03 rate hearing.

BPA's GRSPs also specify that a 40-day SN CRAC section 7(i) proceeding will be used to make changes to the FB CRAC parameters. *See* 2002 GRSPs, WP-02-A-09, Appendix at 26. Such an expedited hearing is inconsistent with conducting the 7(b)(2) rate test. In order to understand this, one must understand the section 7(b)(2) rate test. In order to conduct a new section 7(b)(2) rate test, BPA would have to rebuild the computer models used in 1999 and 2000 to reflect new Subscription power sales contracts and any policy changes over the last 4 years. BPA Response to Motion to Compel, SN-03-M-22. Because the section 7(b)(2) rate test basically compares two sets of power rates that differ only by the assumptions listed in section 7(b)(2) of the Northwest Power Act, BPA would need to obtain or generate all of the data required to develop such rates. *Id*. The rebuilt computer model then would have to be supplied with the new data from newly developed BPA rate studies. *Id*. BPA would need to develop a new Loads and Resources Study and supporting Documentation, replacing the WP-02 Loads and Resources Study, WP-02-FS-BPA-01, and Documentation, WP-02-FS-BPA-01A. *Id*. BPA also would need to develop a new Revenue Requirements Study and supporting Documentation, replacing the WP-02 Revenue Requirements Study, WP-02-FS-BPA-02, and Documentation, WP-02-FS-BPA-02A. *Id*. BPA also would need to develop a new Risk Analysis Study, replacing the WP-02 Risk Analysis Study, WP-02-FS-BPA-03. *Id*. BPA also would need to develop a new Marginal Cost Analysis Study and supporting Documentation, replacing the WP-02 Marginal Cost Analysis Study, WP-02-FS-BPA-04, and Documentation, WP-02-FS-BPA-04A. *Id*. BPA also would need to develop a new Wholesale Power Rate

Development Study and supporting Documentation, replacing the WP-02 Wholesale Power Rate Development Study, WP-02-FS-BPA-05, and Documentation, WP-02-FS-BPA-05A and 05B. *Id*. BPA then would need to develop a new Section 7(b)(2) Rate Test Study and supporting Documentation, replacing the WP-02 Section 7(b)(2) Rate Test Study, WP-02-FS-BPA-06, and supporting Documentation, WP-02-FS-BPA-06A. *Id*. As part of the process of developing new computer models and supporting studies for a new Section 7(b)(2) Study and Documentation, BPA would need to conduct customer and constituent workshops to present the modeling and data changes and receive comments and suggestions. *Id*. The extent of the foregoing work precludes the review of the 7(b)(2) rate test in a 40-day expedited hearing.

As noted in BPA's testimony, the section 7(b)(2) rate test is the result of a complex analysis that essentially forecasts BPA's power rates under two very different worlds. Keep, *et al*., SN-03-E-BPA-11, at 75. The rate test involves the projection and comparison of two sets of wholesale power rates for the general requirements loads of BPA's public body, cooperative, and Federal agency customers (7(b)(2) Customers). *Id*. The two sets of rates are: (1) a set for the test period and the ensuing 4 years assuming that section 7(b)(2) is not in effect (Program Case rates); and (2) a set for the same period taking into account the five assumptions listed in section 7(b)(2) (7(b)(2) Case rates). *See* Section 7(b)(2) Rate Test Study, WP-02-FS-BPA-06, at 1. *Id*. In BPA's general rate cases, it requires months to conduct the section 7(b)(2) rate test. *Id*. Even assuming, *arguendo*, that BPA could have prepared a section 7(b)(2) rate test before the SN CRAC initial proposal, the time needed *by parties* to adequately review and respond to such a proposal, in BPA's experience, would not be available in an expedited section 7(i) hearing. *Id*. The Administrator would not have specified a 40-day SN CRAC section 7(i) proceeding if that proceeding were to include performing a new section 7(b)(2) rate test. *Id*.

While the parties describe the section 7(b)(2) rate test in very general terms, they fail to mention that, in order to conduct the rate test, BPA must prepare all the information needed to develop completely new base rates. In other words, to conduct the test, BPA would have to prepare a complete new general rate case filing as opposed to the much more limited information needed to implement an adjustment clause such as the SN CRAC. Because this is so, if BPA had to conduct the section 7(b)(2) rate test in order to implement the SN CRAC, BPA would not need to establish an SN CRAC and BPA would simply develop completely new rates. Thus, with regard to SUB's argument that all 7(b)(2) issues were not decided in the WP-02 proceeding, the GRSPs, as discussed above, are not silent on the issue.

SUB also argues all 7(b)(2) issues were not decided in the WP-02 proceeding because it is not unusual for 7(b)(2) issues to vary from rate case to rate case, and that each 7(i) process is unique. SUB Brief, SN-03-B-SP-01, at 7. This argument makes little sense. By definition, any 7(b)(2) rate test conducted at a later time than another rate test would be different from the prior rate test. This is not the issue. The issue is whether the section 7(b)(2) rate test should be conducted when BPA implements adjustment clauses.

SUB also notes the Hearing Officer did not grant BPA's motion to strike SUB's 7(b)(2) testimony. *Id*. at 7-8. SUB argues the denial of BPA's motion was based, in part, on the finding that the 7(b)(2) test as it relates to the SN CRAC was not addressed in the WP-02 rate proceeding. *Id*. at 8. This argument is not persuasive. First, the Hearing Officer's order stated

that it made no conclusion regarding whether or not BPA is required to conduct the section 7(b)(2) rate test when implementing the SN CRAC. Order, SN-03-O-12. Also, the Hearing Officer's order was based on statements in the public agencies' pleading that were inconsistent with actual events. For example, the public agencies told the Hearing Officer that BPA had never held a section 7(i) hearing without conducting the section 7(b)(2) rate test. *See* Order SN-03-O-12; BPA Response to Motion to Compel, SN-03-M-22. This statement is incorrect, because BPA has held at least seven section 7(i) hearings without conducting the 7(b)(2) rate test. *See* BPA Response to Motion to Compel, SN-03-M-22. This fact is not disputed. Canby and SUB note that their statement was based on a previous BPA statement, which noted that BPA had conducted the 7(b)(2) rate test in every rate case since 1985, except in cases where the rate case was settled and the test was not performed. Canby Ex. Brief, SN-03-R-CA-01, at 10-11; SUB Ex. Brief, SN-03-R-SP-01, at 12-13. BPA acknowledges that its statement was imprecise, and should have noted that BPA has conducted the rate test in every rate case *where BPA has developed its base rates*. BPA's statement, however, was not made in the context of adjustment clauses, but rather general rate development. *See* 2002 ROD, at 13-60. The public agencies, of course, could have independently reviewed BPA's past rate cases to identify those BPA rate hearings without a section 7(b)(2) rate test. They did not do so. In any event, whether BPA or the public agencies failed to note that BPA's past section 7(i) hearings have not required BPA to conduct a 7(b)(2) rate test is not the point. The point is that the Hearing Officer relied on a statement that BPA had not conducted section 7(i) hearings without conducting the 7(b)(2) rate test, and this statement was incorrect.

SUB argues that because BPA established that the PPC should not be permitted to change its position regarding the inapplicability of the 7(b)(2) rate test to BPA's CRACs, including the SN CRAC, BPA should be judicially estopped from pointing out that BPA has previously held at least seven section 7(i) hearings where BPA did not conduct the 7(b)(2) rate test. SUB Ex. Brief, SN-03-R-SP-01, at 12-13. This argument is not persuasive. The PPC changed its position on a substantive ratemaking *issue*. This is completely different from correcting a *factual error*. SUB is basically arguing that BPA should rely on a known misstatement of fact. BPA will not do so.

Similarly, the public agencies failed to advise the Hearing Officer that the issue of the conduct of the 7(b)(2) rate test with regard to the SN CRAC was addressed in the WP-02 record. This is established at length in the Joint Customers' brief in BPA's supplemental WP-02 rate proceeding, as discussed below. The Joint Customers' arguments established that the 7(b)(2) rate test did not apply to the establishment or implementation of the SN CRAC. Just as the Hearing Officer had no knowledge that BPA had previously held section 7(i) hearings without conducting the section 7(b)(2) rate test, there is no evidence the Hearing Officer had knowledge of the record that addressed the 7(b)(2) rate test in the WP-02 proceeding. Canby argues that BPA's recognition that the Hearing Officer had no evidence before him showing that the issue of the 7(b)(2) rate test had previously been addressed in the WP-02 record is an attempt to revisit the Hearing Officer's ruling that permitted SUB to file testimony regarding the 7(b)(2) rate test. Canby Ex. Brief, SN-03-R-CA-01, at 11-12. This is incorrect. The Administrator could revisit the Hearing Officer's ruling regarding the disputed testimony and reverse such ruling given the incorrect and omitted information upon which the ruling was based. The Administrator is not doing so. Instead, BPA is responding to the argument that the denial of BPA's motion to strike

was based on a "legitimate" finding that the 7(b)(2) test as it relates to the SN CRAC was not addressed in the WP-02 rate proceeding. This statement, given the record, is simply wrong.

SUB cites BPA's statement that "[t]he public agencies failed to advise the Hearing Officer that the issue of the conduct of the 7(b)(2) rate test with regard to the SN CRAC was addressed in the WP-02 record", and argues that BPA's Supplemental ROD did not specifically decide this issue. SUB Ex. Brief, SN-03-R-SP-01, at 13. To the contrary, BPA's Supplemental ROD concluded that BPA was not required to conduct the 7(b)(2) rate test when BPA established the SN CRAC. *See* 2002 Supplemental ROD, WP-02-A-09, 6-1 to 6-15. The record also described why the rate test was inapplicable. *See* JCG Brief, WP-02-B-JCG-01. The Hearing Officer should have been advised of these facts.

SUB also argues that its failure to respond to the Joint Customers' statements as to why the 7(b)(2) rate test did not apply to the SN CRAC does not imply concurrence or acquiescence on the issue. SUB Ex. Brief, SN-03-R-SP-01, at 13. BPA has not argued that it does. BPA simply notes that a party should provide the Hearing Officer with material that is directly relevant and important to the issue before him, which did not occur in this case.

Finally, SUB argues that the Hearing Officer reviewed limited materials in drafting his order, so the Hearing Officer must have reviewed sufficient materials to legitimately reach his conclusion. SUB Ex. Brief, SN-03-R-SP-01, at 13. This, however, is obviously not the case. As noted above, BPA's Supplemental ROD concluded that BPA was not required to conduct the 7(b)(2) rate test when BPA established the SN CRAC. *See* 2002 Supplemental ROD, WP-02-A-09, at 6-1 to 6-15. The record also described why the rate test was inapplicable. *See* JCG Brief, WP-02-B-JCG-01. These materials were not mentioned by the Hearing Officer, were not provided to the Hearing Officer, and there is no indication the Hearing Officer reviewed them in making his determination. In any event, the Hearing Officer's order simply allowed testimony into the record. It expressly did not decide whether BPA was required to conduct the 7(b)(2) rate test for the SN CRAC.

SUB notes BPA's statement that it is inappropriate for SUB to suggest only modifying a portion of the model used to conduct the 7(b)(2) test and that SUB implicitly acknowledges there is insufficient time to conduct a 7(b)(2) test. SUB Brief, SN-03-B-SP-01, at 13. SUB argues that it suggested adjusting the model used in the WP-02 proceeding because treatment of the issues identified by SUB, which were decided in the WP-02 rate case, was already part of the WP-02 modeling logic. *Id*. This response, however, does not address the fact that costs and loads, among other data, change virtually every day. Keep, *et al*., SN-03-E-BPA-11, at 76. It is impractical to conduct a section 7(b)(2) rate test whenever such changes occur, for BPA would constantly be conducting the rate test. *Id*. Furthermore, there are hundreds of inputs to the section 7(b)(2) rate test, all of which must be based on the best information available and all of which may affect the results of the rate test. *Id*. at 77-78. It would be inappropriate to allow specific customers to pick and choose which parameters of the test to update and which to ignore. *Id.*

SUB notes BPA's argument that, due to the need to develop virtually all the information needed to establish new base rates in order to conduct a section 7(b)(2) rate test, it would not make sense to require BPA to conduct the rate test in the expedited SN CRAC proceeding because BPA

could simply establish new base rates. SUB Brief, SN-03-B-SP-01, at 12-13. SUB disagrees for five reasons. First, SUB argues that BPA had ample time to conduct the studies and modeling needed to conduct the rate test. *Id*. This argument does not answer the question. Claiming BPA had time to conduct the rate test, which has been rebutted previously, does not explain why BPA would implement an adjustment clause when BPA had prepared all the work needed to establish new base rates.

Second, SUB argues BPA could ask the Hearing Officer to hold an additional hearing specifically for the 7(b)(2) test. *Id*. This argument also does not answer the question. Suggesting BPA should hold an additional hearing does not explain why BPA would establish an adjustment clause when, if required to conduct the 7(b)(2) rate test, BPA would have prepared all the work needed to establish new base rates, rendering the adjustment clause superfluous.

Third, SUB argues BPA has settled cases in the past whereby the parties agreed not to run the 7(b)(2) test and it could do so in an SN CRAC proceeding as well. *Id*. This argument lacks merit because BPA cannot force parties to agree not to run the 7(b)(2) rate test, which is inappropriate to run in the SN-03 proceeding in any event.

Fourth, SUB argues BPA could have structured an SN CRAC to recover a specific amount of money to replenish reserves without basing the SN CRAC on a complicated multi-year process burdened by multiple requirements (such as a zero net revenue requirement). *Id*. It is unclear from SUB's argument how the design of the SN CRAC would affect whether BPA should conduct the 7(b)(2) rate test. It is the proposal to conduct the rate test that creates the information needed to develop new base rates, not the design of the SN CRAC.

Finally, SUB argues that the CRAC mechanisms are not functioning as intended, and the SN CRAC is being driven by multiple issues - including significant increases in program costs, and augmentation costs which were intended to be recovered through the LB CRAC are spilling over into the FB and SN CRACs. SUB Brief, SN-03-B-SP-01, at 13. It is unclear how this argument relates to the fact that conducting the 7(b)(2) rate test would create the information needed to develop new base rates and render the SN CRAC superfluous. In any event, the LB CRAC was never designed to fully address the problem of augmentation exceeding the May Proposal forecast. Wedlund, *et al.*, SN-03-E-BPA-15, at 4-5. Rather, the LB CRAC was designed to fully recover that portion of augmentation costs needed to meet loads. *Id*. The LB CRAC design allows all augmentation costs to be recovered using the LB CRAC so long as BPA's augmentation need exceeds the amount of augmentation power placed under contract before a given month. *Id*. When the amount of augmentation power under contract prior to a given delivery month exceeds the amount of augmentation need for that month, then some of the costs of that augmentation are not recoverable from the LB CRAC. *Id*. The possibility of including some augmentation costs in the FB and SN CRACs is not new information and should not come as a surprise. *Id*., citing 2002 GRSPs, Section II.F.2 at 111 (" . . . actual and forecasted revenues and expenses that are associated with the production, acquisition, marketing, and conservation of electric power, will be included in determinations under the FB CRAC").

Canby, ICNU/ALCOA, Golden Northwest, and GPU argue BPA should have prepared the section 7(b)(2) rate test prior to the SN CRAC proceeding in order to incorporate the test into the proceeding. Canby Brief, SN-03-B-CA-01, at 13; Canby Ex. Brief, SN-03-R-CA-01, at 8;

ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 26-27; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 5; Golden Northwest Brief, SN-03-B-GN-01, at 15; GPU Brief, SN-03-B-SG-01, at 12; SUB Ex. Brief, SN-03-R-SP-01, at 17-18. This argument, however, makes the dubious assumption that BPA would spend 6 to 10 months preparing a single study for an expedited hearing where *all* issues and procedural requirements are completed in 40 days. As noted above, the time needed *by parties* to adequately review and respond to such a proposal would not be available in a 40-day expedited section 7(i) hearing. Keep, *et al*., SN-03-E-BPA-11, at 75. More significantly, the parties fail to address the central fallacy of their argument, namely, if BPA were to prepare all of the work necessary to conduct the section 7(b)(2) rate test, which is the information needed to develop base rates, the SN CRAC would be superfluous. The purpose of an adjustment clause is to allow a utility to recover costs without the need to conduct an entirely new base rate proceeding.

Second, Canby and ICNU/ALCOA argue the GRSPs allow BPA and other parties to extend the schedule for the SN CRAC proceeding, citing the GRSP's statement that "[t]he hearing shall be completed within 40 days, unless a different duration is agreed to by the parties." Canby Brief, SN-03-B-CA-01, at 20; ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 27. This argument is not persuasive. If BPA believed it was required to conduct the section 7(b)(2) rate test in implementing the SN CRAC, BPA would not have established a 40-day expedited hearing, but rather a much longer hearing. It would make no sense to establish a 40-day hearing that *always* would have to be extended longer than 40 days whenever such a hearing was held. This would render the 40-day requirement meaningless.

SUB argues BPA held two public meetings on liquidity tools, instead of spending time on the rate test. SUB Brief, SN-03-B-SP-01, at 11; SUB Ex. Brief, SN-03-R-SP-01, at 17. This argument is not convincing. First, as previously established, the 7(b)(2) rate test could not have been developed and conducted in two days. Furthermore, for the reasons stated in this section, BPA is not required to conduct the rate test when implementing the SN CRAC.

Canby notes BPA's statement that the GRSPs do not contemplate that BPA will conduct the rate test when implementing adjustment clauses. Canby Brief, SN-03-B-CA-01, at 15. Canby argues that the GRSPs do not control because BPA cannot adopt a provision in the GRSPs or interpret such GRSPs in a manner that contradicts a statute. *Id*. Canby argues that if there is a conflict, the statute prevails. *Id*. There is no conflict in the instant case, however, because section 7(b)(2) of the Northwest Power Act does not require BPA to conduct the rate test when BPA implements adjustment clauses. BPA's consistent interpretation of the Act is that the rate test is only conducted when BPA establishes its base rates, including the PF rate.

Administrative Record of GRSPs. In determining the intent of the GRSPs, it is helpful to review the administrative record of the establishment of the SN CRAC. Such review establishes there was no intent to conduct the 7(b)(2) rate test in implementing the SN CRAC or the other CRACs. In BPA's 2002 supplemental rate case, BPA developed the LB, FB, and SN CRACs. During the proceeding, a diverse group of parties, comprising nearly all of BPA's customers and four regional utility commissions, filed joint testimony and briefs as the "Joint Customers". (This is not the same group of parties comprising the "Joint Customers" in the SN-03 rate proceeding). As discussed in greater detail below, some of these parties now argue contrary

positions from those reflected in their brief. In its brief, this diverse group described BPA's WP-02 rate development process:

> This WP-02 rate proceeding was initiated by BPA on August 13, 1999, Federal Register notice, 64 Fed. Reg. 44318 (1999), in which BPA proposed new wholesale power rates to take effect October 1, 2001. Throughout late 1999 and early 2000, BPA conducted a hearing process in accordance with section 7(i) of the Northwest Power Act. During the course of this hearing process, all aspects of the BPA rate proposal were subjected to detailed analysis by rate case parties, including the proposed base rates and risk mitigation tools.
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> * * *
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> The Federal Register Notice, 65 Fed. Reg. 75272 (2000), initiating the second phase of the WP-02 rate proceeding, which set out BPA's proposed revisions to the risk mitigation tools contained in the May 2000 ROD adopting the base rates, stated:
>
> > BPA proposal to amend the risk mitigation tools, rather than revise the base rates, does not require that BPA reexamine in this proceeding every issue that was debated and decided in the earlier phase of this proceeding. . . .

JCG Brief, WP-02-B-JCG-01, at 3-5. The Joint Customers noted that "[t]he JCG proposal [which was incorporated into BPA's supplemental proposal], including the LB, FB, *and SN* CRACs and the revised DDC, is an integrated package of risk mitigation tools that should be adopted in its entirety. The integrated package directly addresses the financial risks faced by BPA in the rate period . . ." JCG Brief, WP-02-B-JCG-01, at 2 (emphasis added). The JCG expressly stated that CRACs did not require BPA to conduct the section 7(b)(2) rate test a second time:

> The JCG proposal [which was incorporated into BPA's supplemental proposal] only modifies the operation of the contingent rate adjustment mechanisms, and does not revise the base rates adopted in the May ROD. *These modifications do not require the recalculation of the section 7(b)(2) rate test . . . .*

Id. at 2 (emphasis added). The Joint Customers reiterated and expounded upon the reason the section 7(b)(2) rate test need not be conducted in establishing the CRACs, including the SN CRAC:

> CRACs are contingent cost recovery clauses that only go into effect to collect additional revenues if certain circumstances develop. BPA has not suggested in any testimony submitted in this proceeding that the base rates adopted in the May ROD be subject to revision. In the first phase of this proceeding, BPA subjected these base rates to all of the statutory tests it deemed necessary to satisfy the requirements of Section 7 of the Regional Act, including the various rate tests

> contained *in sections 7(b)* and (c) of the Regional Act *[which include the section 7(b)(2) rate test]*. *And since it is only the contingent cost recovery clauses contained in the GRSPs, and not the base rates contained in the rate schedules, that are being modified in the second phase of this proceeding, there is no legal requirement that these rate tests be performed a second time.*

Id. at 5 (emphasis added). The Joint Customers stated their position yet again:

> Some rate case parties have argued that even though BPA has proposed no changes to the base rates contained in the May 2000 ROD, and has focused on what revisions should be made to these contingent rate adjustment provisions, BPA should nevertheless perform for a second time both the section 7(b)(2) rate test and the section 7(c) floor rate calculations. WP-02-DS-06 at 2-7. This argument is in error.
>
> BPA has from time to time in past rate case included contingent rate adjustment clauses in its rates to cover financial contingencies that could be adequately dealt with in BPA's base rates. The inclusion of these contingent rate adjustment clauses in the GRSPs has never required a second performance of the section 7(b)(2) rate test . . . .
>
> By their very nature, contingent rate adjustment clauses deal with financial events whose timing, magnitude, and consequences are difficult or impossible to accurately forecast. For example, in the first year of the rate period augmentation, cost estimates range from $1.0 to $6.5 billion. WP-02-E-JCG-03 at 19. That is why they are dealt with in contingent clauses and not in base rates. *And for the same reason, attempting to perform the section 7(b)(2) rate test and the section 7(c) floor rate calculation based on the possible operation of these contingencies rate adjustment clauses would be, at best, an exercise in speculation, or at worst an excursion into completely subjective matters.*
>
> The purpose of this second phase of the WP-02 proceeding is to provide BPA with the contingent rate mechanism that it needs to ensure recovery of the revenues needed to fulfill its obligations. *The Regional Act does not require that these contingent rate mechanisms individually be evaluated on the basis of the section 7(b)(2) . . . rate test. Rather, these contingent rate adjustment clauses, when combined with base rates, must demonstrate that BPA can ". . . recover, in accordance with sound business principles, the costs associated with the acquisition, conservation, and transmission of electric power, including the amortization of the Federal investment in the Federal Columbia River Power System . . . ."* 16 U.S.C. 839e(a)(1).

Id. at 6-7. GPU, PPC and SUB argue that the Joint Customer Group's brief argued only that there was no need to conduct the 7(b)(2) rate test for *establishing* the SN CRAC (and LB and FB CRACs), not for *implementing* the SN CRAC. GPU Ex. Brief, SN-03-R-GP-01, at 10-11; PPC/IEA Ex. Brief, SN-03-R-PP-01, at 9-10; SUB Ex. Brief, SN-03-R-SP-01, at 19. This

argument is not persuasive. The Joint Customers' brief addressed all three of BPA's CRACs, including the SN CRAC. When the Joint Customers addressed this issue, all rate case parties knew that the proposed establishment of the SN CRAC would include a subsequent section 7(i) hearing. The SN CRAC was not simply implemented in a subsequent hearing, it was also further established through amended GRSPs. Despite the fact that the Joint Customers knew that the SN CRAC would be further established and implemented in a subsequent hearing, they concluded this did not require BPA to conduct a 7(b)(2) rate test for the SN CRAC. The Joint Customers' arguments regarding the 7(b)(2) rate test apply to both the establishment and implementation of the SN CRAC. In BPA's supplemental rate case, the Joint Customers noted that the supplemental rate proposal "only modifies the operation of the contingent rate adjustment mechanisms, and does not revise the base rates adopted in the May ROD. These modifications do not require the recalculation of the section 7(b)(2) rate test . . ." JCG Brief, WP-02-B-JCG-01, at 2. In other words, the SN CRAC, because its establishment and implementation do not revise the base rates adopted in the May ROD, does not require a 7(b)(2) rate test. The Joint Customers also noted "since it is only the contingent cost recovery clauses contained in the GRSPs, and not the base rates contained in the rate schedules, that are being modified in the second phase of this proceeding, there is no legal requirement that these rate tests be performed a second time." *Id*. at 5. In other words, the Joint Customers distinguished between the modification of the GRSPs and the modification of base rates, thereby showing that the modification of the GRSPs, *including through the SN CRAC hearing process,* did not require a 7(b)(2) rate test.

PPC argues that BPA cannot point to where the 2002 Supplemental ROD or the GRSPs preclude BPA from conducting the section 7(b)(2) rate test. PPC/IEA Ex. Brief, SN-03-R-PP-01, at 10. To the contrary, BPA's 2002 Supplemental ROD concludes that the 7(b)(2) rate test does not apply to the LB, FB or SN CRACs at pages 6-1 to 6-15. With regard to BPA's GRSPs, as explained previously, Section II.F.3 provides that the SN CRAC regards adjusting the FB CRAC parameters and thus involves cost recovery, not cost allocation. Also, the GRSPs refer to a 40-day hearing process, which is inconsistent with conducting the 7(b)(2) rate test. Conversely, the parties have cited *no* statements in the Supplemental ROD, the GRSPs, or the entire administrative record, for any evidence that BPA concluded that the SN CRAC required BPA to conduct the 7(b)(2) rate test.

GPU argues the Administrator noted that running a 7(b)(2) test would be an exercise in speculation because the financial events that would trigger the need for a CRAC "[we]re difficult or impossible to accurately forecast" at that time, and suggest that this implies BPA should conduct the test when BPA obtains such information. GPU Ex. Brief, SN-03-R-GP-01, at 10. In the 2002 Supplemental ROD, the Administrator stated:

> The DSIs' and SUB's argument has been addressed in BPA's policy testimony, which explains why BPA is proceeding with changes in its risk mitigation strategy instead of conducting a completely new rate case. *See* Burns and Berwager, WP-02-E-BPA-62; Burns and Berwager, WP-02-E-BPA-70. Ebberts, *et al*., WP-02-E-BPA-79, at 7. In addition, as noted above, BPA's proposed rates comport with BPA's rate directives; BPA has developed an appropriate policy approach to address the unprecedented volatility in the electric power market (*see*

> Burns and Berwager, WP-02-E-BPA-62; Burns and Berwager, WP-02-E-BPA-70); BPA is facing unprecedented uncertainty in the development of its rates; BPA has properly performed all of its rate studies; assuming that BPA were to revise its rate studies, BPA would also review all other policy, technical, and legal issues regarding the development of rates; BPA lacks the time necessary to conduct a completely new rate case; and there must be some end to the incorporation of changed conditions in rates in order to conclude the rate development process and such a solution must work in a volatile market. *Id*. These reasons militate against conducting a second section 7(b)(2) study, or other studies, which essentially would require BPA to conduct a completely new rate case. *Id*.

See 2002 Supplemental ROD, at 6-12 to 6-13. GPU is correct that one of the numerous reasons provided by the Administrator in concluding that a 7(b)(2) rate test was not necessary in establishing the CRACs was that there was uncertainty in the development of BPA's rates due to market volatility and other factors. This does not, however, require BPA to perform the rate test when BPA acquires additional information later. The Administrator listed numerous reasons for not conducting the rate test, including but not limited to, that BPA had already conducted the rate test and did not need to conduct it again; that it would be inappropriate for BPA to review all other policy, technical, and legal issues regarding the development of rates, which essentially would require BPA to establish new base rates; etc. The fact that additional information might be available in a later SN CRAC hearing does not support a new 7(b)(2) rate test because the SN CRAC is only an "upward adjustment to posted [base] power rates" and does not involve the establishment of new BPA rates.

Furthermore, the Joint Customers clarified the reason that BPA would hold a subsequent section 7(i) hearing when implementing the SN CRAC:

> Recent events have amply demonstrated that our ability to accurately forecast for a five-year period development in the wholesale power market, and the electric utility industry on the West Coast generally, is limited. . . . [I]t is conceivable that events will occur during the rate period that will pose financial risks to BPA that are not encompassed by the LB and FB CRACs. To address this risk, the JCG proposed, and BPA included in its Supplemental Proposal, the Safety Net CRAC ("SN CRAC"). The SN CRAC permits BPA to initiate a process to revise the FB CRAC parameters if it has missed, or has forecast a high likelihood of missing, a payment to a creditor or the Treasury during the rate period. There are no specified limits on the amount of additional revenues that BPA can collect under the SN CRAC.

JCG Brief, WP-02-B-JCG-01, at 12. As noted below, the purpose of including the implementation of the SN CRAC in a section 7(i) hearing was *not* to require BPA to conduct a new section 7(b)(2) rate test. To the contrary, it was to ensure that BPA recovered additional costs that BPA could not recover through base rates, in order to recover BPA's total costs. 16 U.S.C. § 839e(a)(1). The Joint Customers stated:

> In essence, the SN CRAC allows BPA to truncate the five-year rate period and make an adjustment to the FB CRAC parameters when it is clear that the LB and FB CRACs are inadequate to ensure timely payment to the Treasury. It also requires that any such change to the FB CRAC parameters will be subjected to review by the FERC, which will ensure that any such change satisfies the cost recovery requirement of section 7(a) of the Regional Act. The SN CRAC is the ultimate demonstration that the region is committed to providing BPA with the tools necessary to fulfill its obligations to the Treasury regardless of what may transpire during the rate period.

JCG Brief, WP-02-B-JCG-01, at 12. The *recovery of BPA's total costs* is completely different than the rationale for the section 7(b)(2) rate test, which is an *allocation of costs* to particular customers. This is confirmed by Section B.2.h of the Partial Stipulation and Settlement Agreement, WP-02 Adjustment Proceeding, which provides:

> . . . the Parties agree that the provisions of the Parties' Proposal that address the Safety Net CRAC (SN CRAC) and the attendant section 7(i) *procedures* to implement such an SN CRAC are consistent with, and permitted by, the language in each Party's respective Subscription power sales agreement with BPA.

(Emphasis added.) Notably, the Settlement Agreement provides that the section 7(i) *procedures* apply to the implementation of the SN CRAC, *not the substantive standards* like the section 7(b)(2) rate test. In summary, the administrative record of the WP-02 rate proceeding establishes that BPA is not required to conduct the section 7(b)(2) rate test in the SN-03 rate proceeding.

SUB acknowledges BPA's statement that it was not BPA's intent to conduct the section 7(b)(2) rate test for the SN CRAC. SUB Brief, SN-03-B-SP-01, at 10-11; SUB Ex. Brief, SN-03-R-SP-01, at 19. SUB argues BPA should not have signed the settlement agreement, which was silent on this issue, and the GRSPs should have addressed this issue. This argument is weak. Under this logic, and assuming the settlement agreement was silent on this issue, it would be equally true that BPA should have signed the settlement agreement because it did not require BPA to conduct the 7(b)(2) rate test when implementing the SN CRAC. Furthermore, as discussed in greater detail above, the GRSPs are implicitly inconsistent with conducting the 7(b)(2) rate test for the SN CRAC, and the administrative record explicitly recognizes this fact.

Canby notes BPA's statement that many parties signed a Partial Stipulation and Settlement Agreement in the WP-02 supplemental rate proceeding, and such parties filed a joint brief stating that BPA need not conduct the rate test for subsequent rate adjustments, including the SN CRAC. Canby Brief, SN-03-B-CA-01, at 12. Canby argues that it did not sign the settlement agreement or endorse the brief. *Id*. Canby argues that it has not waived its rights. *Id*. BPA has not claimed that Canby has waived its rights. The issue, however, is BPA's intent in establishing the SN CRAC GRSPs with regard to whether such GRSPs contemplate conducting the 7(b)(2) rate test for the SN CRAC. This can be determined regardless of Canby's past position on the issue.

The PPC notes that while it signed on to the Joint Customer Group (as formed for the WP-02 rate proceeding) brief in BPA's supplemental rate proceeding, which established the LB, FB, and SN CRACs, and which argued BPA did not have to conduct the rate test in developing the CRACs, PPC is not bound by the arguments in such brief. PPC/IEA Brief, SN-03-B-PP-01, at 13. This issue, however, must be addressed in the context of governing law. The rule of judicial estoppel prevents a party from advancing inconsistent propositions in different judicial proceedings, including an administrative proceeding. *See generally Callanan Road Improvement Company v. United States*, 345 U.S. 507, 512-13 (1953); *Arizona v. Shamrock Foods Co*., 729 F.2d 1208, 1215 (9th Cir. 1984); *United States v. Matheson*, 532 F.2d 809, 819-20 (2d Cir. 1976); *Smith v. Montgomery Ward & Co*., 388 F.2d 291, 292 (6th Cir. 1968); *Lewis v. Atlas Corporation*, 159 F.2d 599, 602 (3rd Cir. 1946). This prevents a party from blowing "hot and cold" in different forums. *Callanan*, 345 U.S. at 513. Even assuming, *arguendo*, that parties may change their positions on issues, PPC's prior agreement with the Joint Customers is particularly telling. This was the proceeding that established the SN CRAC and also established that BPA would hold a section 7(i) hearing for implementing the SN CRAC. This proceeding also established BPA's intent that BPA would not conduct the section 7(b)(2) rate test in the SN CRAC section 7(i) hearing.

PPC argues that the Partial Settlement Agreement did not stipulate that the rate test would not apply to a section 7(i) hearing and PPC did not waive a number of rate test issues. PPC/IEA Brief, SN-03-B-PP-01, at 13-14. While the Partial Stipulation and Settlement Agreement did not expressly state the rate test would not apply to the SN CRAC hearing, this conclusion is implicit in the agreement. This is demonstrated by the Joint Customers' brief, which describes in detail why the rate test is inappropriate for the SN CRAC hearing. Also, while PPC did not waive a number of rate test issues, these issues regarded only the rate test issues in BPA's May 2000 rate proposal, not the rate test issues in the supplemental proposal, which established the SN CRAC. *See* Partial Stipulation and Settlement Agreement, Exhibit B, Sections I.8 - I.15.

Furthermore, each Subscription power sales agreement contains an Exhibit A, Rate Commitments. BPA Response to Motion to Compel, SN-03-M-22. Section 3(b) of such exhibit, entitled Priority Firm Power Rate Treatment, provides:

> BPA agrees that the 3-Year Rates and 5-Year Rates available to <<Customer>> consistent with this exhibit shall not be subject to revision during their respective terms, except for the application of a Cost Recovery Adjustment Clause . . . as provided in the PF applicable rates schedules and GRSPs and this Agreement.

These contract provisions confirm that BPA's base rates do not change during the respective contract periods, except for the CRACs; that is, the base rates, which were developed in part by conducting the section 7(b)(2) rate test, are not subject to the rate test for a second time. Because nearly all of BPA's power customers hold a Subscription power sales agreement, BPA and the parties to the Partial Stipulation and Settlement Agreement specifically intended and drafted the SN CRAC proposal in a manner that did not require the application of the section 7(b)(2) rate test. Furthermore, the contract provisions distinguish between BPA's rates, such as the PF rate, and adjustment clauses.

BPA's Section 7(i) Hearing Rules. SUB, ICNU/ALCOA, and Golden Northwest argue the SN CRAC, like the PF rate, is a rate as defined in the 7(i) rules. SUB Brief, SN-03-B-SP-01, at 10; ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 25-27; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 4-5; Golden Northwest Brief, SN-03-B-GN-01, at 14. ICNU/ALCOA note that BPA's Procedures define "rate" as "the monetary charge, discount, credit, surcharge, pricing formula, or pricing algorithm for any electric power or transmission service provided by BPA, including charges for capacity and energy." ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 25; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 4-5. ICNU/ALCOA argue that the SN CRAC rate increase fits within this definition because it is a monetary charge, surcharge, and/or new pricing formula for power costs that will be charged to BPA's customers, specifically, "[t]he SN CRAC will be an upward adjustment to posted power rates," citing Section II.F.3 of the GRSPs. *Id*. at 26. ICNU/ALCOA argue that the SN CRAC also differs from other CRACs because it does not specify the exact monetary charge, pricing formula, or pricing algorithm, and BPA must conduct a new proceeding to determine the new "upward adjustment" or surcharge that will result from the triggering of the SN CRAC. *Id*.

BPA agrees that the SN CRAC, as an adjustment clause, is a "rate" as defined in BPA's hearing procedures. Similarly, the SN CRAC, like any adjustment clause, must be established in a section 7(i) hearing. Section 7(i) and BPA's Procedures, however, are *procedural* provisions, not *substantive* provisions. BPA has always conducted a section 7(i) hearing when establishing rates, including adjustment clauses. BPA conducted a section 7(i) hearing when BPA established its 2002 base rates, when BPA established the LB, FB, and SN CRACs, and BPA is conducting a section 7(i) hearing for the implementation of the SN CRAC. Section 7(i), however, and the fact that BPA is conducting a section 7(i) hearing, does not require BPA to conduct the section 7(b)(2) rate test. The SN CRAC section 7(i) hearing was to provide the parties procedural protection and to ensure BPA's recovery of its total costs, not to develop new base rates. While an adjustment charge is treated as a "rate" for procedural purposes, from a substantive perspective, an adjustment clause is not a rate, but is a component of a rate. ICNU/ALCOA argue that under BPA's rationale, BPA could avoid the 7(b)(2) rate test by characterizing new rates as adjustment clauses. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 5. This argument is not convincing. BPA's base rates are the PF, RL, NR, IP, and NF rates. Adjustment clauses are specific clauses designed to recover a specified set of costs *in addition to base rates*. These two concepts are clearly separated. BPA cannot say that a base rate is an adjustment clause and vice versa. For example, a BPA customer cannot be charged only an adjustment clause. There would be no way to determine what the customer would pay for power. A customer must be charged a rate, to which an adjustment clause may apply. This is why BPA establishes rates, such as the PF, NR, and IP rates. A rate can exist without an adjustment clause. An adjustment clause cannot exist without a rate.

ICNU/ALCOA argue that the specific monetary amount or surcharge that will be charged through the SN CRAC may be imposed only after BPA has completed a section 7(i) rate hearing, which requires that BPA follow specific procedures when "establishing rates." ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 26. They argue BPA cannot claim that it is not establishing rates once it has formally initiated the section 7(i) process to increase the power costs paid by its customers. *Id*. This argument misses the point. BPA does not deny that adjustment clauses are components of BPA's rates or that rate components, like base rates, are established in

section 7(i) hearings. BPA, however, is not establishing the base rate schedules under which BPA sells power to its customers. Such rates already were established in BPA's WP-02 rate proceeding and ROD, where BPA conducted the section 7(b)(2) rate test. Part of those established rates is the SN CRAC, which also was established in a prior section 7(i) hearing. The current hearing is for the implementation of the existing SN CRAC, which is only an adjustment clause that requires parties to pay for specified costs in addition to their established rates. As BPA previously noted in establishing the SN CRAC:

> BPA addressed this cost recovery problem by amending certain risk mitigation tools contained in the 2002 GRSPs, *which apply to base rates*.… The primary cost structure and *the rates developed to recover those costs remain unchanged*. … Because the primary change in BPA's ability to recover costs was the combination of an unanticipated increase in loads with higher and more uncertain market prices, to best enhance cost recovery, the Supplemental Proposal has modified the CRAC to address these specific circumstances.…

2002 Supplemental ROD, WP-02-A-09, at 2-6 (emphasis added). Conducting a section 7(i) hearing for the implementation of an existing adjustment clause only requires BPA to perform the requirements for implementing the adjustment clause. It does not require BPA to develop new data regarding every element needed to establish new base rates, or to apply all of the Northwest Power Act's rate directives to completely new data. This would require BPA to completely reestablish BPA's wholesale power rates and would render the SN CRAC superfluous.

BPA's Prior Administrative Practices. It is helpful to review BPA's past administrative practices in implementing the section 7(b)(2) rate test. As noted below, review of BPA's historical practices demonstrates that, since 1985, BPA has held at least seven section 7(i) hearings to establish rates wherein BPA did *not* conduct the section 7(b)(2) rate test. BPA's longstanding legal interpretation and administrative precedent therefore do *not* require BPA to conduct the section 7(b)(2) rate test in every section 7(i) rate hearing. The criterion for conducting the section 7(b)(2) rate test is not simply whether a section 7(i) process occurs, but rather the substantive nature of the hearing.

BPA previously held at least seven section 7(i) hearings to establish rates wherein BPA did not conduct the section 7(b)(2) rate test. In 1986, BPA developed the Variable Industrial Power rate schedule VI-86. *U.S. Dep't of Energy – Bonneville Power Admin.*, 36 FERC ¶ 61,142 (1986). In 1986, BPA developed the Southern California Edison Contract Formula rate schedule SC-86. *U.S. Dep't of Energy – Bonneville Power Admin.*, 36 FERC ¶ 61,350 (1987). In 1987, BPA developed a Surplus Firm Power rate schedule SL-87. *U.S. Dep't of Energy – Bonneville Power Admin.*, 40 FERC ¶ 61,350 (1986). In 1990, BPA developed a Pacific Power & Light Company Capacity Contract Formula rate schedule PPL-90. *U.S. Dep't of Energy – Bonneville Power Admin.*, 53 FERC ¶ 61,318 (1990). In 1999, BPA revised the Firm Power Products and Services rate schedule FPS-96R. *U.S. Dep't of Energy – Bonneville Power Admin.*, 95 FERC ¶ 61,082 (2001). In 2000, BPA amended the WP-96 Unauthorized Increase Charge. *U.S. Dep't of Energy – Bonneville Power Admin.*, 94 FERC ¶ 62,084 (2001). On January 15, 2003, FERC approved the PNCA-02 rate. *U.S. Dep't of Energy – Bonneville Power Admin.*, 102 FERC ¶ 62,030

(2003). In all of the foregoing section 7(i) hearings, BPA did not conduct the section 7(b)(2) rate test. BPA's longstanding statutory interpretation and administrative precedent therefore do *not* require BPA to conduct the section 7(b)(2) rate test in every section 7(i) rate hearing.

GPU argues BPA does not have discretion to ignore the section 7(b)(2) rate test, claiming that BPA's practice of conducting the rate test in prior section 7(i) proceedings does not support such discretion. GPU Brief, SN-03-B-SG-01, at 12. SUB also argues that the section 7(b)(2) rate test is supported by precedent, claiming that BPA conducts the rate test whenever BPA holds a section 7(i) hearing. SUB Brief, SN-03-B-SP-01, at 9-10. SUB then admits that BPA refuted this argument and noted that BPA has held at least seven section 7(i) hearings where BPA did not conduct the section 7(b)(2) rate test. *Id*. SUB then argues that the cases cited by BPA did not deal with preference customer rates, were settled, or assumptions were not changed from prior 7(b)(2) tests. *Id*.; SUB Ex. Brief, SN-03-R-SP-01, at 20. Canby also argues that the cases cited by BPA did not involve the preference customers' PF rate, only changed rates for non-public agencies, or adjusted specialized rates. Canby Brief, SN-03-B-CA-01, at 9. Canby argues BPA must conduct the section 7(b)(2) rate test whenever BPA sets or adjusts the PF rate. *Id*. Golden Northwest also adopts this position. Golden Northwest Brief, SN-03-B-GN-01, at 15.

In response to these arguments, it should first be noted that BPA does not claim to have the discretion to ignore the 7(b)(2) rate test. BPA also does not claim that BPA's prior practice of conducting the rate test only when establishing base rates gives BPA the discretion to ignore the 7(b)(2) rate test. Instead, BPA has interpreted the Northwest Power Act consistently regarding the conduct of the rate test and has consistently applied that interpretation in the establishment and implementation of adjustment clauses. BPA conducted the rate test in establishing the rates to which the SN CRAC applies. BPA's previous arguments also establish that it is not necessary to conduct the 7(b)(2) rate test when implementing adjustment clauses.

SUB and Canby argue that BPA's previous hearings did not deal with preference rates. This is not persuasive because the SN CRAC proceeding is not establishing and does not change BPA's base PF rate. By their very nature, contingent rate adjustment clauses deal with financial events whose timing, magnitude, and consequences are difficult or impossible to accurately forecast. JCG Brief, WP-02-B-JCG-01, at 6-7. These contingent rate adjustment clauses, when *combined* with base rates, must demonstrate that BPA can ". . . recover, in accordance with sound business principles, the costs associated with the acquisition, conservation, and transmission of electric power, including the amortization of the Federal investment in the Federal Columbia River Power System . . . ." 16 U.S.C. § 839e(a)(1). *Id*.

Furthermore, even assuming, *arguendo*, that adjustment clauses were considered the establishment of the PF rate, BPA has previously implemented adjustment charges that applied to the PF rate. In 2000, BPA amended the WP-96 Unauthorized Increase Charge. *U.S. Dep't of Energy – Bonneville Power Admin.*, 94 FERC ¶ 62,084 (2001). This charge applies to the PF rate, yet BPA did not conduct a 7(b)(2) rate test to develop a new PF rate to which the charge would apply. Furthermore, in 1986, BPA developed the Variable Industrial Power rate schedule VI-86. *U.S. Dep't of Energy – Bonneville Power Admin.*, 36 FERC ¶ 61,142 (1986). The DSI rate post-1985 must comply with the rate directives of section 7 of the Northwest Power Act.

16 U.S.C. § 839e(c). These directives apply to the IP rate just as section 7(b)(2) applies to the PF rate. Yet BPA did not conduct a complete redevelopment of rates to establish the variable rate. Furthermore, the post-1985 DSI rate is based on the PF rate plus a margin. 16 U.S.C. § 839e(c)(2). BPA did not conduct a new 7(b)(2) rate test to establish a new PF rate, upon which the IP rate was then based. It is not necessary to conduct the 7(b)(2) rate test to establish and implement adjustment clauses or adjustable rates.

SUB argues that BPA's previous hearings involved assumptions that were not changed from prior 7(b)(2) tests. This argument lacks merit. Any expedited section 7(i) hearing that occurs after a previous general rate case will necessarily be held at a time when underlying data is different than the general rate case. This is because of many factors, such as, for example, having actual load or resource data for past months instead of forecasted data. Regardless of these changes, BPA did not conduct a new 7(b)(2) rate test in its prior expedited proceedings.

Another avenue for inquiry is BPA's past practices in the WP-02 rate proceeding. The current section 7(i) hearing to implement the SN CRAC is directly related to the WP-02 proceeding because the WP-02 proceeding established the SN CRAC. As noted previously, parties to BPA's supplemental rate proceeding litigated the issue of whether the section 7(b)(2) rate test should be conducted in the development of the LB, FB, and SN CRACs. Virtually all of the rate case parties argued, and the Administrator concluded, that the rate test should not be conducted for the LB, FB, and SN CRACs. This constitutes the law of the case.

Canby admits BPA did not conduct the rate test when BPA developed the LB, FB, and SN CRACs in BPA's supplemental rate proceeding. Canby Brief, SN-03-B-CA-01, at 17. Canby and SUB argue this creates no precedent because the SN CRAC at this time was a proposal that allowed BPA to hold a rate proceeding in the future, and did not contain a rate design or modeling of the impact of the SN CRAC on different power rates. *Id*.; SUB Brief, SN-03-B-SP-01, at 10. This argument is not persuasive. First, BPA's supplemental ROD states "BPA has not modeled the impact of the SN CRAC, because many of the details of its implementation will be elaborated through the expedited 7(i) process to be initiated upon the triggering of the SN CRAC, and those details will depend on the particular circumstances that resulted in the triggering." Supplemental ROD at 2-7. This is not a reference to the 7(b)(2) rate test. The "details" referred to are "the circumstances that resulted in the triggering" of the SN CRAC. The SN CRAC triggers based upon a finding that "BPA forecasts a 50 percent or greater probability that it will nonetheless miss its next payment to Treasury or other creditor." In making this determination, BPA determines Treasury payment probability, which involves cost recovery, but BPA does not conduct a new 7(b)(2) rate test, which involves cost allocation. Second, as noted previously, the arguments presented by the Joint Customers in BPA's supplemental rate hearing established that the 7(b)(2) rate test does not apply to BPA's CRACs, including the SN CRAC. These arguments apply not only to the initial establishment of the SN CRAC in the 2002 GRSPs, but also to the implementation of the SN CRAC.

GPU argues that BPA's supplemental rate proposal was not a separate proceeding from the WP-02 proceeding, and BPA only prepared one administrative record for the proceeding. GPU Brief, SN-03-B-SG-01, at 11. As GPU is aware, BPA's supplemental proposal was developed in a *separate* section 7(i) hearing from BPA's initial proposal, although both hearings developed

BPA's 2002 power rates. The additional GRSPs for the SN CRAC also are being developed in a separate section 7(i) hearing. Furthermore, the provision for a subsequent hearing for the SN CRAC is contained in the 2002 GRSPs. The current SN CRAC proceeding is simply implementing the existing GRSPs. The fact that a section 7(i) hearing occurs to implement the existing GRSPs shows how closely related these proceedings are. This provides no basis for suggesting that BPA should conduct a section 7(b)(2) rate test, which would essentially require BPA to conduct a general rate case, but suggests, to the contrary, that any subsequent hearing to implement the SN CRAC would be limited to what is necessary to revise the FB CRAC parameters.

As noted in detail above, the administrative record describes the Joint Customers' proposal in BPA's supplemental rate case, which was incorporated into BPA's supplemental proposal. In the ROD, the Administrator adopted this proposal. The record shows that it was not appropriate to conduct the section 7(b)(2) rate test for the LB, FB, and SN CRACs for the following reasons:

(1) CRACs are contingent cost recovery clauses that only go into effect to collect additional revenues if certain circumstances develop.

(2) In the first phase of the WP-02 proceeding, BPA subjected its base rates to the section 7(b)(2) rate test.

(3) Because it is only the contingent cost recovery clauses contained in the GRSPs, and not the base rates contained in the rate schedules, that are being modified in BPA's supplemental rate proceeding, there is no legal requirement that the section 7(b)(2) rate test be performed a second time.

(4) In the past, BPA has included contingent rate adjustment clauses in its rates to cover financial contingencies that could be adequately dealt with in BPA's base rates, and these contingent rate adjustment clauses have never required a second performance of the section 7(b)(2) rate test.

(5) The Northwest Power Act does not require that LB, FB, and SN CRACs individually be evaluated on the basis of the section 7(b)(2) rate test; rather, the CRACs, when combined with base rates, must demonstrate that BPA can ". . . recover, in accordance with sound business principles, the costs associated with the acquisition, conservation, and transmission of electric power, including the amortization of the Federal investment in the Federal Columbia River Power System . . . ." 16 U.S.C. 839e(a)(1)

Joint Customer Brief, WP-02-B-JC-01, at 2-12. The reasons the section 7(b)(2) rate test was not conducted for the development of BPA's LB, FB, and SN CRACs apply equally to the current SN CRAC rate hearing.

SUB argues that while the assumptions in the SN-03 rate proceeding have changed relative to the assumptions used in the 7(b)(2) test for the WP-02 rate proceeding, the triggering of the SN CRAC could have occurred without changes in the assumptions for the 7(b)(2) test. SUB Brief,

SN-03-B-SP-01, at 11. SUB argues that if BPA had missed a Treasury payment, BPA could have used the same assumptions it used in the WP-02 rate case and this would have resulted in no change to the 7(b)(2) rate test. *Id*. SUB argues that because BPA reflected actual assumptions in its rate proposal, BPA is making the SN CRAC process more complicated. *Id*. This is incorrect. Section II.F.3.a of the GRSPs provides that "[i]n determining which proposal to include in its initial proposal in the SN CRAC Section 7(i) proceeding, BPA will give priority to prudent cost management and other options that enhance Treasury Payment Probability while minimizing changes to the FB CRAC." This language provides that BPA does not simply adopt the assumptions used in the WP-02 proceeding when implementing the SN CRAC. Furthermore, whenever a rate hearing is held after a prior rate hearing, data existing at the time of the subsequent hearing will be different than the first hearing.

Decision 1

BPA is not required to conduct the section 7(b)(2) rate test when implementing the SN CRAC.

Issue 2

Whether the Administrator should ask the Hearing Officer to conduct an additional hearing where BPA would conduct the section 7(b)(2) rate test.

Parties' Positions

SUB argues the Administrator should ask the Hearing Officer to conduct an additional hearing where BPA would conduct the section 7(b)(2) rate test. SUB Brief, SN-03-B-SP-01, at 4-6; SUB Ex. Brief, SN-03-R-SP-01, at 20. Canby argues BPA must conduct the rate test in order to have a full and complete record upon which the Administrator can make his decision. Canby Brief, SN-03-B-CA-01, at 18. The IOUs, on the other hand, suggest BPA should reject directing the Hearing Officer to conduct a new section 7(i) hearing. IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 10.

BPA's Position

It is unnecessary and inappropriate for BPA to conduct a new hearing to perform a second section 7(b)(2) rate test. BPA conducted the section 7(b)(2) rate test in developing BPA's 2002 wholesale power rates and BPA is not required to conduct the section 7(b)(2) rate test when implementing the SN CRAC. Keep, *et al*., SN-03-E-BPA-11, at 74-78; BPA Response to Motion to Compel, SN-03-M-22.

Evaluation of Positions

SUB argues that the duties of the Hearing Officer are proscribed in the contractual arrangement with BPA and by statute, quoting section 7(i) of the Northwest Power Act, 16 U.S.C. § 839e(i), which provides:

> One or more hearings shall be conducted as expeditiously as practicable by a hearing officer to develop a full and complete record and to receive public

comment in the form of written and oral presentation of views, data, questions, and argument related to such proposed rates.

SUB Brief, SN-03-B-SP-01, at 4-6. SUB and Canby argue that BPA must conduct the 7(b)(2) rate test in the SN-03 rate proceeding to create a full and complete record. *Id*.; SUB Ex. Brief, SN-03-R-SP-01, at 20; Canby Brief, SN-03-B-CA-01, at 18-19. SUB notes the Procedures Governing Bonneville Power Administration Rate Hearings, 51 Fed. Reg. 5,611 (1986) (BPA Procedures) allow a party to submit motions to the Hearing Officer, but under the rules a party cannot compel a Hearing Officer to compel BPA to conduct a 7(b)(2) test in order to establish a full and complete record. SUB Brief, SN-03-B-SP-01, at 4-6. SUB argues it is the responsibility of the Hearing Officer to meet his or her statutory obligation to ensure the record is fully developed, even if carrying out the responsibility resides outside the scope of the 7(i) rules. *Id*. SUB argues the Hearing Officer should have addressed the 7(b)(2) issue when it was first raised near the onset of this proceeding. *Id*. SUB argues the 7(b)(2) issue has continually resurfaced in testimony, motions, and orders. *Id*. SUB argues that without a 7(b)(2) test the record remains incomplete and the Administrator cannot make a decision on an incomplete record. *Id*. To fulfill the requirement that the record be complete, SUB states the Administrator should request the Hearing Officer exercise his authority to hold an additional hearing in order for the issue of the 7(b)(2) test to be properly developed. *Id*. This argument lacks merit.

Section 7(a)(1) of the Northwest Power Act provides that "[*t]he Administrator* shall establish, and periodically review and revise, rates for the sale and disposition of electric energy and capacity …." 16 U.S.C. § 839e(a)(1) (emphasis added). Section 7(i)(2) of the Northwest Power Act provides that "[o]ne or more hearings shall be *conducted* as expeditiously as practicable by a hearing officer …." 16 U.S.C. § 839e(i)(2) (emphasis added). Thus, BPA's rate hearings are initiated by the Administrator, not the Hearing Officer. The Hearing Officer only conducts BPA's rate hearings once requested.

In essence, SUB seeks review of the Hearing Officer's order denying SUB's motion to compel BPA to conduct a section 7(b)(2) rate test in the SN-03 rate proceeding. The Hearing Officer's order stated:

1. **The Public Agencies' motion is untimely, procedurally faulty, and fails to provide good cause for its tardiness.**

   The Public Agencies did not file their motion to compel until May 9, 2003, three working days prior to the beginning of cross-examination. Given the impossibility of conducting a 7(b)(2) rate test in that time, the motion would require a revision of the SN-03 procedural schedule. Section 1010.10(B) of BPA's procedures provides that a hearing officer may request an extension of time only upon a determination the party's showing "has merit and is not dilatory." While the 7(i) hearing procedures provide for the filing of motions to compel, those motions must be filed in a timely manner that does not unduly delay the proceeding. In this case, the public agencies missed their window of opportunity to seek data regarding the 7(b)(2) rate test by a substantial margin and without any excuse.

The Public Agencies also did not follow proper procedure in their motion. Section 1010.18(e) of BPA's procedures requires a party to first attempt to "resolve the objection informally with the objecting party" before filing a motion to compel. The Public Agencies put forth no evidence that they attempted to do so.

2. **Granting the Public Agencies' motion would unduly burden the record, delay the proceedings, and deprive other parties of their opportunity to participate in an equal, fair, and orderly manner.**

   The Public Agencies do not contend that BPA can conduct a section 7(b)(2) rate test in three days. Since the SN-03 schedule is a statutorily structured expedited proceeding—developed by all the parties and adopted by the hearing officer—the effect of the Public Agencies' motion is dilatory, unduly burdensome to the proceedings, and likely to deprive parties of the opportunity to participate in an equal, fair, and orderly manner.

Order, SN-03-O-15. BPA finds the order is well reasoned and the motion was properly denied.

SUB's arguments also are not persuasive. SUB argues the Hearing Officer should have addressed the 7(b)(2) issue when it was first raised near the onset of this proceeding. *Id*. This argument makes little sense. The Hearing Officer does not initiate procedural matters, but rather resolves them. The only motion presented to the Hearing Officer before the motion to compel was BPA's motion to strike SUB's 7(b)(2) testimony (the IOUs filed a similar motion). BPA Motion, SN-03-M-03; IOU Motion, SN-03-M-01. Addressing a motion to strike testimony does not create a responsibility for the Hearing Officer to address a completely different procedural claim that was not raised by any party.

SUB and Canby argue that without a 7(b)(2) test the record remains incomplete and the Administrator cannot make a decision on an incomplete record. SUB Brief, SN-03-B-SP-01, at 4-6; SUB Ex. Brief, SN-03-R-SP-01, at 20; Canby Brief, SN-03-B-CA-01, at 18-19. This is incorrect. As noted previously in this ROD, BPA is not required to conduct a section 7(b)(2) rate test when implementing the SN CRAC. Because BPA is not required to do so, the substantive record regarding the section 7(b)(2) rate test is therefore complete. Furthermore, as SUB recognizes, the litigants have debated this issue in motions and responses. The litigants therefore have developed a full and complete record regarding the issue of whether BPA is required to conduct the 7(b)(2) rate test.

Decision 2

It is unnecessary and inappropriate for BPA to conduct an additional hearing to perform the section 7(b)(2) rate test.

2.1.5 NEPA-Related Issues

Three parties raised issues in their briefs regarding BPA's compliance with the National Environmental Policy Act (NEPA) for the SN CRAC rate proposal. GPU Brief, SN-03-B-GP-01, at 8-9; GPU Ex. Brief, SN-03-R-GP-01, at 16-17; CUB Brief, SN-03-B-CA-01, at 20-22; CUB Ex. Brief, SN-03-R-CA-01, at 14-15; CRITFC Brief, SN-03-B-CR/YA-01, at 47-48; CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 9. In addition, GPU, CRITFC, and SOS/NWEC submitted direct testimony concerning BPA's NEPA compliance strategy for the SN CRAC rate proposal. Lovely, *et al.*, SN-03-E-GP-01, at 11-23; Sheets, *et al.*, SN-03-E-CR/YA-01, at 7; Weiss, SN-03-E-SA-01, at 20-22. In response to motions to strike by BPA, the Hearing Officer ordered that the portions of the parties' direct testimonies concerning NEPA analysis be stricken from the administrative record. Order, SN-03-M-09.

NEPA compliance issues are outside the scope of issues to be litigated in this proceeding. BPA conducts environmental reviews under NEPA of its ratemaking actions separately from but approximately concurrently with BPA's evidentiary hearings. BPA Motion, SN-03-M-02; Order, SN-03-M-09. BPA develops wholesale power rates in formal evidentiary hearings conducted in accordance with section 7(i) of the Northwest Power Act. *Id.*; 16 U.S.C. § 839e(i). BPA, however, conducts environmental review of its ratemaking actions (under NEPA and implementing regulations) *separately* from but parallel to BPA's formal evidentiary hearing. 42 U.S.C. § 4321-4347; *see also* 40 C.F.R. § 1500-1508; 10 C.F.R. §1021. Indeed, for the instant proceeding, BPA initiated its separate consideration of possible appropriate NEPA compliance documentation for the rate proposal *before* the section 7(i) rate hearing process was announced in the Federal Register. BPA Motion, SN-03-M-02, at 2, citing 68 Fed. Reg. at 12052 (stating that "BPA *is in the process* of assessing the potential environmental effects of this proposed rate adjustment, consistent with the requirements of [NEPA] and its implementing regulations.") (emphasis added).

BPA is not required by the Northwest Power Act, NEPA, or the NEPA regulations to conduct NEPA reviews of proposed ratemaking actions as part of the formal evidentiary section 7(i) rate hearing. BPA Motion, SN-03-M-02, at 2, citing 16 U.S.C. § 839e(i). BPA's NEPA review process thus occurs *parallel* to BPA's rate development hearings, not within the formal hearings. BPA Motion, SN-03-M-02, at 2.

Inclusion of NEPA review in the formal hearing process would be contrary to the manner in which environmental review under NEPA must occur. *Id.* For example, only parties granted intervention in the formal hearing may raise substantive issues regarding BPA's rate development in that hearing. *Id.*, citing "Procedures Governing Bonneville Power Administration (BPA) Rate Hearings," Section 1010.4(e), 51 Fed. Reg. 5,611 (1986). The review of NEPA issues in the formal hearing therefore would limit such review to a small number of parties. BPA Motion, SN-03-M-02, at 2. One of the primary purposes of NEPA, however, is to foster public participation in agency actions, rather than limit such participation. *Id.*, citing *Trout Unlimited v. Morton*, 509 F.2d 1276, 1282 (9th Cir. 1974) (stating that one of the purposes to be served by NEPA documentation is to "provide the public with information on the environmental impact of a proposed project as well as encourage public participation in the development of that information"); see also 40 C.F.R. § 1506.6 (requiring agencies to use

appropriate measures to involve the public in its decision-making under NEPA). If NEPA review of BPA's SN-03 rate proposal were conducted through the formal section 7(i) rate hearing and its restricted public participation, BPA would run afoul of NEPA's public involvement directive. BPA Motion, SN-03-M-02, at 3. Parties' concerns about BPA's compliance with NEPA for this rate proposal are not appropriately addressed in the formal section 7(i) rate hearing, but rather are best suited for consideration in the ongoing parallel NEPA process BPA is conducting for the SN-03 rate proposal. *Id*. Parties' stricken testimony was provided to BPA's NEPA staff conducting BPA's separate but concurrent environmental review of BPA's SN CRAC rate proposal, thus assuring that the testimony would not be ignored. *Id*.

For these reasons, NEPA issues raised by the parties are not addressed in this ROD (except, as noted below, for the procedural issue of whether the Hearing Officer correctly struck NEPA testimony from the record) and are not considered part of the evidentiary record for the SN-03 hearing. Instead, the portions of the parties' briefs and testimony that raise NEPA issues have been provided to BPA's NEPA staff for consideration in the parallel NEPA process that has been conducted separately from the SN-03 hearing. These issues have been addressed and responded to as appropriate, along with other NEPA-related comments received by BPA outside of the SN-03 hearing, in the separate NEPA documentation prepared for the SN-03 rate adjustment proposal. BPA has issued its NEPA documentation for this proposed rate adjustment separately from the Administrator's ROD for this proposal (see section 3.11 for more information concerning this separate NEPA documentation). NEPA issues raised by the parties, however, are included in the general SN-03 rate case administrative record and are considered by the Administrator in making a final decision concerning the SN CRAC rate adjustment. This administrative record also includes the various NEPA documents prepared by BPA in recent years that are relevant to this proposal, as well as comments received during the public processes for these other NEPA documents.

Although NEPA compliance issues are outside the scope of issues to be litigated in the SN-03 evidentiary hearing, GPU also has raised a procedural issue concerning whether the Hearing Officer properly excluded GPU's NEPA testimony from the evidentiary record. GPU Brief, SN-03-B-GP-01, at 15-17; GPU Ex. Brief, SN-03-R-GP-01, at 17. This procedural issue is addressed in Chapter 3 of this ROD, and BPA incorporates by reference responses to arguments raised by the parties regarding the review of NEPA issues in BPA's formal hearing.

2.2 Loads and Resources

The Loads and Resources Study represents the compilation of the load, sales, contract, and resource data necessary for developing BPA wholesale power rates. It is described in Chapter 2 of the SN-03 Study, SN-03-E-BPA-01, and Chapter 2 of the Documentation for the SN-03 Study, SN-03-E-BPA-02. The Loads and Resources Study is also described in the direct testimony of Hirsch, *et al*., SN-03-E-BPA-05, and the rebuttal testimony of Hirsch, *et al*., SN-03-E-BPA-12. The results of the Loads and Resources Study are used to: (1) provide base data to determine resource costs for the Revenue Recovery Study; (2) provide regional sales and hydro data for use in the Secondary Revenue Forecast; (3) provide base data to derive billing determinants in the Revenue Forecast; and (4) provide load and resource data for use in calculating risk in the Risk Analysis (SN-03-E-BPA-01, Chapter 6). SN-03 Study, SN-03-E-BPA-01, Chapter 2.

The Loads and Resources Study includes major interrelated Federal system components: (1) a Federal system load and sales forecast that includes BPA's power sales contracts and other BPA contract obligations; (2) Federal system resources that include BPA's Federal system generating resources and other BPA contract purchases; (3) the Federal loads and resources balance that relates Federal loads and sales to the Federal generating resources and contract purchases; and (4) regional hydro resources. *Id.*

The Federal system load and sales forecast is the forecast of firm energy load that BPA expects to serve during the FY 2003-2006 period under firm requirements power sale contracts. *Id.* The Federal system load and sales forecast is composed of customer group sales forecasts for public body and cooperative utilities and Federal agencies (public agencies), direct service industrial customers (DSI), investor-owned utilities (IOU), and other BPA power sales contract obligations. *Id.* BPA's other contract obligations are comprised of contracts not defined under BPA's firm requirements power sale contracts. *Id.* These obligations include contract sales to utilities, marketers, and power commitments under international treaty. *Id.*

BPA markets power from generating resources that include Federal and non-Federal hydro projects, other contracted generating projects, and other BPA hydro-related contracts. *Id.* The combination of these generating resources represents most of the available firm output from the Federal System. *Id.* BPA's current projection of the output of these generating resources is incorporated in the Loads and Resources Study. *Id.* BPA's other resources are comprised of contract purchases and exchanges, return energy associated with BPA's capacity contracts, and return and exchange energy associated with capacity-for-energy exchanges. *Id.*

The Federal loads and resources balance completes BPA's loads and resources picture. *Id.* It compares monthly the Federal system load and sales forecast under BPA's power sales contracts and contract obligations to the Federal system generating resources and BPA's contract purchases, under 1937 water conditions, for FY 2003-2006. *Id.*

The regional hydro used in the Secondary Revenue Forecast, Chapter 4 of the SN-03 Study, includes all regional hydro: regulated hydro, independent hydro, and non-utility generators (NUG) hydro. *Id.* This larger set of regional hydro generation for the 50 water-years of record (August 1928 through July 1978) is compiled for FY 2003-2006. *Id.*

Parties raised no issues in their briefs regarding BPA's Loads and Resources Study.

2.3 Revenue Recovery

The Revenue Recovery Study is a supplement to the Revenue Requirement Study filed by BPA in support of its 2002 wholesale power rates in May 2000 (WP-02-FS-BPA-02). It is described in Chapter 3 of the SN-03 Study, SN-03-E-BPA-01, and Chapter 3 of the Documentation for the SN-03 Study, SN-03-E-BPA-02. The Revenue Recovery Study is also described in the direct testimony of Lefler, *et al*., SN-03-E-BPA-06, and the rebuttal testimony of Lefler, *et al*., SN-03-E-BPA-13. The purpose of the Study is to demonstrate that the revenues from BPA's current wholesale power rates (including LB and FB CRACs), as adjusted by the SN CRAC, are sufficient to recover, in accordance with sound business principles, the Federal Columbia River Power System (FCRPS) costs associated with the production, acquisition, marketing, and conservation of electric power. SN-03 Study, SN-03-E-BPA-01, Chapter 3. These costs include: recovery of the Federal investment in hydro generation, fish and wildlife recovery, and conservation; Federal agencies' operations and maintenance (O&M) expenses allocated to power; capitalized contract expenses associated with such non-Federal power suppliers as Energy Northwest; other purchase power expenses, such as short-term power purchases; power marketing expenses; cost of transmission services necessary for the sale and delivery of FCRPS power; and all other generation-related costs incurred by the Administrator pursuant to law. *Id.* The Revenue Recovery Study does not address spending levels or cost recovery for BPA's transmission function. *Id.*

The Revenue Recovery Study outlines the policies, forecasts, assumptions, and calculations used to revise the total generation expenses included in the revenue requirements for the May 2000 rate filing. *Id.* BPA is adhering to the planned generation amortization payments included in that filing. *Id.* Consequently, repayment studies have a diminished role in these proceedings. *Id.*

Consistent with RA 6120.2 and the standards applied by FERC on review of BPA's rates, the adequacy of proposed rates must be demonstrated. *Id.* The revised revenue test demonstrates that projected revenues from the adjusted power rates will meet cost recovery requirements for the remainder of the rate test and repayment period. *Id.*

Issue 1

Whether BPA should amortize Conservation Augmentation (ConAug) capitalization for the power contract period ending in FY 2011 versus 20 years.

Parties' Positions

PPC/IEA and WPAG argue that BPA should amortize the investment for ConAug over 20 years, as opposed to the shorter power contract period ending in FY 2011 as assumed in the initial proposal. PPC Brief, SN-03-B-PP-01, at 10; WPAG Brief, SN-03-B-WP-01, at 3; WPAG Ex. Brief, SN-03-R-WA-01, at 6.

BPA's Position

BPA believes that the current policy is the prudent and correct treatment. Lefler, *et al.*, SN-03-E-BPA-13, at 5. For regulatory assets such as conservation that can only be capitalized under Financial Accounting Standard Number 71, the useful life of the asset must be tied to the ability to demonstrate cost recovery. *Id.* BPA's policy is based on the view that, for ConAug, cost recovery is best demonstrated by the duration of signed power contracts, through 2011. *Id*.

Evaluation of Positions

PPC states that while changing to a 20-year amortization period will not help avoid the SN CRAC, it will increase net revenues. PPC Brief, SN-03-B-PP-01, at 10. BPA witnesses testified that from a cash standpoint, there would be little effect on the SN CRAC rate from changing BPA's policy on the current ConAug amortization. Lefler, *et al.*, SN-03-E-BPA-13, at 5. There would be no impact on the principal payments to treasury, since the schedule of Federal principal payments is not being changed from that scheduled in the May 2000 proposal. *Id*. Interest payments would likely increase due to a somewhat higher interest rate on longer-term bonds. *Id*. For regulatory assets such as conservation that can only be capitalized under Financial Accounting Standard Number 71, the useful life of the asset must be tied to the ability to demonstrate cost recovery. *Id*. BPA's policy is based on the view that for ConAug, cost recovery is best demonstrated by the duration of signed power contracts, through 2011. *Id*. BPA intends to review and reconsider its policy on conservation capitalization prior to the next rate case, and will initiate discussions with BPA's independent auditor to determine the implications of making such a change in the middle of a contract period. *Id*.

Decision 1

BPA will continue its current policy to amortize ConAug capitalization over the life of the signed power contracts, through 2011.

Issue 2

Whether amortizing the cost of ConAug contracts over the 10- year period of such contracts will undermine BPA's energy conservation policies.

Parties' Position

GPU contends that the SN CRAC proposal to amortize ConAug agreements for a 10-year period instead of the useful life of the assets will undermine BPA's energy conservation policies by affecting the ConAug agreements with its customers. GPU Brief, SN-03-B-GP-01, at 9.

BPA's Position

BPA believes that the current policy is the prudent and correct treatment. Lefler, *et al.*, SN-03-E-BPA-13, at 5. For regulatory assets such as conservation that can only be capitalized under Financial Accounting Standard Number 71, the useful life of the asset must be tied to the

ability to demonstrate cost recovery. *Id.* BPA's policy is based on the view that for ConAug, cost recovery is best demonstrated by the duration of signed power contracts, through 2011. *Id.*

Evaluation of Positions

GPU argues that BPA has made this assumption based on its mistaken view that the useful life of ConAug assets must be tied to the ability to demonstrate cost recovery, *i.e.,* the term of the current power sales contracts, which terminate in 2011. GPU Brief, SN-03-B-GP-01, at 9.

First, BPA did not propose a change in its present ConAug amortization practice. Instead, BPA's policy for ConAug deviates from the existing 20-year conservation life. Lefler, *et al.*, SN-03-E-BPA-06, at 10. This policy differs from past treatment by BPA of "legacy conservation investments," under contracts that paralleled the initial long-term 20-year power sales contracts offered by BPA to its regional customers pursuant to section 5(g) of the Northwest Power Act. In contrast, ConAug agreements are short-term purchases of conservation that BPA entered into as part of its augmentation purchases to meet regional load obligations placed on BPA under Subscription contracts which are no more than 10-years in duration. Since the intent of these investments is to provide benefits only during the 10-year Subscription power sales contract term, FY 2002-2011; the asset life reflects that time period (of the contract) rather than an average or composite life. *Id.*

GPU states that BPA "erroneously assumes" that it will have no power sales contracts with its customers after 2011 and that this assumption will, in essence, increase the rate impact of the ConAug program relative to other conservation programs that are amortized over their full 20 year life. GPU Brief, SN-03-B-GP-01, at 9. BPA made no such assumption. BPA assumes that it will continue to offer contracts for the sale of power to its customers after the expiration of existing contracts. The nature of the rate impact has not clearly been articulated. ConAug agreements do not allow customers to add conservation programs beyond 2006. When ConAug ends, BPA and its customers will continue their conservation efforts under other long-term conservation programs. BPA intends to review and reconsider the policy on conservation capitalization prior to the next rate case and will initiate discussions with BPA's independent auditor to determine the implications of making such a change in the middle of a contract period. Lefler, *et al*., SN-03-E-BPA-13, at 5.

Decision 2

BPA's existing ConAug amortization policy will not undermine BPA's energy conservation policies.

2.4 Secondary Revenue Forecast

2.4.1 Introduction

BPA's secondary revenue forecast is comprised of two parts: the amount of secondary energy BPA is forecasting to sell or purchase, and a price forecast at which BPA is forecasting to sell or purchase. Oliver, *et al*., SN-03-E-BPA-08, at 1. When the two are combined, they result is a secondary revenue forecast. *Id*. BPA obtains its primary revenues from the sale of hydroelectric power and other resources to firm customer loads. *Id*. at 2. BPA plans its system so it can meet its firm load obligations even if critical water conditions materialize, by purchasing additional power if needed to meet loads. *Id*. "Critical" water conditions are characteristic of the nearly worst water supply conditions in the existing 50-water year historical record. Secondary revenues are derived from the sale of power in excess of BPA's firm load obligations. *Id*. Because predicting long-term water conditions is exceedingly difficult, BPA forecasts secondary revenues using the 50-water year historical water record when setting long-term rates. *Id*. The 50-water year historical record is one of the variables used to generate the distribution of secondary revenues. *Id*.

Once BPA enters the water year under consideration, BPA revises its secondary revenue forecast using the best available hydrologic data to predict expected secondary generation levels. *Id*. In the case of the currently proposed SN CRAC, BPA is using the best available data for FY 2003, and the 50-water year historical record for FY 2004-2006. *Id*. BPA, however, is adjusting FY 2004 to reflect the need to refill reservoirs following a below-normal FY 2003 period. *Id*. Information about the 50-water year historical record can be found in the Loads and Resources Study in the SN-03 Study, SN-03-E-BPA-01, chapter 2.

Secondary revenues are part of the PBL's total revenues and expenses. Oliver, *et al*., SN-03-E-BPA-08, at 2. In determining PBL's net revenue forecast for future years, secondary revenues are a subset of the overall revenue forecast. *Id*. Information about the overall revenue forecast can be found in the SN-03 Study, SN-03-E-BPA-01, chapter 5.

BPA's secondary revenue forecast is a product of two components: (1) a forecast of secondary market sales and purchase volumes; and (2) a forecast of expected prices for those sales or purchases. Oliver, *et al*., SN-03-E-BPA-08, at 2-3. Secondary market sales are made from generation available in excess of BPA's firm load obligations. *Id*. at 3. For the current rate proposal, these sales are broken out by month and by light load hour (LLH) and heavy load hour (HLH) periods. *Id*. BPA purchases power when it "believes" or "predicts" or "is concerned that" it may not have enough energy to meet its load obligations. *Id*.

Secondary market surpluses and deficits were generated through a simulation process. *Id*. BPA produced a distribution of secondary market sales by subtracting firm loads from LLH and HLH generation for each future month across the full range of water conditions represented by the 50-water year historical record. *Id*. This distribution is comprised of a separate value for LLH and HLH generation for each month under 50 different water conditions. *Id*. Information about the surpluses and deficits can be found in the Risk Analysis chapter of the SN-03 Study. *See* SN-03 Study, SN-03-E-BPA-01, chapter 6. Revenues from the secondary market were estimated

for HLH and LLH for each month by multiplying the secondary energy forecast (using the process described above) by a projected secondary sales price generated by the AURORA model (described below). Oliver, *et al*., SN-03-E-BPA-08, at 3. The resulting LLH and HLH revenues were summed to get a monthly total and the monthly totals were summed to get an annual total. *Id*. The expected value of the distribution of annual values is reported in the revenue forecast. *Id*. The summary statistics for the distributions of the secondary revenues are provided in the documentation for the SN-03 Study, SN-03-E-BPA-02, chapter 6.

Power purchase volumes were estimated using the same process used to estimate secondary market sales. Oliver, *et al*., SN-03-E-BPA-08, at 3. When monthly loads were subtracted from monthly generation for a particular water condition (during LLH or HLH) and the difference was negative, then a power purchase was deemed necessary. *Id*.

Purchased power expenses were estimated using the same process used to estimate secondary market revenues. *Id*. at 4. Purchased power expenses were estimated by multiplying the LLH or HLH price in a particular month by the corresponding purchased power quantity. *Id*. The same process was followed for all water conditions and months where purchases were necessary. *Id*. The LLH and HLH purchases for each month were summed to provide the monthly totals, and summed again to provide the annual total. *Id*. The expected value of the distribution of annual values is reported as the total purchased power expense estimate. *Id*. The summary statistics for the distributions of purchased power expenses are provided in the documentation for the SN-03 Study, SN-03-E-BPA-02, chapter 6.

BPA used the AURORA model as the central power market modeling tool in developing the secondary revenue forecast. Oliver, *et al*., SN-03-E-BPA-08, at 4. The assumptions and methodology used in AURORA are provided in the SN-03 Study, SN-03-E-BPA-01, chapter 4. AURORA is a marginal production cost model that estimates market prices for power in the Pacific Northwest region. Oliver, *et al*., SN-03-E-BPA-08, at 4. AURORA was used to estimate the prices BPA would receive or pay when BPA was selling or buying secondary energy. *Id*. BPA also used RiskMod in developing its secondary revenue forecast. *Id*. RiskMod is a model that constructs distributions of varying hydro conditions, gas price levels, and load levels, and supplies these to AURORA to produce a distribution of prices for secondary market sales and purchases. *See* SN-03 Study, SN-03-E-BPA-01, chapter 6.

As noted above, AURORA is a production cost model. Oliver, *et al*., SN-03-E-BPA-08, at 4. AURORA uses the variable cost of the last marginal generating unit required to equate supply and demand as a proxy for the future spot market price in a future hour. *Id*. This price proxy is used as the single price for all power sold or purchased in a given hour. *Id*. The assumptions underlying AURORA are that all power is marketed on an hourly basis, all sellers receive the same price, and the price is equal to the cost of the last kilowatt sold. *Id*. at 4-5. This is the theoretical world of a perfectly competitive hourly spot market with perfect price transparency. *Id*. at 5.

The market into which BPA sells secondary power and purchases power is not a single-price, transparent, perfectly competitive market with an hourly marginal clearing price. *Id*. It is a bilateral market without a single central exchange or central market-clearing mechanism. *Id*.

Prices are not perfectly transparent and buyers and sellers are not guaranteed the marginal price on every hour. *Id.* Instead, prices are negotiated based on current or future expectations, marketing needs, and risk preferences as well as factors other than the production cost of the most expensive generation unit on line at the time. *Id.* Rather than realizing the hourly marginal price during each hour, BPA's experience is that it receives prices for its secondary sales that more closely reflect the average value associated with the amount of energy BPA is displacing from the market through its secondary sales. *Id.* As a result of the fundamental difference between the theoretical world of AURORA and the actual market in which BPA sells and purchases power, BPA concluded it was not appropriate to simply apply the output of AURORA without considering any adjustments. *Id.* BPA therefore used a broader marginal band to approximate prices that BPA would receive for its secondary revenue. *Id.*

2.4.2 BPA's Secondary Revenue Forecast

Issue 1

Whether BPA's secondary revenue forecast is reasonable.

Parties' Positions

PNGC and PPC/IEA argue that BPA's AURORA model contained flaws, was outdated, and produced a flawed forecast of secondary energy revenues. PNGC Brief, SN-03-B-PN-01, at 2-3, and PPC/IEA Brief, SN-03-B-PP-01, at 10-11, citing Bliven, *et al*., SN-03-E-JC-01, at 28-46.

BPA's Position

BPA does not agree that BPA is using an out of date, default database. Oliver, *et al*., SN-03-E-BPA-14, at 3. Although BPA proposes to update some of its resource files for the final proposal, the Joint Customers have not demonstrated that updating data renders BPA's forecast irrational. *Id*. at 15.

Evaluation of Positions

First, it should be noted that the testimony of the Joint Customers was extremely helpful in developing BPA's secondary revenue forecast. *See* Bliven, *et al.*, SN-03-E-JC-01. BPA adopted many of the suggestions of the Joint Customers in BPA's forecast.

PNGC and PPC/IEA argue that BPA's AURORA model contained flaws, was outdated, and produced a flawed forecast of secondary energy revenues. PNGC Brief, SN-03-B-PN-01, at 2-3, and PPC/IEA Brief, SN-03-B-PP-01, at 10-11, citing Bliven, *et al*., SN-03-E-JC-01, at 28-46. PNGC and PPC/IEA, however, provide only summary descriptions of BPA's secondary revenue forecast. Review of the record refutes their contentions. While PNGC and PPC/IEA argue that BPA's AURORA model was outdated, the only support provided for this statement is a citation to the testimony of Bliven, *et al*., SN-03-E-JC-01. While this testimony states that BPA is using a version of AURORA that is older than the version currently available, it also states that "[o]ur sense is that while there are differences between versions 5.6 and 6.3, they are not necessarily

ones that need to be addressed in this case, especially given the short timeframe of the SN-CRAC process. Therefore, given the magnitude of the changes necessary to move from 5.6 to any of the 6.X versions, we are comfortable enough with the version of the model to accept BPA's continued use at this time." Bliven, *et al.*, SN-03-E-JC-01, at 32-33. Thus, PNGC and PPC/IEA's argument that BPA's AURORA model is outdated was not pursued by the Joint Customers themselves.

Also, while the Joint Customers developed reference cases with regard to BPA's secondary revenue forecast, they stated: "It should be noted that we are not advocating that the BPA should use these values in its rate setting modeling. Rather, we are advocating that BPA update its input dataset to be current with the market as it exists today, and use that updated data in its normal course of rate, risk, and modeling. The results from our reference cases may not be those determined through the full range of risk variables that BPA models." Oliver, *et al.*, SN-03-E-BPA-14, at 10, citing Attachment C.

PNGC and PPC/IEA also argue that BPA's AURORA model contained flaws and produced a flawed forecast of secondary energy revenues. PNGC Brief, SN-03-B-PN-01, at 2-3, and PPC/IEA Brief, SN-03-B-PP-01, at 10-11, citing Bliven, *et al.*, SN-03-E-JC-01, at 28-46. This argument also lacks merit. BPA does not agree that BPA is using an out of date, default database. Oliver, *et al.*, SN-03-E-BPA-14, at 3. In data response BPA-JC-004, the Joint Customers state a comparison analysis was not performed between the default database provided by the vendor and the dataset used by BPA. The statement in testimony referred exclusively to the resource file, and was made solely based on the witness' recollection that at one time, a default dataset issued by the vendor had a number of the same duplications of resources. *Id.*, citing Attachment A. BPA, in fact, updated the resources in the default database. *Id.* BPA, however, reviewed the Joint Customers' data and adopted several legitimate changes identified by the Joint Customers that BPA now proposes to make in its AURORA database. *Id.* There are over 100,000 inputs that feed into the AURORA model, and BPA acted reasonably to keep those inputs as current as possible. *Id.* at 15. Although BPA proposes to update a limited number of its resource files for the final proposal, the Joint Customers have not demonstrated that updating a limited amount of data renders BPA's forecast irrational. *Id.* BPA's forecast is reasonable. *Id.*

Decision 1

BPA's secondary revenue forecast is reasonable.

Issue 2

Whether BPA should decrement loads in AURORA by 2,500 MW to provide a reasonable proxy for the type of prices BPA can be expected to earn in a bilateral market.

Parties' Positions

ICNU/ALCOA argue BPA should not decrement loads in AURORA to "adjust" for surplus hydro because surplus hydro is already accounted for in the AURORA model. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 5-6.

BPA's Position

In order to reflect the fact that BPA sells and purchases power in a bilateral market, BPA ran the AURORA model in a mode that decremented PNW loads by 2,500 aMW. Oliver, *et al*., SN-03-E-BPA-08, at 5-6. Decrementing PNW loads by 2,500 aMW is a reasonable proxy for the type of prices BPA can be expected to earn in a bilateral market, as opposed to a marginal price market. *Id*. at 6. The arguments advanced by the Joint Customers have not convinced BPA that the 2,500 aMW adjustment should be eliminated. Oliver, *et al*., SN-03-E-BPA-14, at 11.

Evaluation of Positions

ICNU/ALCOA argue that there are other AURORA changes that should be made. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 10. For example, BPA made a 2,500 MW decrement to loads in AURORA to "adjust" for surplus hydro. *Id*.; citing Oliver, *et al*., SN-03-E-BPA-08, at 5-6; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 16. ICNU/ALCOA argue this decrement does not need to be made because surplus hydro is already accounted for in the AURORA model. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 10, citing Bliven, *et al.*, SN-03-E-JC-01, at 43; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 16. ICNU/ALCOA argue BPA used a different adjustment to "account" for surplus hydro in the May 2000 rate case. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 10, citing Oliver, *et al*., SN-03-E-BPA-08, at 8; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 16. ICNU/ALCOA claim BPA states that it may make a different adjustment for surplus secondary revenues in the future. *Id*. ICNU/ALCOA argue that BPA's adjustment should be rejected because it is arbitrary and capricious to make different adjustments based on factors that have already been modeled. *Id*.

The arguments advanced by the Joint Customers have not convinced BPA that the 2,500 aMW adjustment should be eliminated. Oliver, *et al*., SN-03-E-BPA-14, at 11. BPA's objective in preparing its secondary revenue forecast is to produce an accurate estimate of the prices it will receive for sales of secondary energy in the wholesale power market. *Id*. The nuances of "exact" versus "approximate" AURORA prices are less of a concern to BPA than the overall accuracy and reasonableness of the secondary revenue forecast. *Id*. Relying entirely on the raw output of a production cost model to forecast an important variable in BPA's overall cost structure is not prudent, especially when the implied market structure of AURORA is different from the dynamics of the market in which BPA transacts, and important behavioral variables are difficult to capture in the model's logic. *Id*. at 11-12. BPA considers its adjustment to be an appropriate and reasonable mechanism to better estimate the prices BPA can obtain for secondary sales given BPA's understanding of market dynamics and BPA's extensive experience in the Pacific Northwest electricity market. *Id*. at 12.

BPA agrees that AURORA reflects the fact that when there is "high" or "low" hydroelectric production in the Pacific Northwest, the price estimates from AURORA reflect these conditions. Oliver, *et al*., SN-03-E-BPA-14, at 12. AURORA then takes an average of numerous random "games" using varying water supply to produce average expected secondary prices. *Id*. BPA's view is that when actual market participants observe that the regional hydro system is really on track to produce an average quantity of secondary energy surplus, they respond by adjusting their expectation of market prices and resource operations. *Id*. This in effect eliminates the random

nature of the AURORA approach. *Id*. The AURORA approach assumes the average water condition appears with no forewarning or advance market knowledge, and that parties simply, and perfectly, displace their dispatchable thermal resources hour-by-hour to match this average water condition. *Id*. In fact, market participants in the WECC can observe over time Pacific Northwest reservoir elevations, snow pack accumulations, and precipitation forecasts. *Id*. They also understand the general nature of whether the Pacific Northwest is short, or surplus, of supply based on regional planning processes such as those conducted by the PNCA and Regional Council. *Id*. They also understand that the Pacific Northwest hydro systems are by and large run of the river systems that cannot massively store and shape their hydro supplies. *Id*. at 12-13. On this basis, BPA has seen market and pricing behavior in these types of conditions that substantially discounts the marginal value of power. *Id*. at 13. The most recent example was FY 2002, where near average Pacific Northwest hydro conditions occurred, yet the average net revenue received by BPA was about $21/MWh. *Id*. (This occurred in a period when natural gas prices averaged above what BPA had seen for 5 years preceding the 2000-2001 market price spikes.) *Id*. In certain periods of spring 2002, hydro run-off had substantial peaks, and the market responded by offering low single digit prices, because it recognized the lack of ability for Pacific Northwest hydro-related marketing interests to store or shape this supply. *Id*.

BPA's past experience with participants in the bilateral market is that when BPA discusses this secondary price issue with them, they are very clear that they understand the Pacific Northwest has a largely non-discretionary power supply that is driven by weather and non-power directives such as fisheries and flood control operations. *Id*.

Also, BPA's 2,500 aMW adjustment is supported by market realities and BPA's experience in selling large volumes of power in the Pacific Northwest. Oliver, *et al.*, SN-03-E-BPA-14, at 13-14. Prices are not perfectly transparent and buyers and sellers are not guaranteed the marginal price on every hour. Oliver, *et al*., SN-03-E-BPA-08, at 5. Instead, prices are negotiated based on current or future expectations, marketing needs, and risk preferences as well as factors other than the production cost of the most expensive generation unit on line at the time. *Id*. Rather than realizing the hourly marginal price during each hour, BPA's experience is that it receives prices for its secondary sales that more closely reflect the average value associated with the amount of energy BPA is displacing from the market through its secondary sales. *Id*. As a result of the fundamental difference between the theoretical world of AURORA and the actual market in which BPA sells and purchases power, BPA concluded it was not appropriate to simply apply the output of AURORA without considering any adjustments. *Id*. BPA therefore used a broader marginal band to approximate prices that BPA would receive for its secondary revenue. *Id*.

In order to reflect the fact that BPA sells and purchases power in a bilateral market, BPA ran the AURORA model in a mode that decremented PNW loads by 2,500 aMW. *Id*. Decrementing PNW loads by 2,500 aMW is a reasonable proxy for the type of prices BPA can be expected to earn in a bilateral market, as opposed to a marginal price market. *Id*. at 6. Under average water conditions, 2,500 aMW is approximately the amount of surplus that comes off the Federal Columbia River Power System (FCRPS). *Id*. This surplus will be marketed in wide-ranging quantities from month-to-month and hour-to-hour. *Id*. The production of this 2,500 aMW of secondary energy is transparent to the market because market participants observe publicly

available hydroelectric forecasts, reservoir elevations, and fish-related operational decisions. *Id*. Due to this transparency, seller and buyer expectations about the amount of secondary hydroelectric generation available for sale may alter the range of prices achieved in the market for the participants. *Id*. BPA concluded that prices at the 2,500 aMW decrement point provide a reasonable proxy for the prices BPA would receive for its secondary energy.

Decrementing load does not undermine the fundamental concept of marginal pricing. *Id*. The range of prices BPA receives in the market is still associated with marginal costs. *Id*. The actual price BPA receives, however, cannot precisely be estimated by the variable cost of generating the last kWh sold. *Id*. For example, the average generation in the Western Electric Coordinating Council (WECC) is about 90,000 aMW. *Id*. A party selling approximately 2,500 aMW into this market would be doing well to receive prices reflecting the marginal 3 percent of generation it might displace in such a market. *Id*.

BPA also used market experience to help develop the secondary revenue forecast. *Id*. The year 1997, for example, brought an enormous 159 MAF of water volume at The Dalles Dam. *Id*. Flush with secondary power, BPA marketed over 4,600 aMW, yet realized a total of only $501 million in net revenue for these sales. *Id*. This occurred because power prices dropped dramatically in response to the huge supply of secondary hydroelectric power. *Id*. Of course, certain factors, such as gas prices, may be quite different today. *Id*. However, BPA's experience indicates that the region's secondary power portfolio is naturally hedged. *Id*. at 7. As hydro supplies decrease, prices tend to increase, and as hydro supplies increase, prices tend to decrease. *Id*. This tends to constrain the range of BPA's secondary revenues. *Id*.

Because BPA was projecting approximately 70 percent of average water conditions in FY 2003, BPA's initial proposal assumed BPA would market approximately 1,344 aMW of net secondary surplus. *Id*. To reflect the fact that BPA was projecting below normal water conditions, BPA decremented the loads in AURORA for FY 2003 by 1,000 aMW. *Id*. A portion of the secondary surplus energy is caused by surplus firm resources BPA acquired to meet customer loads that were expected to exceed the FCRPS critical power supply capabilities (surplus augmentation). *Id*. In FY 2004-2006, BPA expects to market approximately 2,500 aMW, which is comprised of secondary hydroelectric generation and surplus firm augmentation resources. *Id*.

Energy marketed by Slice customers is not included in this 2,500 aMW figure. *Id*. The "natural hedging effect" is not significantly affected by the allocation of secondary power sales among Slice customers and BPA's marketing of secondary energy. *Id*. The regional hydroelectric system is an integrated system that produces approximately 15,800 aMW of hydroelectric generation on average. *Id*. WECC market participants obtain data on the hydroelectric supply and expected power production in total. *Id*. These hydro supply observations are the factors that drive macro market price responses, not the number of parties selling the resource. *Id*. A good example of this was June 2002, the first spring period after Slice implementation. *Id*. Hydroelectric supplies peaked in this period, and even with many more parties selling this supply, June 2002 experienced among the lowest monthly average market prices in the last 10 years. *Id*. at 7-8.

Historically, the FCRPS produces about 2,500 aMW of secondary energy under average water conditions. *Id*. at 8. Therefore, BPA has had extensive experience observing the impacts on WECC markets of this level of surplus supply. *Id*. BPA has marketed significantly more than the expected 2,500 aMW of power for FY 2004-2006 in several previous years, yet BPA has never realized more than $532 million in net secondary revenues. *Id*. Therefore, BPA's initial proposal forecasts for FY 2004-2006, which averaged $529 million per year in net revenues, were reasonable when compared with BPA's historical record of secondary revenues received, as well as the effects of bilateral selling and the natural hedging effect of prices and volumes. *Id*.

This is not the first time BPA has adjusted the AURORA output to develop its secondary revenue forecast. *Id*. In BPA's May 2000 rate case, BPA adjusted the AURORA prices in certain instances during the April, May, and June (Q2) timeframes. *Id*. These prices were adjusted because BPA observed that during periods of heavy Q2 surplus, the market will adjust its pricing behavior as it observes large volumes of hydro supply being produced that must be run through the system in response to spring flood control or other non-power requirements. *Id*. Under these conditions, any party marketing "must run resources" likely would not receive the prices reflected in the AURORA marginal price output. *Id*. In essence, buyers understand that parties marketing FCRPS output are in a condition where they must generate and sell secondary power, and such buyers are therefore likely to pay less for excess supply. *Id*.

BPA previously applied other adjustments to the AURORA forecast. *Id*. at 9. In BPA's May 2000 rate case, additional adjustments were made to AURORA to generate forward market prices. *Id*. AURORA was used in BPA's May 2000 rate case to determine the price forecast for flat block forward markets as a means of determining the financial benefits BPA was proposing to offer regional IOUs on behalf of their residential and small farm loads. *Id*. AURORA was run in much the same manner as it has been run for the current secondary revenue forecast. Loads were decremented by 1,800 aMW to derive a price at which either BPA or the IOUs could purchase a block of energy to serve the IOUs' residential loads. *Id*., citing Oliver, *et al*., WP-02-E-BPA-20. AURORA was used in developing BPA's 2002 Supplemental Proposal, but in a somewhat different manner. Oliver, *et al*., SN-03-E-BPA-08, at 9. In winter 2000/2001, the WECC market was experiencing a well-documented, sustained price spike. *Id*. The AURORA model was not able to produce the high prices that were being experienced in the market at that time. *Id*. In order to more accurately reflect realities of the market at that time, BPA had to use market prices derived from actual purchases and price quotes for FY 2002 and 2003, and then revert to AURORA prices for FY 2004-2006. *Id*.

BPA foresees other modifications to the AURORA price forecast in the future. *Id*. BPA has always applied professional judgment and experience to AURORA when estimating secondary revenues. *Id*. As the market in the PNW and WECC changes, so does the market in which BPA sells and purchases power. *Id*. BPA will continue to use AURORA or another production cost model as a starting point to estimate marginal prices. *Id*. From that point, depending on current market design and BPA's experience marketing power at that time, BPA will apply its best judgment to evaluate how realistic it is to achieve the results produced by the model. *Id*.

BPA recognizes the critical role that secondary revenues plays in its rate setting process. Oliver, *et al.*, SN-03-E-BPA-14, at 15. This is the reason BPA applies the AURORA model in a fashion

that is consistent with BPA's experience in the Pacific Northwest electricity market. *Id*. The Joint Customers argue that making adjustments to AURORA prices, even when they conflict with BPA's historical experience and understanding of BPA's daily business, "undermines the value of tools like AURORA." *Id*. BPA believes that uncritically accepting the output of tools like AURORA undermines the value of seasoned professional judgment and ignores the uncertainty surrounding estimates of secondary revenues. *Id*. Despite the need for a few adjustments to BPA's inputs, BPA considers its approach to have been entirely rational, prudent, and in the best interests of the agency and its customers. *Id*. at 15-16.

INCU/ALCOA argue that BPA's rationale that the model does not produce the prices BPA expects from the market based on its experience is so broad as to allow BPA to adopt any adjustment. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 16. BPA, however, has not stated that BPA should ignore the model and pick an arbitrary number as its secondary revenue estimate. To the contrary, BPA's analysis began with the model and used the model's results in the development of its forecast. BPA noted, as explained in greater detail above, that the model results alone do not provide an accurate forecast of BPA's secondary revenues. Also as noted above, BPA conducted an analysis based on its extensive professional experience in order to modify the model results to establish a more accurate forecast.

ICNU/ALCOA argue that BPA's seasoned professional judgment produced a different adjustment in the May 2000 ROD, and may produce a different adjustment next time. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 16. This is to be expected. BPA must prepare a secondary revenue forecast whenever BPA develops rates. BPA's rate adjustments are generally years apart. When BPA develops a new secondary revenue forecast, BPA is dealing with different conditions, regulatory environments, marketing experience, etc. BPA's adjustments therefore may differ with each new forecast.

ICNU/ALCOA argue that BPA's seasoned professional judgment did not foresee the price increases in 2000-2001 or the price decreases in 2001-2002 and this failure is a significant contributor to BPA's financial problems. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 16-17. BPA has not claimed that its secondary revenue forecasts are perfect. Any forecast, almost by definition, will have some margin of error. BPA, however, must make the best forecast possible based on the information available at the time of the forecast. As with any forecast, there may be unforeseeable events that have dramatic impacts on forecasts of secondary revenues, such as a drought, the recent western energy crisis, etc.

Decision 2

BPA properly decrements loads in AURORA by 2,500 MW to provide a reasonable proxy for the type of prices BPA can be expected to earn in a bilateral market.

Issue 3

Whether BPA's forecasted secondary revenues should increase to reflect improved water conditions.

Parties' Positions

ICNU/ALCOA note that, due to improved water conditions and higher markets, secondary revenues will be higher in FY 2003. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 10.

BPA's Position

BPA will update the hydroelectric assumptions, as well as other information, for the final proposal. Oliver, *et al*., SN-03-E-BPA-14, at 16. BPA will recognize the implications and impacts of the variables for the final proposal. *Id.*

Evaluation of Positions

ICNU/ALCOA note that, due to improved water conditions and higher markets, secondary revenues will be higher in FY 2003. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 10. They note the Joint Customers estimated this improvement at $103 million. *Id*., citing Bliven, *et al*., SN-03-E-JC-01, at 11. They also note BPA agrees that conditions have improved and BPA will revise its secondary revenue forecast in the final proposal based on the April mid-month forecast. *Id*., citing Hirsch, *et al*., SN-03-E-BPA-12, at 5. They also note that, at hearing, BPA provided a conservative estimate of a $50-$60 million increase in secondary revenues due to improved water conditions. *Id*., citing Tr. 43.

BPA will update the hydroelectric assumptions, as well as other information, for the final proposal. Oliver, *et al*., SN-03-E-BPA-14, at 16. BPA will recognize the implications and impacts of the variables for the final proposal. *Id.*

Decision 3

BPA will update hydroelectric assumptions, as well as other information, for the final proposal.

2.5 Revenue Forecast and Augmentation Power Expenses

BPA's Revenue Forecast for the SN-03 rate proceeding is described in Chapter 5 of the SN-03 Study, SN-03-E-BPA-01, and Chapter 5 of the Documentation for the SN-03 Study, SN-03-E-BPA-02. The Revenue Forecast is also described in the direct testimony of Wedlund, *et al.,* SN-03-E-BPA-09, and the rebuttal testimony of Wedlund, *et al.,* SN-03-E-BPA-15. The Revenue Forecast projects revenues given specified rates and loads. For the 2003 SN CRAC rate proposal, two revenue forecasts were prepared. First, BPA forecasted revenues using rates that became effective on October 1, 2001, for FY 2003, 2004, 2005, and 2006 that reflect application of the LB and FB CRACs. Wedlund, *et al*., SN-03-E-BPA-09, at 2. A forecast of revenues during the current fiscal year is necessary for three reasons: (1) the current fiscal year is not yet over, (2) the forecast is used to determine BPA's cash balance at the beginning of the period (*i.e.*, 2004-2006), and (3) the revenues received during this year are required both for the determination of the proposed rate level and for FERC's review of the rate proposal. Changes in the revenues expected to be received during the current year, between when the initial proposal and final proposal are filed, can have a significant effect on the starting reserves entering the fiscal year when the proposed rates will be in effect. FERC requires BPA to file projected sales for five historical years and for the remainder of the effective rate period by rate schedule whenever BPA proposes to change its rates. The second forecast, which applies the SN CRAC adjusted rates, is used to demonstrate that the proposed rates enable BPA to meet its revenue requirement. *Id*.

Forecasts of purchased power expenses are included and presented with the forecast of revenues because power purchases supplement Federal power generation and enable BPA to earn additional revenues through power sales. During the current rate period, BPA obligated itself to purchase significant amounts of power in order to satisfy increased load obligations. The majority of BPA's purchased power expenses were to meet additional system loads and are referred to as augmentation power purchases. These augmentation expenses are documented in the Revenue Forecast.

Parties raised no issues in their briefs regarding BPA's Revenue Forecast. Issues raised regarding the forecast of secondary sales and associated revenues are discussed in chapter 2.4 of this ROD.

2.6 Risk Analysis

2.6.1 Introduction

The objective of the Risk Analysis is to identify, model, and analyze the impact that key operational risks have on BPA's net revenue (revenues less expenses) risk exposure. The impacts of operational risks are quantified through the use of the RiskMod Model. SN-03 Study, SN-03-FS-BPA-01, chapter 6. The results from the Risk Analysis are subsequently used in the ToolKit model to evaluate the impact that certain risk mitigation measures have on reducing BPA's net revenue risk, so that BPA can develop rates that cover all its costs and provide a high probability of making its treasury payments on time and in full during the rate period. SN-03 Study, SN-03-FS-BPA-01, chapter 7. In addition to its use in the Risk Analysis, RiskMod is used to calculate the surplus energy revenues, power purchase expenses, 4(h)(10)(C) credits, and FCCF credits reported in the Secondary Revenue Forecast and Revenue and Purchase Power Expense Forecast, SN-03-FS-BPA-01, chapters 4 and 5.

2.6.2 RiskMod Model

The RiskMod model quantifies the impact that various Federal load, Federal resource, electricity price, 4(h)(10)(C) credit, and FCCF credit conditions have on BPA's operational net revenue risk. SN-03 Study, SN-03-FS-BPA-01, chapter 6. The RiskMod model calculates net revenues (revenues less expenses) using monthly data for HLH and LLH electricity generation, firm loads, surplus energy sales, and power purchases. Monthly HLH and LLH energy values are calculated using load and resource data from the Loads and Resources Study. SN-03 Study, SN-03-FS-BPA-01, chapter 2.

Net revenues are calculated using PNW HLH and LLH electricity prices estimated by the AURORA model, SN-03 Study, SN-03-FS-BPA-01, chapter 4; expense data from the Revenue Recovery, SN-03 Study, SN-03-FS-BPA-01, chapter 3; and various rate and revenue data from the Revenue Forecast, SN-03 Study, SN-03-FS-BPA-01, chapter 5.

Issue 1

Whether BPA's risk analysis properly accounts for the risks associated with natural gas volatility.

Parties' Positions

CRITFC contends that BPA is not using historical price data to forecast forward natural gas price volatility. CRITFC Brief, SN-03-B-CR/YA-01, at 28. It contends BPA is using the AURORA model to simulate future natural gas prices based upon a high, medium, and low natural gas price forecast with each of these forecasts assuming a fairly constant price. *Id*. at 28-29. CRITFC contends BPA's reliance on AURORA ignores historic volatility and consequently impacts the value of secondary revenues forecasted in the rate case. *Id*. at 29.

BPA's Position

BPA has properly forecasted natural gas price volatility. Conger, *et al*., SN-03-E-BPA-16, at 3-5. CRITFC's argument reflects a misunderstanding about the methodology used in the Risk Analysis. In BPA's Risk Analysis, the AURORA model does not simulate future natural gas prices and BPA does not simulate future natural gas prices using high, medium, and low natural gas price forecasts that assume fairly constant prices. Conger, *et al*., SN-03-E-BPA-16, at 4. Rather than using AURORA, BPA simulates future natural gas price risk using the Natural Gas Price Risk Model (NGPRM), which is one of the risk simulation models that comprises RiskSim, a component of RiskMod. *Id*. Also, *see* SN-03 Study Documentation, SN-03-FS-BPA-02, at 6-39 to 6-50 for a detailed description of the manner in which BPA models natural price gas risk, including a description of how BPA calculated and used historical natural gas price volatility in the NGPRM. The NGPRM simulates various patterns of gas prices around a base case gas price forecast, which yields a probability distribution of potential future gas prices. *Id*. Under this methodology, no high or low natural gas price forecasts are used. *Id*. The simulated natural gas prices from the NGPRM are then input into the AURORA model, which then outputs the associated electricity prices. This methodology has been described in detail in the documentation of the Risk Analysis, SN-03-FS-BPA-02, at 6-39 to 6-50.

Evaluation of Positions

CRITFC's contentions regarding BPA's risk analysis of gas prices reflect a basic misunderstanding about how BPA developed its risk analysis in this area. Contrary to CRITFC's assertion, BPA does not use the AURORA model to simulate future natural gas prices and does not simulate natural gas prices using a high, medium, and low natural gas price forecast. Conger, *et al*., SN-03-E-BPA-16, at 4. BPA's alleged use of the AURORA model to simulate gas prices is the basis for their argument that BPA's analysis is somehow faulty. In addition, CRITFC fails to explain why it believes modeling gas price risk in AURORA is flawed. Rather than providing any compelling explanation as to why an AURORA analysis is problematic, it merely concludes that it is somehow deficient.

Irrespective of the merits of CRITFC's argument about AURORA, in the end, it is moot because BPA does not use AURORA in the calculation of natural gas price volatility. BPA simulates natural gas price risk, using historical natural gas price volatility, with the NGPRM. Conger, *et al.*, SN-03-E-BPA-16, at 4-5. Although this matter was explained in BPA's direct case, in data responses, in rebuttal testimony, and the methodology was described in the documentation of the Risk Analysis, CRITFC nonetheless argues that BPA is improperly relying on the AURORA model. BPA's risk analysis of natural gas price volatility is reasonable and should be adopted.

Decision 1

BPA's risk analysis properly accounts for the risks associated with natural gas volatility.

Issue 2

Whether BPA properly addresses the uncertainties associated with the West Coast power market.

Parties' Positions

CRITFC believes that BPA should model more market uncertainty in its risk analysis. CRITFC Brief, SN-03-B-CR/YA-01, at 29. BPA's failure to address this uncertainty properly will increase the likelihood that BPA's rates will not be sufficient to cover costs and repay treasury. *Id*. CRITFC points to the extreme electricity price volatility seen during 2000-2001 as evidence of this need.

In its Brief on Exceptions, CRITFC continues to argue that BPA faces significant uncertainty and risk in the West Coast electricity market. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 10.

BPA's Position

Because of FERC intervention into the West Coast markets, as well as the increase in capacity and reduction in demand since the crisis, it is unlikely the West Coast will see the extreme electricity price volatility seen during FY 2000-2001. Conger, *et al.*, SN-03-E-BPA-16, at 6. Also, such high electricity prices during FY 2004-2006, even under poor water conditions, will likely be more beneficial to BPA than detrimental. *Id*. The reason for this is that BPA is over-augmented, even under critical water conditions. *Id*. Under such a load and resource condition, it is unlikely that BPA would have to purchase additional power, but instead would be selling surplus energy. *Id.* The kind of market uncertainty posited by CRITFC would likely result in BPA earning higher surplus energy revenues and net revenues than it otherwise would under lower electricity prices. *Id.*

Evaluation of Positions

CRITFC argues that BPA's SN CRAC proposal does not address the uncertainties associated with the West Coast power market. CRITFC Brief, SN-03-B-CR/YA-01, at 29-30. CRITFC notes that BPA describes how it treats the uncertainty associated with the West Coast power market in exhibit SN-03-E-CR-01UUUU (sic). *Id.* Based on the market manipulations seen in California during 2000 and 2001, CRITFC argues that BPA should model more market uncertainty in its risk analysis. *Id.* CRITFC argues that failure to properly address this uncertainty increases the likelihood that BPA's rates will not be sufficient to meet its costs and repay the treasury. *Id.*

CRITFC argues that the electric price volatility in 2000-2001 was the result of the manipulation of the California deregulation scheme and a drought in the Pacific Northwest. CRITFC Brief, SN-03-B-CR/YA-01, at 29-30. CRITFC notes that the State of California is considering a change in the laws that govern the regulation of electricity, but not all of these changes have been implemented. *Id*. CRITFC also notes that the price caps adopted by FERC are temporary and it is unclear what will happen to market prices if the caps are removed or modified. *Id.* Therefore,

CRITFC argues there is some probability that wholesale energy providers will find ways to manipulate the market and/or the Northwest will experience another significant drought prior to and including 2006, and, therefore, assuming there is no probability of these events ignores history. *Id.*

CRITFC expresses its concerns in terms of a general unease regarding the West Coast market and a perceived failure by BPA to model the level of uncertainty it sees. CRITFC does not identify any specific new things BPA should assume in its modeling or what recommended changes to the modeling are needed to account for their unease. Responding to CRITFC's concerns is difficult because BPA feels it has appropriately modeled the risk around prices in the West Coast market. BPA has examined both the operational and price risk associated with the West Coast market and factored these into its analysis. The implication of CRITFC's concern is BPA should somehow add an assumption for the risk that generators and marketers will violate the law and manipulate the market. CRITFC does not say how BPA should do this nor did it present any testimony on this point. In its Brief on Exceptions, CRITFC reiterates the contention that there exists significant price risk, but does not provide any new or additional information that would contradict the findings in the draft ROD. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 10.

BPA presented evidence that both current and projected market conditions through the remainder of the current rate period are materially different from FY 2000-2001. Conger, *et al.*, SN-03-E-BPA-16, at 6. These differences make it unlikely that the West Coast will see the extreme electricity price volatility experienced in FYs 2000-2001. *Id.* In particular FERC has intervened to impose price caps and has indicated that it would do so again if the market evidenced unusual and prolonged periods of high prices. *Id.* In addition, current economic factors have demand well below and capacity above the levels witnessed during the price spikes of FY 2000-2001. *Id.* Finally, BPA's own resource portfolio is surplus due in large measure to a drop in DSI load that has made some power purchases for augmentation surplus power for BPA. *Id.* This surplus power provides a natural hedge for BPA against high prices in the market generally. Since BPA is over-augmented, electricity price volatility in the future would likely be beneficial to BPA since it would earn higher surplus energy revenues and overall net revenues than under lower electricity prices. *Id.*

Decision 2

BPA properly addressed the uncertainties associated with the West Coast power market.

Issue 3

Whether BPA properly addressed the uncertainties associated with BPA's internal operating costs.

Parties' Positions

CRITFC notes that BPA's actual internal operating costs were higher than its forecast for these costs in the May 2000 Rate Case. CRITFC Brief, SN-03-B-CR/YA-01, at 30. CRITFC believes

that BPA's new estimates of internal operating costs do not seem reasonable given the recent history. *Id*. BPA's customers have not independently reviewed BPA's assumptions about its costs, rather the customers have relied upon BPA processes to review the cost and have concluded that they are reasonable assumptions. *Id.* at 31. CRITFC takes issue with the Joint Customer proposal that it believes argues for assuming an additional $580 million in additional cost reductions. *Id.* It believes that this recommendation ignores the possibility that BPA's costs will be higher than BPA has assumed. *Id.*

In its Brief on Exceptions, CRITFC argues that, based on the draft ROD, BPA misunderstands its concerns regarding internal operating cost uncertainty. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 10. It contends BPA has assumed there was no uncertainty about its internal operating costs. *Id*. at 10. CRITFC also contends that it has consistently expressed concern that BPA's estimates of internal operating costs will be higher than assumed. *Id.* at 11. These overly optimistic assumptions will limit BPA's ability to cover its costs and pay the treasury. *Id*.

BPA's Position

BPA believes that it has properly addressed risks associated with its internal operating costs. Keep, *et al*., SN-03-E-BPA-11, at 35. BPA has developed an integrated and multi-faceted plan for controlling and managing the internal operating costs that impact power rates. *Id*. BPA has taken extensive steps to manage its cost and those efforts have been detailed in testimony. *Id*. at 36-37. They include reduction in employee awards, moratorium on new hires, early retirement for employees, management training on cost management, limitations on travel, training, overtime, retention pay, and cancellation or delay of technology projects. *Id*. In addition, BPA has established customer meetings to review current year actual and forecasted expense levels. *Id*. Given this level of commitment, BPA believes it can manage to spending levels.

BPA estimates of internal operating costs have been made in various forums over the past several months. *Id*. at 38. Differences from the May 2000 rate case and Financial Choices will occur through time as BPA makes additional decisions regarding cost cuts and more current information is available. *Id*.

Evaluation of Positions

CRITFC contends that BPA's forecast of internal operating costs involves a good deal of uncertainty. CRITFC Brief, SN-03-B-CR/YA-01, at 30. Rather than presenting evidence of alternative assumptions, CRITFC merely asserts that BPA's failure to accurately forecast its internal operating costs in the WP-02 proceeding demonstrates a level of risk that BPA must account for. *Id*.

CRITFC contends that BPA failed to properly address this issue in the draft ROD. It contends that BPA has assumed that there is "no" uncertainty surrounding the level of internal operating costs. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 10. CRITFC's contention that BPA has assumed there is "no" risk that its internal operating costs will exceed the assumptions in the rate

case is factually inaccurate. BPA is not assuming that there is no risk that its internal operating costs could exceed forecasted levels, rather it is stating that it is willing to assume this risk for purposes of establishing the level of the SN CRAC. BPA feels strongly that it is a manageable risk, given its commitment to control these costs.

As noted in BPA's testimony, BPA has gone to great lengths to cut and manage its costs. Keep, *et al.*, SN-03-E-BPA-11, at 35. This commitment to manage costs has included establishing internal cost controls and internal cost management plans to ensure that internal expense levels will be managed to levels established as a result of the General Managers' meetings on cost control. *Id.* BPA has also established workgroups with customers and constituents to get input on, evaluate, track, and report spending levels. *Id*.

Internal costs are also somewhat unique in that BPA has a somewhat greater degree of control over these costs as compared to other cost categories where BPA must work with a cost partner like Energy Northwest, the Corps, or Reclamation to establish cost levels. *See generally*, Keep, *et al*., SN-03-E-BPA-11, at 66-67. Therefore, unlike other cost categories, internal operating costs represent an area where BPA can assert more direct influence over levels. *Id*. As a consequence, the risk surrounding these costs is not as great as some others. In this SN CRAC Rate Case, BPA has updated its costs to reflect the requirements needed in the current operating environment, which were not accounted for in BPA's WP-02 Rate Cases. Additionally, as noted above, BPA has enhanced its procedures and processes to better manage its internal operating costs. Keep, *et al.*, SN-03-E-BPA-11, at 35-37. As a result, the risk that BPA will manage to budgets for internal operating costs is a reasonable risk under the circumstances absent a force majeure event. *Id*.

As a part of its overall cost management plan, the PBL has established informal monthly meetings with customers, customer representatives, and constituents to review current year actual and forecast expense levels for both program and internal operations expenses charged to power rates. In these forums, the PBL also reports on changes to expense levels including reductions taken to date. Keep, *et al.*, SN-03-E-BPA-11, at 37. The parties have requested that BPA provide a more formal opportunity to review BPA's finances and spending levels. Therefore, in addition to the formal public process workshops for the SN CRAC described in the GRSPs, BPA is committed to provide an ongoing intensive process of cost disclosure by BPA and opportunities for customers and others to review costs and provide input to BPA. Though not part of the rates process, BPA agrees to provide these opportunities.

CRITFC has also not presented any evidence that demonstrates BPA's forecast of internal operating costs is not accurate nor has it shown the appropriate level of risk that BPA should assume, given CRITFC's perceived uncertainty. To the extent CRITFC believes the changes in forecasts from the WP-02 proceeding to Financial Choices to today reflect either BPA's uncertainty regarding or inability to forecast operating costs, this argument is misplaced. CRITFC's contention that the inaccurate assumptions of the past will repeat themselves in the future, without evidence of better assumptions for these costs, is a hollow argument. While BPA's actual internal operating costs have exceeded the levels assumed in the WP-02 rate case, BPA also explained the background behind those WP-02 assumptions and why it believes the risk around the current assumptions involve a manageable risk. Keep, *et al.*, SN-03-E-BPA-11,

at 2-17. Whether parties accept or reject BPA's explanation about why the WP-02 forecast proved incorrect, is ultimately immaterial to BPA's statutory obligations. BPA's internal costs have increased over WP-02 forecasts and it is obligated by statute to set its rates to cover its total system costs, which include the internal operating costs charged to power rates. 16 USC § 839e(a)(1).

Although CRITFC's issue is framed as one involving the uncertainty surrounding BPA's internal operating costs, CRITFC also objects to BPA adopting the Joint Customer proposal to assume an additional $580 million in cost reductions in this proceeding. CRITFC Brief, SN-03-B-CR/YA-01, at 31. This issue is addressed in chapter 2.1 of this ROD.

Given the level of BPA's commitment to managing its costs, the levels projected in this proceeding are reasonable assumptions.

Decision 3

BPA properly addressed the uncertainties associated with BPA's internal operating costs.

Issue 4

Whether BPA properly addressed the uncertainties associated costs of the Bureau of Reclamation, the Corps of Engineers, and Energy Northwest.

Parties' Positions

CRITFC contends that BPA is assuming that the costs for the Corps, Bureau, and ENW will not change from the assumptions in the rate case. CRITFC Brief, SN-03-B-CR/YA-01, at 32. It contends that the forecast of these costs in the WP-02 proceeding was $349 lower than actual costs. *Id.* Given recent history, CRITFC believes it is not reasonable to assume the current assumptions are accurate, and the failure to address this uncertainty increases the likelihood BPA's rates will not be sufficient to cover its costs. *Id.*

BPA's Position

BPA has worked extensively with the Corps, Reclamation, and ENW on their expense forecasts included in this rate proceeding. Keep, *et al.*, SN-03-E-BPA-11, at 37. Through the Joint Operating Committee, BPA is working with the Corps and Reclamation to set and manage to budget levels. *Id*. ENW has expressed its intent to keep its costs for CGS as low as it can, consistent with safe and reliable plant operation. *Id*. Through these processes, BPA is confident that the three agencies will stay within cost budgets, absent a *force majeure* type event. *Id*.

Evaluation of Positions

Although framed in the context of the costs associated with the Corps, Reclamation, and ENW, this issue is the same as the one above involving the risk associated with BPA's internal operating costs. There is a major difference, however. BPA has more direct control over its

internal costs than it does over the Corps, Reclamation, and ENW costs. BPA has developed plans with the Corps, Reclamation, and ENW to develop reasonable budgets that reflect the best information available. Keep, *et al.*, SN-03-E-BPA-11, at 37. There is no evidence in the record to suggest that there is better information available. CRITFC's contention that recent history suggests that the forecasts are not reliable ignores the fundamental question about the appropriate levels for these costs.

BPA believes that the cost levels are reasonable assumptions based upon the best available information. Also, with the exception of the cost items that BPA is proposing limiting the recovery of spending levels in the automatic adjustments of the SN CRAC (*see* chapter 2.7 of this ROD), additional costs will be reflected in the calculation of Accumulated Net Revenue (ANR), and to the extent necessary, collected through an adjustment to the SN CRAC.

Decision 4

BPA properly addressed the uncertainties associated with costs of the Bureau of Reclamation, the Corps of Engineers, and Energy Northwest.

Issue 5

Whether BPA properly addressed the uncertainties associated with its forecast of secondary revenues.

Parties' Positions

CRITFC notes that during Financial Choices, BPA revealed that it had over-estimated its secondary revenue forecast by $710 million as compared to its forecast in the WP-02 June 2001 Rate Case. CRITFC Brief, SN-03-B-CR/YA-01, at 33. Based upon this outcome, and given the complexity of estimating these costs, BPA should assume that there will be significant uncertainty associated with these costs through 2006. *Id*. Failure to address this uncertainty increases the likelihood that BPA's rates will not be sufficient to meet its costs and repay treasury. *Id*.

In its Brief on Exceptions, CRITFC argues that it continues to be concerned about BPA's estimate of secondary revenues. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 11. This overly optimistic assumption could result in less revenue and increased risk for BPA. *Id*.

BPA's Position

BPA believes its Risk Analysis accounts for a significant amount of uncertainty in BPA's surplus energy revenues due to both quantity and price risk. Conger, *et al.*, SN-03-E-BPA-16, at 6-7. The uncertainty in the quantity of BPA's surplus energy sales due to hydro generation, CGS nuclear plant output, and firm load risk are estimated in RiskMod, and the price risk, which is used to estimate surplus energy revenue risk in RiskMod, is estimated by AURORA. SN-03 Study Documentation, SN-03-FS-BPA-02, chapter 6.

The overestimate of secondary revenues by $710 million cited by CRITFC in data response IN-BPA: 035 was due to lower than originally expected prices received for surplus energy sales during FY 2002, lower forecasted prices for surplus energy sales during FY 2003-2006, and approximately 600 aMW of lower generation in FY 2002 than expected, compared to when rates were set in June 2001. Conger, *et al.*, SN-03-E-BPA-16, at 6-7. At the time of the estimate (June 2001), prices were at record levels and BPA forecasted that prices would remain high for at least two years. *Id.* Prices dropped significantly after FERC intervention into the market during the summer of 2001 and the loss of generation was due in large measure to a record drought in 2001 and the carryover effects into 2002. *Id.*

The $710 million consists of lower actual and forecasted prices, which amounted to a reduction of $610 million ($360 million in FY 2002 and $250 million in FY 2003-2006) in surplus energy revenues, and lower generation in FY 2002, which amounted to a reduction of $100 million in surplus energy revenues. *Id.* In both the June 2001 rate proposal and this SN CRAC rate proposal the type of generation risk experienced in FY 2002 was accounted for in the Risk Analysis. *Id.* In contrast with the June 2001 rate proposal when BPA's forecast of surplus energy revenues was high because electricity prices were high, BPA's forecast of surplus energy revenues in this SN CRAC rate proposal is lower because expected electricity prices are much lower. *Id.* This lower forecast, in conjunction with the price risk reflected in the Risk Analysis, substantially reduces the chances that BPA has significantly underestimated its surplus energy revenue risk in this SN CRAC rate proposal. *Id.*

Evaluation of Positions

CRITFC contends that BPA should assume significant uncertainty associated with its secondary revenue forecast in the rate case based upon the complexity of estimating these amounts. CRITFC Brief, SN-03-B-CR/YA-01, at 33, CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 11. In the context of surplus energy revenues, it is unclear from CRITFC's argument what BPA either fails to assume or improperly assumes in terms of "significant uncertainty" in secondary revenues over the balance of the rate period. Conger, *et al.*, SN-03-E-BPA-16, at 6-7. CRITFC provides no proposed alternative assumptions or remedy for this perceived problem. Rather than providing alternative assumptions, CRITFC notes that BPA over-estimated secondary revenues in the June 2001 rate determinations. CRITFC Brief, SN-03-B-CR/YA-01, at 33, CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 11. BPA explained the unusual circumstances surrounding the June 2001 forecast. Conger, *et al.*, SN-03-E-BPA-16, at 6-7. At the time, prices were at record high levels and there was no indication that prices would drop as rapidly as they did. *Id.* As BPA notes, prices began to drop after FERC intervened in the market in late June 2001 and imposed price caps. *Id.* While there are differences between the June 2001 forecast and actual secondary revenues over the FY 2002 and FY 2003 period, the differences are understandable and explainable given the unusual factors in play.

BPA calculates the risk surrounding its secondary revenues by estimating the uncertainty in the quantity of BPA's surplus energy sales due to hydro generation, CGS nuclear plant output, and firm load risk in RiskMod and by estimating the price risk, which is used to calculate surplus energy revenue risk in RiskMod, with AURORA. SN-03 Study, SN-03-FS-BPA-01, at 1-2.

These assumptions appear reasonable, and there is no evidence in the record of alternative assumptions that make the current assumptions flawed.

Finally, BPA deliberately recognized the possibility of potential adverse financial conditions, such as the uncertain nature of its secondary revenues, in its variable FB CRAC and SN CRAC rate designs. Keep, *et al.*, SN-03-E-BPA-04, at 16-17. The LB, FB, and SN CRAC were designed to mitigate BPA's revenue and cost uncertainties. *Id.* It is BPA's view that these CRAC mechanisms are accomplishing this task and, if necessary, BPA has the ability to institute further SN CRAC adjustments in the face of adverse financial conditions, such as a substantial erosion in secondary energy revenues. McCoy, *et al*., SN-03-E-BPA-10, at 10.

Decision 5

BPA properly addressed the uncertainties associated with its forecast of secondary revenues.

2.7 Rate Design

BPA and Parties have proposed a number of modifications to the original rate design in testimony and rebuttal to reflect what they consider a more balanced approach for adjusting rates. This section discusses whether BPA should maintain the three financial standards (TPP, TRP, and zero net revenue) as proposed in the initial proposal for setting the SN CRAC adjustment to rates, and what the appropriate levels are considering BPA's improved financial condition. Also discussed is a proposed fourth financial standard, called Creditor Payment Probability (CPP) that may more accurately reflect BPA's ability to pay its creditors. This section also identifies how BPA proposes to implement the contingent feature of the SN CRAC, including what cost and revenue items will be included in the August calculations, and the schedule for including potential settlement between IOU and public customers. Also examined is whether BPA should adopt a single year or multi-year approach to adjusting rates and why it is important to solve BPA's larger financial problems rather than simply responding to the current-year probability of paying treasury. In addition, rate case parties have proposed a refund mechanism if BPA reserve levels exceed established threshold levels to balance the need to improve BPA's financial situation but also minimize the impact on ratepayers if BPA's finances improve. Also under consideration are concerns about whether BPA should remove the cap on the amount collected under the SN CRAC and whether BPA should adopt flat or sloped rates over the FY 2004-2006 period. Finally, this ROD considers whether BPA should change how it evaluates whether or not the SN CRAC has triggered by adjusting the look-forward analysis beyond the current fiscal year.

Issue 1

Whether the SN CRAC should be designed as a single-year or variable multi-year adjustment to rates.

Parties' Positions

NRU, the IOUs, GNA, PNGC, PGU, ICNU, and ALCOA all argue that the SN CRAC should be a single year adjustment to rates, rather than a multi-year adjustment in BPA's initial proposal. GNA in particular argues that the SN CRAC is only designed to address problems associated with missing treasury payments or the next treasury payment. GNA Brief, SN-03-B-GN-01, at 13. ICNU and ALCOA argue that a three-year SN CRAC is unnecessary to address BPA's financial problems. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 23. In their opinion, the SN CRAC is not intended to recover past losses and rebuild reserve levels as BPA's proposal does. *Id.* They contend that when the SN CRAC was proposed in the WP-02 proceeding, it was intended only to be a "temporary" upward adjustment to rates. *Id.* They claim a multi-year SN CRAC is inconsistent with that intent. *Id*.

ICNU and ALCOA are concerned that a variable multi-year automatic adjustment will not impose the rate discipline for BPA to control its costs. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 12.

In their Brief on Exceptions, ICNU and ALCOA contend that the DROD ignores its request for a single-year SN CRAC rate increase. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 15. ICNU and ALCOA contend the SN CRAC was intended to be only a temporary rate adjustment. *Id*. They contend that the decision in the DROD was based upon the erroneous finding that a single year SN CRAC would require BPA to collect a five-year net revenue problem in one year. *Id*.

BPA's Position

BPA believes that a multi-year SN CRAC rate adjustment is appropriate to address the financial problems faced by the agency. BPA is forecasting negative net revenues over the balance of the rate period. SN-03-E-BPA-04, at 15. To properly address this net revenue problem would requires a very large SN CRAC in FY 2004. *Id.* at 16.

BPA is also very concerned with the fragile state of the Pacific Northwest economy. This concern resulted in a proposed temporary lowering of the treasury repayment standards in the initial proposal. Keep, *et al*., SN-03-E-BPA-11, at 47. The concern about the economy, in part, led staff to develop a multi-year and variable SN CRAC rate design. *Id*. BPA believed this design structure resulted in the lowest rate possible, while still allowing BPA to meet its requirement to set rates sufficient to recover its costs and ensure a high probability of paying treasury over the balance of the rate period. *Id*. at 47-48.

Given BPA's financial condition and the guidance from management to mitigate the impact of any rate increase on the regional economy, collecting the SN CRAC over the balance of the rate period addressed these problems. *Id*. In addition, the multi-year feature provides greater security that BPA will be able to restore a high probability of making its treasury payments over the balance of the rate period as provided for in the GRSPs. *Id*.

Finally, the variable adjustment to rates was not designed to relax cost control, rather it was established to create a mechanism to deal with risks of all types, including cost uncertainties. *Id.* at 54. In order to preserve cost control incentives, BPA argues against weakening the SN CRAC by limiting it to a single year and instead believes explicit caps on levels of certain costs that can be recovered through the SN CRAC is a more appropriate mechanism.

Contrary to the implication of ICNU and ALCOA's Brief on Exceptions, the DROD did not ignore the issues raised with regard to a single or multi-year SN CRAC adjustment. Rather than ignoring the issues, the Administrator made findings that differed from the outcome advocated by ICNU and ALCOA.

Evaluation of Positions

A variety of customers believe the SN CRAC should be imposed on a year-by-year basis rather than on a multi-year basis. There are several reasons given for this. GNA contends that the SN CRAC is designed only to address problems associated with a missed treasury payment or the next treasury payment. GNA Brief, SN-03-B-GN-01, at 13. Others argue that the adjustment is intended to be only a "temporary" adjustment to rates and not one that spans the remainder of the

rate period. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 23. They believe having a multi-year adjustment is inconsistent with the intended design of the SN CRAC. *Id.*

BPA correctly notes that it has a net revenue problem over the balance of the rate period that could not reasonably be collected in one year. Keep, *et al*., SN-03-E-BPA-04, at 15. Because of the nature of the problem, it is appropriate to collect revenues associated with BPA's financial condition over the balance of the rate period. One of the three criteria BPA established for its proposal involved establishing rates to cover its costs in accordance with sound business principles. *Id.* at 13. A multi-year design provides greater security that BPA will be able to restore a high probability of making its treasury payments over the balance of the rate period as provided for in the GRSPs. *Id.* at 15.

ICNU and ALCOA believe the Administrator is in error because a single year SN CRAC would not require BPA to collect a five-year net revenue problem in one year. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 15. ICNU and ALCOA's contention reflects a basic disagreement about limitations on the potential design of the SN CRAC and an erroneous assumption about the net revenue problem that would need to be collected. When ICNU and ALCOA state the draft ROD was based upon the erroneous finding that a single year SN CRAC would require BPA to collect a five-year net revenue problem in one year, they are misstating the finding. The net revenue shortfall discussed above is a three-year and not a five-year problem. Secondly, while ICNU and ALCOA contend BPA is overestimating the net revenue problem, they presented no evidence to support this assertion. The final study shows that over the balance of the rate period, absent any adjustment to rates for an SN CRAC, PBL will have a net revenue shortfall of $250 million.

Underlying ICNU and ALCOA's argument is a belief there are strict limitations on the design of the SN CRAC. ICNU and ALCOA contend that the GRSPs do not allow for a multi-year SN CRAC. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 23. The GRSPs provide:

> The SN CRAC will be an upward adjustment to posted power rates subject to the FB CRAC by modifying the FB CRAC parameters. BPA will propose changes to the FB CRAC parameters that will, *to the extent market and other risk factors* allow, achieve a high probability that the remainder of treasury payments during the FY 2002-2006 rate period will be made in full. BPA's proposal *could include changes to the Revenue Amount, duration (*the length of time the SN CRAC would be in place, which could be more than one year), *and the timing of collection*. The additional revenue to be generated by the SN CRAC will be collected through a uniform percentage increase in all rates subject to the FB CRAC and a commensurate decrease in the financial portion of the Residential Exchange Settlement. (Emphasis added)

These provisions give broad discretion to the Administrator to fashion a solution to BPA's financial problem. Under the GRSPs, not only may the Administrator determine the amount of money collected, but it is within his discretion to determine the time period over which the adjustment is collected (*i.e*., one v. multiple years) and the timing of collection (*i.e*., flat v. tilted).

ICNU and ALCOA's argument is also inconsistent with the decision in the WP-02 Supplemental ROD. In adopting the SN CRAC, the Administrator stated that "details of its implementation will be elaborated through the expedited 7(i) process to be initiated upon triggering of the SN CRAC, and those details will depend on the particular circumstances that resulted in the triggering." WP-02-A-09, at 2-7. Rather than limiting BPA to a particular rate design, the WP-02 Supplemental ROD clearly contemplated that the solution would fit the nature of the problem. BPA has previously described a net revenue shortfall over the balance of this rate period. Keep, *et al*., SN-03-E-BPA-04, at 15. Given the multi-year nature of the problem, it is appropriate to design the solution to be multi-year as well.

ICNU and ALCOA raised concerns that the variable multi-year feature to the SN CRAC takes away any rate discipline to control costs because BPA can just raise rates to cover any increase. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 12. BPA has demonstrated a strong commitment to cost control over the balance of the rate period. Keep, *et al*., SN-03-E-BPA-11, at 10-16. BPA explained in testimony that it will manage to budget levels assumed in this proceeding absent a *force majeure* event. *Id*. In addition, BPA has had mechanisms in rates with variable rate structures. Keep, *et al*., SN-03-E-BPA-11, at 53. These mechanisms did not result in an increase in rates. The variable design is not intended to relax cost controls but rather it is a means of dealing with risks, including cost uncertainties just as the three CRACs themselves are inherently designed to do. McCoy, *et al.*, SN-03-E-BPA-17, at 4. In addition, the variable, multi-year design allowed BPA to minimize the rate impact on the region as compared to a fixed multi-year design. The variable design allows the rate to be lower on an expected value basis as compared to a fixed design. Absent a *force majeure* event, the caps on cost recovery of certain items, as proposed by BPA, will preserve the cost-control incentives that parties believe are important.

Decision 1

The SN CRAC adjustment will be a variable multi-year adjustment to rates.

Issue 2

Whether BPA should have a forward-looking trigger for the SN CRAC.

Parties' Positions

CRITFC and SOS/NWEC believe the trigger for the SN CRAC should be forward looking so that it can increase and decrease the size of the SN CRAC. CRITFC Brief, SN-03-B-CR/YA-01, at 50; SOS/NWEC Brief, SN-03-B-SA-01, at 14.

BPA's Position

The design of the trigger mechanism was decided in the Administrator's Supplemental Record of Decision (June 2001). Matters decided in the WP-02 proceeding were expressly excluded from the scope of this proceeding in the Federal Register Notice. McCoy, *et al*., SN-03-E-BPA-17, at 1. NWEC raised this issue in BPA's Supplemental Rate proceeding and the Administrator

considered and rejected the proposal by NWEC to have the SN CRAC trigger for events beyond the current fiscal year. CRITFC and SOS/NWEC do not agree with the Administrator's decision and are attempting to relitigate the matter again in this proceeding. *Id.* at 1-2.

Even though BPA believes this matter is not within the scope of this proceeding, BPA does not agree with the conclusions of CRITFC and SOS/NWEC that a new trigger mechanism is needed. The trigger mechanism as stated in the 2002 GRSPs allows a forward look for the current year only to assess if there is 50 percent or lower probability of making the treasury payment for that year. CRITFC and SOS/NWEC argue that BPA should be able to look beyond the current year to address possible events that would negatively impact the ability to recover costs. Allowing BPA to trigger the SN CRAC beyond the current fiscal year for events that have not yet occurred and could be mitigated through other actions would place unfair pressure on ratepayers. This does not preclude BPA from setting rates once the SN CRAC has triggered to solve for events taking place outside of the current year.

Evaluation of Positions

The question of whether the SN CRAC should adjust the trigger for the SN CRAC to look beyond the current fiscal year was evaluated and addressed in the WP-02 Supplemental ROD. *See* WP-02-A-09, at 4-23. In the WP-02 proceeding, NWEC proposed a five-year rolling forecast of TPP. Although CRITFC and SOS/NWEC provided little detail about how the forward look would work, any forward look presents many of the same problems as were noted in WP-02 Supplemental ROD. Because this issue was addressed and specifically rejected by the Administrator in the WP-02 proceeding it is not appropriate to revisit the matter again in this proceeding.

CRITFC and SOS/NWEC propose this adjustment to the SN CRAC trigger because of a concern about matters outside of the rate current fiscal year that could impact BPA's costs or revenues negatively. There are events that could produce the type of sudden or major impacts on BPA's financial situation that the SN CRAC is designed to address. A forward looking trigger as suggested by SOS/NWEC and CRITFC does not provide any real protection against these events. It is impossible to predict "surprise" events like natural disasters, unplanned outages or major changes in market prices and weather. The fact that particular events may be predicted because the business or policy decisions impose a timeline for implementation does not make the trigger proposal more reasonable. While a cost due to regulatory change may be foreseeable in the future, there are also a significant number of other unknown factors that could impact positively BPA's ability to make its treasury payment. Because market prices and hydro conditions are unknown until the actual fiscal year, triggering the SN CRAC based upon a predicted future cost event could result in BPA unnecessarily increasing rates.

Decision 2

The issues concerning the triggering of the SN CRAC were appropriately decided in the WP-02 proceeding. This 7(i) hearing is dealing only with the particular design and level of the SN CRAC adjustment, and BPA will not adjust the trigger mechanism for the SN CRAC.

Issue 3

Whether BPA should provide a refund mechanism in the SN CRAC design to rebate to customers money if BPA's reserve levels exceed established threshold levels.

Parties' Positions

WPAG contends the SN CRAC must contain a refund mechanism to allow monies collected through rates to be returned to customers if BPA's financial circumstances change significantly. WPAG Brief, SN-03-B-WA-01, at 10. WPAG notes that the energy market in recent years has been marked by dramatic changes. *Id.* WPAG believes the current design only addresses the potential downside risk and ignores potential improvements in BPA's financial condition. *Id.* at 11. WPAG proposed a mechanism that would rebate to the customers one-half of the ANR that are in excess of the SN CRAC Threshold plus $15 million, up to the trigger point for the Dividend Distribution Clause (DDC). *Id.* at 11. Under this proposal, after BPA is no longer collecting monies under the FB or SN CRACs and has ANR in excess of $15 million above the SN CRAC Threshold levels for that year, BPA would rebate back one-half the amount by which the ANR exceeds the established limits. *Id.* at 11-12.

GPU proposes a fifty percent refund of any amounts by which ANR exceed the SN CRAC Thresholds. GPU Brief, SN-03-B-SG-01, at 5.

SUB argues for a refund if BPA's reserve levels exceed $350 million. SUB Brief, SN-03-B-SP-01, at 17-18. SUB believes that $350 million is a reasonable figure given the level of ending reserves in BPA's initial proposal. *Id*. SUB does not believe the proposed change would require any changes to the DDC. *Id.* at 18.

In its Brief on Exceptions, SUB states that draft ROD improperly characterized its refund proposal. SUB Ex. Brief, SN-03-R-SU-01, at 8. Under SUB's proposal, a refund would occur if ending reserves are greater that $350 million at the end of the rate period. *Id*. The draft ROD improperly understood the refund to be possible every year and not just once at the end of the rate period. *Id*. at 9. SUB complains that it is impossible to measure the refund proposal without additional information and as a result cannot conclude it is reasonable. *Id*. at 10.

In its Brief on Exceptions, CRITFC argues that the proposed rebate mechanism will weaken BPA's financial health. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 13. They contend that the rebate proposal was not adequately addressed in the SN-03 rate proceeding. *Id*. They further argue that the rebate will result in lower ending reserves and is not consistent with Fish and Wildlife Funding Principle No. 4. *Id*.

BPA's Position

BPA stated that such a change to the SN CRAC design was not necessary or prudent. McCoy, *et al*., SN-03-E-BPA-17, at 11. Contrary to WPAG's assertions, the current design does respond to improvements in BPA's financial condition. There can be a reduction of the amount of money collected under the SN CRAC (and FB CRAC) as a result of improvements to BPA's finances.

Id. As BPA's ANR increases, the levels of the SN CRAC is reduced or eliminated. BPA already has in place the DDC, which will rebate funds to the customers under a set of circumstances that the WPAG and GPU agreed to as part of the settlement of the WP-02 rate case. *Id*.

BPA does not agree with SUB's refund proposal. The reserve levels of $350 million appears to be an arbitrary figure selected by SUB based upon an expected value of ending reserves in BPA's initial proposal with no analysis to support whether the reserve levels were adequate. *Id.*

Evaluation of Positions

WPAG proposes a refund mechanism that would allow monies collected through rates to be refunded to the customers. WPAG Brief, SN-03-B-WA-01, at 10. Under this proposal, if BPA's ANR exceeds the SN CRAC Thresholds by $15 million and BPA is not adjusting base rates upward through either the FB or SN CRAC, BPA would refund one-half of the money by which the PBL ANR exceeds the Threshold levels. *Id.* at 11-12. SUB proposes a refund if BPA's reserve levels exceed $350 million. SUB Brief, SN-03-B-SP-01, at 17-18.

BPA is concerned about the potential impact that a rate increase might have on the region's economy. Keep, *et al*., SN-03-E-BPA-04, at 13. One of the three criteria for the SN CRAC design, which management provided to staff, was to mitigate to the extent possible the impact of any rate increase so as to avoid any unnecessary impact on the region's economy. *Id*.

BPA contended that its initial proposal responded to improvements in BPA's overall financial condition through reductions in the SN CRAC percentage increase in rates by adjustments downward or its elimination altogether if ANR reached particular levels. McCoy, *et al*., SN-03-E-BPA-17, at 11. While the variable design responds to improvements in BPA's overall financial condition, given the magnitude of the economic problems in the region, the balance between improving BPA's finances and mitigating the impacts to the regional economy calls for an additional response. If BPA's ANR rises to the point that BPA no longer needs to collect the SN CRAC or FB CRAC, it is reasonable for BPA to provide some additional rate relief to its regional customers.

WPAG's proposal for a refund is a reasonable suggestion. If BPA's financial condition improves to the point that it is no longer necessary to collect the SN or FB CRAC and BPA has exceeded the SN CRAC Threshold levels, a rebate of one-half of those higher-than-expected ANR levels is not unreasonable. SUB's proposal, does not provide any analysis to demonstrate whether it is consistent with the financial standards adopted in this proceeding. In addition, SUB's proposal as clarified in its Brief on Exceptions, would only refund money once at the end of the rate period. Given the statements about the fragile state of the regional economy, if BPA's financial health is restored to the point it no longer needs the FB or SN CRACs, then refunding the monies prior to the end of the rate period seems to be a better mechanism to address the concerns about the economy.

WPAG's proposal, on the other hand, recommends initiating the refund only when BPA has reached some financial stability and it is no longer collecting revenues under the SN or FB

CRAC. Under those limited circumstances it is sensible to refund some portion of the monies collected from customers.

While WPAG's proposal provides some of the details necessary to transform this idea into a mechanism BPA can implement in its rates, there are a couple of areas that need to be refined. In particular, WPAG's proposal does not provide the detail necessary on how BPA should distribute the refund among its customers. BPA has in place a mechanism with the DDC that with some modifications would provide a reasonable means of ensuring an equitable distribution of the funds.

Decision 3

BPA will provide a refund mechanism in the SN CRAC design to rebate to customers previously collected money if PBL ANR exceeds established SN CRAC threshold levels by $15 million subject to a minimum rebate of $5 million.

Issue 4

Whether BPA should maintain the three financial standards (TPP, TRP and zero net revenue) for setting the SN CRAC adjustment to rates.

Parties' Positions

WPAG argues that it is beyond the scope of the current GRSPs to use the SN CRAC to collect past losses if a high probability of making future treasury payments is achieved. WPAG Brief, SN-03-B-WA-01, at 20. NRU urges BPA to reject the "zero net revenue" and TRP standards. NRU Brief, SN-03-B-NR-01, at 6. ICNU and ALCOA argue the zero net revenue standard allows BPA to rebuild those reserves by recovering for both its actual losses from FY 2002 and FY 2003 and its forecasted losses from FY 2004 to FY 2006. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 19. ICNU and ALCOA believe this financial standard allows BPA to recover for past losses. *Id*. They contend that is inconsistent with the SN CRAC as defined by GRSPs. *Id*.

CRITFC and SOS/NWEC argue that a three-year TPP of 50 percent fails to address the risks BPA faces and greatly increases the possibility BPA will not be able to pay the treasury or will cut its fish and wildlife funding obligations in order to avoid a missed treasury payment. CRITFC Brief, SN-03-B-CR/YA-01, at 40; SOS/NWEC Brief, SN-03-B-SA-01, at 7-8. CRITFC and SOS/NWEC are also concerned that a 50 percent TPP does not meet the Fish and Wildlife Funding Principles. *Id*.

CRITFC argues in its Brief on Exceptions that the 80 percent three year TPP financial standard is too low because it is the equivalent of a 69 percent five-year TPP. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 14.

BPA's Position

BPA's initial proposal designed the SN CRAC to meet the following financial standards: the SN CRAC should produce PBL net revenues that are at least zero over the five year rate period; a TPP standard for this rate period reduced to a 50 percent probability that BPA can make all of its treasury payments in the FY 2004-2006 period; and a new Treasury Recovery Probability (TRP) standard, which is the probability that BPA will be able to make all of its FY 2006 payments to the U.S. Treasury, including repayment of any amounts it might miss in FY 2003-2005. *See* Keep, *et al.,* SN-03-E-BPA-04, at 13-15.

The three financial standards in BPA's proposal, taken together, reflect BPA's concern for the current weakened economic condition of the Northwest, BPA's mitigation of overall rate increases, and provision for a reasonable level of assurance that BPA's obligations to the U.S. Treasury will be satisfied by the end of FY 2006. Keep, *et al.,* SN-03-E-BPA-11, at 29. BPA believes this is consistent with the original intent of the SN CRAC to restore a high probability that treasury payments during the remainder of the rate period will be made in full to the extent market and other risk factors allow. *Id*. This intent is explicitly stated in the GRSP language. Keep, *et al*, SN-03-E-BPA-04, at 2. The three financial standards represent an appropriate compromise to balance financial objectives and the financial problems in the region. BPA proposed the combination of the three financial standards because the rate levels that would have been required to meet BPA's traditional single standard, a three-year TPP of 92.6 percent (equivalent to a five-year TPP of 88 percent) would have posed a very significant burden for a region with the nation's highest unemployment rates. BPA therefore relaxed the TPP standard to 50 percent for the three-year period covered by the SN CRAC, and added the other two standards to ensure that BPA would be on a path to recover its financial health. Keep, *et al.*, SN-03-E-BPA-4, at 14-15. BPA believes it needs measures of current and future liquidity (TPP and TRP), period cost recovery (zero net revenue), and long-term viability (multi-year repayment studies set to recover future costs) in setting rates for the remainder of a multi-year period. Keep, *et al.,* SN-03-E-BPA-11, at 29. Additionally, BPA traditionally sets rates to recover the higher of depreciation or amortization, which is explicitly a standard of the higher of accrual or cash results. *Id.* As an alternative to this multi-faceted approach, BPA could have chosen to maintain its traditional TPP standard of setting rates to ensure an equivalent 80-88 percent probability that BPA can make all of its treasury payments in the FY 2004-2006 three-year rate period. Had BPA taken the traditional approach, this would have resulted in rates and ending reserve levels far in excess of those resulting from the combination of the three standards. *Id*. at 30. *Also see* SN-03-FS-BPA-01, Chapter 7 of the Final Study, SN CRAC Design, showing results for three year TPP equal 87.5%, the equivalent of five-year 80% TPP.

Evaluation of Positions

A primary focus of this rate proceeding for many parties has been a desire to eliminate or minimize the size of any SN CRAC adjustment to base rates. Parties advocated cost cutting and the use of financial tools as mechanisms to avoid any rate increase. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 17-18; NRU Brief, SN-03-B-NR-01, at 5; PNGC Brief, SN-03-B-PN-01, at 5; GPU Brief, SN-03-B-GP-01, at 4-5; PPC/IDEA Brief, SN-03-B-PP-01, at 8-9; WPAG

Brief, SN-03-B-WA-01, at 2. The parties also contend that any rate increase at this time is not appropriate given the weakened state of the regional economy.

BPA acknowledged the concerns about the regional economy and has endeavored to minimize the size of any SN CRAC adjustments. One of the three criteria expressed by management to guide staff when designing the SN CRAC was to minimize the impact of any rate increase on the regional economy. Keep, *et al*., SN-03-E-BPA-04, at 13. BPA cut costs and increased revenues in an effort to minimize the size of any SN CRAC adjustment. As part of the Financial Choices process BPA has cut or deferred its costs by approximately $350 million over the balance of the rate period. Keep, *et al*., SN-03-E-BPA-04, at 9. In addition, BPA has cut more than $80 million in expenses and the secondary revenues forecast for FY 2003 has significantly increased since BPA's initial proposal. These developments improved but did not solve the financial problems faced by BPA.

Parties have also noted improvements in BPA's financial condition since the initial proposal. In particular, WPAG notes that since the rate case was initiated, improvements in stream-flow forecasts and relatively high market prices have increased the expectation of BPA's secondary revenues since this initial proposal. WPAG Brief, SN-03-B-WA-01, at 6. "One example of where the contemporary wisdom fell short, the March Miracle. In January, nobody expected March to be a deluge. It was. These kind of things happen." Oral Tr. 15.

At the time of the initial proposal BPA had a 39 percent probability of making its treasury payment at the end of FY 2003. This is no longer the case. As noted, substantial cost reductions, cash improvement and improved secondary revenue now makes the likelihood of paying the treasury in full in FY 2003 close to 100 percent. BPA's near term finances have improved due, in part, to an unexpected cold and wet March and April (which significantly improved the snow pack) coupled with relatively high market prices, additional cost reductions, contract termination savings, and cash flow improvements due to aggressive debt management. Nonetheless, BPA still has a net revenue shortfall over the remaining three years of the rate period unless some adjustment to rates is made.

Concerns about the impact of a rate increase on the regional economy led BPA management to direct staff to design the SN CRAC in a manner that could, to the extent possible, minimize the size of the rate increase. Keep, *et al*., SN-03-E-BPA-04, at 13. As a result, BPA's initial proposal did not attempt to adjust rates to the levels necessary in order to achieve the 80-88 percent five-year TPP goal from the WP-02 proceeding. Setting rates to meet that standard, given BPA's financial condition at that time, would have meant rates at levels the region's currently weak economy likely could not sustain. As a consequence, while not abandoning the prior standard, BPA recognized that it needed to develop different financial standards to measure the proposed adjustment in this SN CRAC proceeding. In response to these concerns, BPA's initial proposal adopted three financial standards that must be met by the SN CRAC adjustment--TPP of 50 percent, TRP of 80 percent, and zero net revenues over the rate period. Keep, *et al.*, SN-03-E-BPA-04, at 13-15.

BPA believed it reasonable to propose the use of the TPP, TRP, and zero net revenue standards based upon two competing objectives: regaining BPA's financial health while striking a balance against the impact of any rate increase on the regional economy. BPA felt that the combination

of the three financial standards, TPP, TRP, and zero net revenue, provided the needed balance to ensure that BPA regained financial health and at the same time did not unduly burden the region at a time when the regional economy is fragile. BPA supported its decision to use the three financial standards by noting that the alternative, relying only on a TPP standard equivalent to the five-year standard of 80-88 percent "would result in rates and ending reserve levels far in excess of those resulting from the combination of the three standards." Keep, *et al*., SN-03-E-BPA-11, at 30.

CRITFC and SOS/NWEC argue that a TPP of 50 percent fails to address the risks BPA faces and greatly increases the possibility it will not be able to pay the treasury. CRITFC Brief, SN-03-B-CR/YA-01, at 40; SOS/NWEC Brief, SN-03-B-SA-01, at 7-8.

This proceeding presents a somewhat unique rate decision for the Administrator. The SN CRAC, as compared to the LB and FB CRACs, allows the Administrator a distinct opportunity to weigh a variety of factors before making an adjustment to the rates. The GRSPs on the SN CRAC state:

> The SN CRAC will be an upward adjustment to posted power rates subject to the FB CRAC by modifying the FB CRAC parameters. BPA will propose changes to the FB CRAC parameters that will, *to the extent market and other risk factors* allow, achieve a high probability that the remainder of treasury payments during the FY 2002-2006 rate period will be made in full. BPA's proposal *could include changes to the Revenue Amount, duration (*the length of time the SN CRAC would be in place, which could be more than one year), *and the timing of collection*. The additional revenue to be generated by the SN CRAC will be collected through a uniform percentage increase in all rates subject to the FB CRAC and a commensurate decrease in the financial portion of the Residential Exchange Settlement. (Emphasis added)

SN-03-A-01, Appendix A. The expansive language used in the GRSPs demonstrates the broad discretion given to the Administrator to fashion a solution to BPA's financial problem. Not only may the Administrator determine the amount of money collected, but it is within his discretion to determine the time period over which the adjustment is collected (*i.e*., one v. multiple years) and the timing of collection (*i.e*., flat v. tilted). In addition, the GRSPs grant the Administrator the ability to weigh the impact that "market and other risk factors" have on the ability to achieve a high probability of making BPA's treasury payments in full. The WP-02 Supplemental ROD also recognized that the SN CRAC remedy fashioned by the Administrator would depend upon particular circumstances that resulted from the triggering. WP-02-A-09, at 2-7.

Because the Administrator is given broad discretion and can weigh a variety of factors to determine the appropriate level and design of the SN CRAC, the decisions here reflect the unique set of circumstances evidenced on the record as facing the agency, considered in the context of BPA's legal responsibilities. The decision to adopt a particular rate design or level in this proceeding should not be seen as creating any precedent for future SN CRAC adjustments or alternatively for rate cases generally. The decisions reflected here evidence a careful weighing

of the particular set of factors related to BPA's current financial condition, the outlook for BPA's financial future and the impact of a rate increase on the region's economy.

While, as indicated, a great number of factual and legal factors must be taken into account in deciding the issues in this case, two legal criteria are worthy of particular note. The first is that an important purpose of the Northwest Power Act is the existence of an "adequate, efficient, economical, and reliable power supply." 16 USC § 839(2). The second criteria is the Administrator's responsibility to act consistent with sound business principles. Throughout BPA's history, Congress has expressed its intent that BPA act in a businesslike fashion. Congress intended in the Bonneville Project Act that the Administrator be enabled "to employ business principles and methods in the operation of a business enterprise . . ." S. Rep. No. 469 (July 18, 1945). Subsequently, section 9 of the Federal Columbia River Transmission System Act would require in part that BPA set rates having regard to the recovery of BPA's costs and "with a view to encouraging the widest possible diversified use of electric power at the lowest possible rates to consumers consistent with sound business principles, . . ." 16 U.S.C. § 838g. The Flood Control Act is similarly worded. 16 U.S.C. § 825s. With the passage of the Northwest Power Act, Congress charged in section 9(b) that "The Secretary of Energy, the [Regional] Council, and the Administrator shall take such steps as are necessary to assure the timely implementation of this Act in a sound and business-like manner." 16 U.S.C. § 839f(b). Finally, section 7(a) of the Northwest Power Act provides that rates shall be established to, in part, recover costs "in accordance with sound business principles."

There is a common thread to both the purpose of the Northwest Power Act to assure an "adequate, efficient, economical, and reliable power supply" and the charge that the Administrator act consistent with sound business principles: the challenge to the Administrator to preserve the value of Federal power for the region now and over time. As a consequence, decisions of the Administrator must be made with both short- and long-term considerations in mind.

The Administrator takes this charge very seriously. Thus, for example, outside the rate case the Administrator made substantial program cost cuts and urged BPA's cost partners (*i.e.*, Corps, Reclamation and ENW) to improve their respective cost controls. While BPA was able to achieve substantial cuts this was done with a view to, among other things, not compromising adequate and reliable operations and BPA's other programmatic responsibilities; improving BPA's current financial position; and relieving upward pressure on rates. While the latter two are more centered on the near term, the former takes into consideration both short- and long-term operational needs.

Not surprisingly, similar short- and long-term considerations have informed BPA's approach to financial policy. Ensuring a high treasury payment probability has been BPA's consistent policy since at least the 1993 rate case. A constant, uninterrupted flow of payments to the United States Treasury in accordance with applicable repayment criteria is BPA's best insurance that it will have continued access to Federal borrowing authority and other financial resources necessary to carry out its programs, not only now but also in the long-term. Missed treasury payments jeopardize BPA's access to capital and also expose BPA to the risk that Congress could do away

with BPA's cost-based rates. Clearly, this would endanger BPA's provision of economical power to the region; it is a scenario that BPA must act to avoid.

Consequently, a case such as this one, which was triggered by a determination that the Administrator has less than a 50 percent probability of making the next Treasury payment is an undertaking with extremely important consequences, not only for current ratepayers but for future generations of BPA customers. Rates are an important vehicle for assuring, together with the other actions taken by BPA, that BPA has a reasonably high probability of making its payments to the treasury. At the same time, near-term employment and competitive impacts of any BPA rate increase are of significant concern to the Administrator. Many parties have made their case loud and clear that the region is experiencing serious economic problems. In light of this, they have challenged BPA to avoid any rate increase and to take whatever actions are necessary to achieve that result. This raises the issue whether it is reasonable to relax BPA's Treasury payment probability, regardless of how low it goes, and to draw on other financial liquidity tools so that there is no near-term rate increase, notwithstanding the longer term implications of a missed treasury payment and threat to BPA's financial integrity. In light of the Administrator's responsibility to act with both short- and long-term considerations in mind, it is not reasonable to relax TPP solely for short-term benefits. The Administrator must strike a balance that preserves the value of Federal power for the region now and over time.

For rate setting purposes, BPA has long recognized that it is appropriate to factor in both short- and long-term considerations. The Administrator recognized this in setting short-term risk mitigation measures in the 1987 rate case:

> BPA also considered sound business principles, as BPA is statutorily obligated to establish its rates to recover its costs consistent with such principles. [Citation omitted.] One sound business principle is that both short- and long-run considerations be taken into account. Setting rates as low as possible runs the risk of BPA having to reschedule its amortization payments. In the long run, the chances of BPA being subjected to repayment reform would be greater given such a repayment track record, with the consequence that rates would not be as low as they might otherwise have been. [Citation omitted.] BPA's risk management strategy has carefully considered and balanced such considerations. [Citation omitted.]

Administrator's ROD, 1987 Final Rates Proposal, at 32 (July 29, 1987). The tension between setting rates in a manner that assures cost recovery and that keeps rates as low as possible is a matter of balancing a number of competing policy considerations within the context of sound business principles.

This was acknowledged again when BPA first adopted its long-term financial plan, including the treasury payment probability standard. As BPA stated at the time,

> The Administrator has a responsibility to take into consideration and weigh a number of complex and difficult factors, as well as the concerns and arguments raised by the parties, in making the final determinations that affect

> BPA's overall rate levels. . . .In evaluating the options available to achieve that balancing, among those is the critical issue of the level of assurance that treasury payments will be met. Inasmuch as all other reasonable avenues to reduce the rate pressures have been pursued and exhausted, it is both reasonable and appropriate to prudently consider and weigh the option of relaxing the treasury payment probability standard phase-in for the FY 1994-95 rate period. That is not to say that there is no limit to relaxation of the standard or, put another way, that a lower rate increase is the only governor of the treasury payment standard. Sound business principles and all of the rationales underlying the 95 percent probability standard counsel a judgmental determination as to the point where further relaxation of the standard cannot be countenanced, ... Given the discussion in section 2.2, supra, the factors discussed in the Financial Plan, the largely unprecedented situation depicted in BPA's supplemental testimony, and the risk facing BPA during the rate period, an 85 percent probability of treasury payment is warranted. . . .

Administrator's final ROD, 1993 Rate Case, WP-93-A-02, at 75-76. BPA faces similar circumstances and considerations in this case.

When BPA began this proceeding, it had less than a 50 percent probability of making the FY 2003 treasury payment and BPA's finances were not anticipated to improve over the balance of the rate period because of a forecast of negative net revenues. Keep, *et al*., SN-03-E-BPA-04, at 15.

To address the "twin goals of moving toward a financially healthier BPA while limiting the rate effect on the regional economy," BPA agreed to reduce its TPP standard to 50 percent, but bolstered the viability of that proposal by invoking other standards in order to create an envelope of financial prudence. *See generally*, Keep, *et al.*, SN-03-E-BPA-04, at 14. While not abandoning the 80-88 percent TPP, BPA did not believe the regional economy could support the then-anticipated level of rate increase necessary to achieve that goal. *Id*. BPA recognized at that time that, in order to demonstrate a high probability of making all of its treasury payments, additional financial standards were necessary to measure the effectiveness of the rate proposal. As a result, BPA added the TRP and zero net revenue standards to augment the reduced TPP standard. *Id.* at 14-15. BPA believed that the combination of these three financial standards gave a high level of assurance that BPA could meet its treasury payment given the limitations of "market and other risk factors." *Id*. at 15.

BPA's financial outlook has improved significantly since the release of the initial proposal. Through a combination of hard work in reducing expenses, cash flow improvements due to ENW/BPA debt management efforts, and the good fortune of improvements in secondary revenues, it is now possible to achieve a much higher TPP at a much lower rate than at the time of the initial proposal.

The GRSPs give the Administrator the discretion to weigh the level of any potential rate increase against the near-term impact on the region's economy. Given the improvements in BPA's near-term finances since the initial proposal, it is logical to revisit the need to use the three

financial standards. While combining the three financial standards was reasonable at the time of the initial proposal, given the improvements in BPA's financial condition, BPA believes the additional TRP and zero net revenue standards are no longer necessary. As noted, it is now possible to greatly increase TPP at a much lower rate level than envisioned at the time of the initial proposal. Thus, the improvements will allow BPA to return to the more traditional TPP-only standard. While the parties have supported abandoning the zero net revenue and TRP financial standards, maintaining a 50 percent TPP-only financial standard would jeopardize BPA's financial condition. BPA continues to face a net revenue shortfall over the balance of the rate period that if not addressed would not produce a high probability of treasury payments as called for in the SN CRAC GRSPs.

Based on the improvements in BPA's financial condition that are on the record, a three-year TPP of 80 percent, consistent with the Fish and Wildlife Funding Principles, produces an average expected value for FY 2004–2006 rates of about 5 percent above the total rate level for 2003. This is a dramatic improvement from the 15.6 percent increase above 2003 rate levels forecasted in the initial proposal and is consistent with the twin goals described above. Under the proposed contingent rate design, further improvements in secondary revenues or further reductions in costs could bring the rate down further, and a settlement of the ongoing dispute over IOU residential benefits could produce an overall rate decrease. While BPA is willing to adjust its financial standards from the initial proposal because of the unique circumstances presented by the poor regional economy, the decision to modify these standards should not be seen as any indication that the zero net revenue or TRP financial standards were not appropriate measures for the SN CRAC nor that an 80 percent three-year TPP is appropriate in any but the most dire circumstances. Nor should the willingness to accept a three-year TPP be viewed as one that abandons the five-year 88 percent TPP goal identified in the WP-02 ROD.

It should be noted that this three-year TPP of 80 percent is equivalent to a five-year TPP of 69 percent, which is below the 80-88 percent set out in the Fish and Wildlife Funding Principles for the WP-02 rate case. CRITFC argues in their Brief on Exceptions that the 80 percent three-year TPP financial standard is too low. CRITFC Ex Brief, SN-03-R-CR/YA-01, at 14. While the five-year TPP equivalent is below the letter of the Fish and Wildlife Funding Principles, this five-year TPP is somewhat understated given that BPA made its FY 2002 treasury payment and will make the FY 2003 treasury payments on time and in full. A 100 percent success in making the treasury payment in the first two years, and an 80 percent TPP for the remaining three years of the rate period is consistent with the Fish and Wildlife Funding Principles. For further discussion, *see* chapter 2.8 on Fish and Wildlife.

Despite the decision to move to a TPP-only standard, it is nevertheless important to address some of the issues raised by the parties regarding zero net revenues and TRP. A number of parties have raised concerns about the zero net revenue standard. ICNU and ALCOA believe the standard cannot be sustained in the context of an SN CRAC because it allows BPA to rebuild those reserves by recovering for both its actual losses from FY 2002 and FY 2003 and its forecasted losses from FY 2004-2006. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 19. A zero net revenue standard is consistent with the GRSPs. The SN CRAC was designed to recover from bad financial results because of the triggering potential based on actually *missing* a payment to treasury or other creditor. Keep, *et al.*, SN-03-E-BPA-11, at 31 (emphasis in original).

BPA is obligated to set the SN CRAC rate levels to assure a high probability of making the remainder of the treasury payments over of the rate period in full. Keep, *et al*., SN-03-E-BPA-11, at 31. Moreover, reserves are a critical element to BPA's overall rate design. Reserves are important in that, by providing a financial buffer, they help maintain BPA's TPP while minimizing rates. Keep, *et al.*, SN-03-E-BPA-04, at 4. Reserves allow BPA to provide some rate stability and assure payment to treasury during periods when revenues are down or when costs increase. For example, BPA started FY 2001 with a relatively high reserve balance, which allowed base rates to be set lower than they otherwise would have been if reserves had been lower. *Id.* Interpreting the GRSPs in a fashion that did not allow it to rebuild its reserve levels is inconsistent with the obligation to assure a high probability of making its treasury payments over the balance of the rate period.

NRU raised separate general concerns about the use of a TRP standard. NRU believes TRP is unnecessary and gives BPA too much flexibility between now and the end of FY 2006 to use the SN CRAC process to (1) fully recover losses already experienced during the rate period; and (2) build in too much of a cushion for reserves to partially mitigate deferrals during the remainder of the current period. Saven, *et al*., SN-03-E-NR-01, at 16. These arguments are similar to those raised regarding the zero net revenue standard. BPA is not determining that the TRP standard is an inappropriate standard, rather that given the change in BPA's financial condition, maintaining this as a financial standard is no longer necessary. BPA believes the single TPP-only standard provides the appropriate financial security.

Decision 4

Given improvements in BPA's financial condition, maintaining the three financial standards for the SN CRAC no longer strikes the necessary balance between the BPA's financial health and the regional economy. Instead of the three financial standards, BPA is adopting a three-year TPP standard of 80 percent.

Issue 5

Whether there is sufficient evidence in the record to support adopting an 80 percent TPP standard.

Parties' Positions

In its Brief on Exceptions, NRU contends there is no record evidence to support the contention that an 80 percent TPP is necessary to preserve BPA's finances. NRU Ex. Brief, SN-03-R-NR-01, at 11. NRU contends it does not have the Toolkit model runs necessary to identify what the appropriate ending reserve levels should be. *Id.* NRU notes the draft ROD stated that an 80 percent TPP would produce $354 million in ending reserves on an expected value basis. *Id.* NRU supports an ending reserve level of $150 and $200 million. *Id.*

GPU argues in its Brief on Exceptions, there is nothing in the evidentiary record to support the adoption of the 80 percent TPP standard or that 80 percent establishes a reasonable balance between the twin goals of a financially healthy BPA and limiting the rate effect on the economy.

GPU Ex. Brief, SN-03-R-GP-01, at 5. There is also nothing in the record to support the claim that the rate impact will be only five percent over the balance of the rate period.

PNGC argues one of the more disappointing aspects of the draft ROD is the retreat from the three financial standards in the initial proposal. PNGC Ex. Brief, SN-03-R-PN-01, at 10. They contend there is no evidentiary support for decision and conclude the only reason for the change is a decision by BPA to make more money off the region. *Id.* They believe that it is perverse for BPA to have a better financial condition and impose a higher financial standard for the SN CRAC. *Id.* at 11.

CRITFC and SOS/NWEC both argued in testimony and brief that BPA should not abandon its obligation to the Fish and Wildlife Funding Principles. CRITFC Ex. Brief, SN-03-R-CR-01, at 41; SOS/NWEC Ex. Brief, SN-03-R-01, at 1.

BPA's Position

There is evidence on the record that supports BPA;s decision to adopt an 80-88 percent TPP. BPA initially proposed repayment standards of zero net revenue, TPP greater than 50 percent and a TRP greater than 80 percent as a way to mitigate the SN CRAC rate increase, given the state of the economy. BPA indicated that without this multi-faceted approach, BPA could have chosen to maintain its traditional TPP standard of setting rates to ensure an equivalent 80-88 percent probability. Keep, *et al.*, SN-03-E-BPA-11, at 30.

Evaluation of Positions

NRU and GPU contend there is no record evidence to support the contention that an 80 percent TPP is necessary to preserve BPA's finances. NRU Ex. Brief, SN-03-R-NR-01, at 11, GPU Ex. Brief, SN-03-R-GP-01, at 5. PNGC argues there is no evidentiary support for the decision and conclude the only reason for the change is a decision by BPA to make more money off the region. PNGC Ex. Brief, SN-03-R-PN-01, at 10.

BPA notes that SOS/NWEC and CRITFC both argued that BPA should adhere to the financial standards set forth in the Fish and Wildlife Funding Principles that require an 80-88 percent TPP.

BPA staff's initial proposal contained three financial standards that on balance, given BPA's financial condition, allowed BPA to get back on a path toward financial recovery and at the same time attempted to minimize the impact on the region. BPA believed that the combination of these three financial standards gave a high level of assurance that BPA could meet its treasury payment given the limitations of "market and other risk factors." *Id*. at 15. These financial standards were not embraced by any segment of the parties participating in this proceeding. The customers in general rejected the three financial standards as too high. In particular, the customer parties believed the zero net revenue standard went beyond what the SN CRAC was intended to recover. Conversely, CRITFC and SOS/NWEC felt the three financial standards were too low and created too great a risk that BPA would miss a Treasury payment or alternatively cut fish and wildlife funding in an effort to avoid the consequences associated with missing a Treasury payment. Both CRITFC and SOS/NWEC argued that BPA was obligated to

maintain the financial standards adopted in the Fish and Wildlife Funding Principles of an 80-88 percent TPP.

PNGC's argument that BPA has changed the financial standard to make more money off the region cannot be correct, since the rate required to meet the three financial standards is higher than the rate required to meet the three-year 80 percent TPP-only standard. *See* SN-03-FS-BPA-01, Chapter 7 of the Final Study, SN CRAC Design.

The NRU, PNGC and GPU contentions that there is no evidence to support an 80 percent TPP are incorrect. As noted, CRITFC and SOS/NWEC both argued for maintaining the 80-88 percent TPP. While BPA staff did not advocate for such a financial standard, the record is not devoid of evidence as the parties suggest.

Decision 5

The record supports adopting an 80 percent TPP-only standard.

Issue 6

Whether an 80 percent TPP-only standard tips the balance between BPA's financial health and the impact on the regional economy too far in favor of BPA's financial health.

Parties' Positions

GPU argues in its Brief on Exceptions, that the adoption of an 80 percent TPP-only standard tips the balance between the twin goals of improving BPA's financial health and minimizing the impact on the region too far in favor of BPA's financial health. GPU Ex. Brief, SN-03-R-GP-01, at 7. The regional economy is still in dire condition and the Administrator should stay with the TRP and TPP standards from the initial proposal. *Id.*

WPAG argues the ROD should abandon the 80 percent TPP standard and keep the 50 percent TPP and 80 percent TRP for determining the parameters of the SN CRAC. WPAG Ex. Brief SN-03-R-WA-01, at 8. It contends that the 80 percent TPP places an unnecessary hardship on the region at a time when the customers and communities are suffering difficult economic times and BPA's finances have improved. *Id*. at 9.

BPA's Position

The three-year 80 percent TPP-only financial standard does not tip the balance too far in favor of improving BPA's financial health at the expense of the region's economy or the other statutory obligations of the agency.

Evaluation of Positions

The decision by the Administrator is a reasonable compromise between BPA's proposed three standards and the parties' proposal to drop the zero net revenue standard. While neither BPA

staff nor the customer parties advocated this specific compromise, it is consistent with the Fish and Wildlife Funding Principles and was advocated by both CRITFC and SOS/NWEC. Sheets, *et al.,* SN-03-E-CR/YA-01, at 41; Weiss, *et al.,* SN-03-E-SA-01, at 6. It is also consistent with the BPA's initial proposal. BPA initially proposed repayment standards of zero net revenue, TPP greater than 50 percent and a TRP greater than 80 percent as a way to mitigate the SN CRAC rate increase, given the state of the economy. BPA indicated that without this multi-faceted approach, BPA could have chosen to maintain its traditional TPP standard of setting rates to ensure an equivalent 80-88 percent probability. Keep, *et al.*, SN-03-E-BPA-11, at 30. Had BPA maintained the original three repayment standards, the SN CRAC adjustment would have been 19.3 percent. Given the state of the economy, BPA felt this rate was too high, and therefore was willing to drop the zero net revenue and TRP standard, which decreased the SN CRAC rate to 15.9 percent. *See* SN-03-FS-BPA-01, Chapter 7, SN CRAC Design.

However, many parties continue to advocate BPA drop the net revenue standard, but maintain the TRP and TPP greater than 50 percent standards. WPAG Ex. Brief SN-03-R-WA-01, at 8; ICNU Ex. Brief SN-03-R-IN/AL-01, at 9; GPU Ex. Brief SN-03-R-GP-01, at 2; Golden Northwest Ex. Brief SN-03-R-GN-01, at 14. While this would result in a slightly lower SN CRAC rate of 14.4 percent, it would also lower BPA's TPP to the unacceptable level of 75 percent. *See* SN-03-FS-BPA-01, Chapter 7, SN CRAC Design. As previously noted, CRITFC and SOS/NWEC advocated an 80 to 88 percent TPP. Adopting the single standard of TPP equal to 80% is a reasonable compromise to all parties. It gives BPA a minimum acceptable treasury payment probability (as the alternative on the record to dropping the multi-standard approach), provides significant rate relief to the region over the initial proposal and meets the minimum TPP advocated by CRITFC and SOS/NWEC.

Therefore, the contention that the rate design adopted in the ROD tips the balance too far in favor of BPA's financial health is misplaced. Contrary to the position advocated by GPU, the 80 percent TPP-only standard does not tip the balance in favor of BPA's financial recovery at the expense of the regional economy.

Decision 6

The 80 percent TPP-only standard does not tip the balance between BPA's financial health and the impact on the regional economy too far in favor of BPA's financial health.

Issue 7

Whether BPA should adopt a Creditor Payment Probability (CPP) to measure its financial risk.

Parties' Positions

CRITFC contends that in order to measure the actual financial risk it faces BPA should use a CPP standard rather than a TPP standard. CRITFC Brief, SN-03-B-CR/YA-01, at 39. CRITFC believes that TPP is not the true measure of financial risk BPA faces. *Id.* Because BPA can defer its treasury payment, it is the payment to other creditors that more accurately reflects BPA's financial risk. *Id.* To determine this financial risk BPA must remove from the

determination of the CPP, any 4(h)(10)(C), FCCF and MOA monies because they cannot be used to pay creditors. *Id.*

CRITFC argues that BPA should use a CPP standard to measure its rate design and should do so without using any 4(h)(10)(C), FCCF and MOA monies. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 14.

BPA's Position

BPA's payment to the treasury is the lowest in BPA's priority of payments. Keep, *et al*., SN-03-E-BPA-11, at 34. If BPA has made any portion of its treasury payment then all other creditors will have been satisfied. *Id*. 4(h)(10)(C), and under specified circumstances FCCF credits, are applied to the treasury payment but it is very unlikely that these credits would be substantial enough to fully cover the power portion of the treasury payment and leave a creditor unpaid. *Id.* BPA does not believe that there are any MOA monies at this time. *Id.*

Evaluation of Positions

CRITFC's proposal to adopt a CPP is misplaced. CRITFC incorrectly assumes that because BPA has the ability to defer a treasury payment, the payment to other creditors is the true measure of its financial position. As BPA correctly notes, the payment to treasury is the last in the line of payments. Because payments to the treasury are the last made in the priority of payment, by definition all other creditors will have been paid before the treasury is paid. By using the probability of making payments to creditors as a measure of BPA's financial condition, CRITFC's proposal would relax rather than strengthen BPA's financial standards because it ignores BPA's largest creditor.

Decision 7

BPA will not adopt a CPP standard to measure its rate proposal.

Issue 8

Whether BPA should remove the Cap on the amounts collected under the SN CRAC.

Parties' Positions

CRITFC contends that BPA should remove any limits on the annual amount collected under the SN CRAC. CRITFC Brief, SN-03-B-CR/YA-01, at 48. CRITFC believes the potential for increased costs or reduced revenues are larger than BPA has assumed in its proposal, and that BPA therefore must remove the cap to have the tools to increase rates to meet its costs and repay the treasury. *Id.*

SOS/NWEC argues that BPA should remove the $470 million Cap on the variable rate mechanism to allow rates to rise to the levels necessary to ensure treasury payment. SOS/NWEC

Brief, SN-03-B-SA-01, at 8. They suggest that in light of the various risks faced by BPA, its proposal is inconsistent with sound business practices. *Id.*

SUB contends that BPA must reject the proposal by SOS/NWEC and CRITFC to remove the cap on amounts collected by the SN CRAC. SUB Brief, SN-03-B-SP-01, at 19.

In their Brief on Exceptions, CRITFC notes that the Cap in the draft ROD is lower than the Cap contained in BPA's initial proposal. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 15. CRITFC believes BPA should remove the Cap so as to assure payment to the Treasury and improve the ability to meet its fish and wildlife obligations. *Id.*

BPA's Position

In the development of the SN CRAC, BPA explored the impacts of a variety of SN CRAC parameters on rates. McCoy, *et al*., SN-03-E-BPA-10, at 6. BPA is concerned about the impact of any rate increase on the economy of the Pacific Northwest, so direction was given to staff that the rate design should mitigate the level of any rate increase, to the extent possible, while at the same time providing a reasonable assurance of cost recovery. Keep, *et al*., SN-03-E-BPA-04, at 13. BPA determined a cap provided an equitable balance between ensuring rate levels are not too high and protection for BPA's finances. McCoy, *et al*., SN-03-E-BPA-10, at 6.

Evaluation of Positions

CRITFC and SOS/NWEC contend there is significant risk associated with future fish and wildlife costs and as a result BPA should remove the cap on the amount collected under the SN CRAC. CRITFC Brief, SN-03-B-CR/YA, at 48. BPA has heard from various customers that the region cannot absorb a large rate increase at this time. SUB Brief, SN-03-B-SP-01, at 19. Uncapping the amount collected under the SN CRAC would increase the maximum possible rate increase without limit, posing to customers the unlikely but extremely worrisome risk of truly enormous rate increases. As noted, BPA attempted to strike a balance between the impact on the region of a rate increase and the financial risks to BPA. Having a cap on amounts collected annually provides a consistent balance between the rate level and impact on the region. McCoy, *et al*., SN-03-E-BPA-10, at 5-6.

The caps included in the initial proposal reflect BPA's financial status at a particular time. Given BPA's improved financial condition and the decisions reflected in this proposal, the Caps are now set at $320 million per year. Given the decision to have a contingent design, the actual dollar amount of the Cap will not be determined until August 2003. *See* GRSPs, Appendix A.

In addition, BPA believes it has captured a reasonable range of risk in development of the SN CRAC. *See* Conger, *et al*., SN-03-E-BPA-07, at 16. To the extent that the Cap keeps BPA from collecting revenues needed for financial security, BPA may retrigger the SN CRAC to adjust the Caps and Thresholds. *See* GRSPs, Appendix A.

Decision 8

The Cap on the amounts collected under the SN CRAC is a reasonable compromise between the impact of power rates on the regional economy and financial health for BPA.

Issue 9

Whether BPA should adopt a contingent recalculation of the SN CRAC that modifies the Caps and Thresholds.

Parties' Positions

CRITFC notes that BPA's contingent adjustment in August 2003 will only consider increases in revenues and decreases in certain cost levels. CRITFC Brief, SN-03-B-CR/YA-01, at 49. CRITFC believes BPA should take note of both good news and bad news when it adjusts the parameters of the SN CRAC and reflect both increases and decreases in its costs and revenues in the adjustment to the parameters. *Id.*

GPU argues that if BPA adopts an SN CRAC it should do so only if it accepts the four principles GPU proposed in testimony. GPU Brief, SN-03-B-SG-01, at 5. Those four principles are the following: (1) The Maximum Planned Recovery Amount for FY 2005 and FY 2006 should be recalculated to achieve the same levels of TPP and TRP as BPA's initial proposal, but the third standard, zero net revenues over the rate period, should be removed; (2) the SN CRAC should impose strict spending controls and prohibitions on using cash for capital investment or early payment of treasury bond principal and appropriations; (3) BPA should adopt a structured method for public participation in BPA's cost and SN CRAC rate decisions such as agreements to reduce or defer payment to regional investor-owned utilities; and (4) BPA should provide a 50 percent refund on any amounts by which ANR exceeds the SN CRAC Thresholds. *Id.*

In its Brief on Exceptions, GPU states that the contingent recalculation should be done on an annual basis rather than as proposed in the draft ROD. GPU Ex. Brief,. SN-03-R-GP-01, at 4. They believe an annual recalculation of the Caps and Thresholds will allow customers to regain trust in BPA's cost control efforts. *Id*. WPAG inserted an annual contingent recalculation of the Caps and Thresholds in its redlined version of the GRSPs. WPAG Ex. Brief, SN-03-R-WA-01, at Appendix A.

In their Brief on Exceptions, CRITFC and SOS/NWEC argue the draft ROD ignored concerns raised in their respective initial briefs involving the contingent adjustment and disregarded potential bad news. CRITFC Ex. Brief, SN-03-R-CY/YA-01, at 16, SOS/NWEC Ex. Brief, SN-03-R-01, at 8. SOS/NWEC in particular are concerned that BPA confused its argument regarding the contingent design with one regarding a forward looking SN CRAC trigger. *Id*. at 8-9. SOS/NWEC is concerned and the variable adjustment, with the caps and thresholds, may not be sufficient to recover BPA's costs if conditions deteriorate. *Id*. at 10.

BPA's Position

BPA has proposed a contingent mechanism that will account for a defined set of future events in August 2003. McCoy, *et al*., SN-03-E-BPA-17, at 12. Through the contingent feature, BPA will include additional savings that have occurred or are forecasted with a high degree of certainty to occur in a recalculation of the thresholds and caps in August of 2003. *Id.* at 14. Any reductions in costs or increased revenues after the August 2003 recalculation will be reflected in the ANR calculation in FY 2004 or FY 2005, and will show up as a reduction in the SN CRAC adjustment for the next fiscal year (FY 2005 or FY 2006). *Id*. at 14-15. Under BPA's proposal, at the time of the contingent recalculation, BPA will change the parameters of the SN CRAC for decreases in the forecasted 2003-2006 budgets for ENW, the Corps, Reclamation and BPA's Fish and Wildlife program, for changes in 2003 PBL net revenue due to improved hydro supply and/or market prices, an IOU settlement, and for decreases in forecasts of BPA's internal operating expenses. *Id*. at 25.

BPA also proposes that an IOU settlement reached too late to be included in the Contingent Recalculation, but before September 15, 2003, will be incorporated by a final recalculation of the SN CRAC parameters, and that an IOU settlement reached after September 15, 2003, and before August 15, 2004, will be incorporated by reducing the SN CRAC Threshold for the 2005 SN CRAC by the amount of the reduction in cash outflow due to the settlement in FY 2005, and by reducing the SN CRAC Threshold for the 2006 SN CRAC by the total reduction in cash outflow due to the settlement in FY 2005 and 2006.

Evaluation of Positions

GPU is in favor of a contingent design but contends that adjustments to the Caps and Thresholds should be annual adjustments to the Caps that adjust so that TPP and TRP are at the same levels as in the initial proposal rather than a one time adjustment in August of 2003 as BPA has proposed. GPU Brief, SN-03-B-SG-01, at 5.

GPU proposes three other elements to the contingent SN CRAC design. These include strict spending controls and prohibitions on using cash, a structured method for public participation in BPA's costs and SN CRAC rate decisions and a refund mechanism. *Id.* These three suggestions are not actual elements of the contingent design but rather are preconditions on the adoption of a contingent SN CRAC. These elements are preconditions because they are not modifications to the contingent design features proposed by BPA or some other party. These elements relate to other matters that are dealt with separately in this ROD and GRSPs. Those preconditions are strict limits on spending by BPA, a structured method for public participation in BPA's decisions on costs and SN CRAC implementation, and a 50 percent refund if ANR exceeds the SN CRAC Threshold. *Id*.

GPU and WPAG believe that the contingent recalculation should occur annually rather than just once at the beginning of the rate period. GPU Ex. Brief, SN-03-R-GP-01, at 4, WPAG Ex. Brief, SN-03-R-WA-01, at A-20 to 21. The BPA staff proposal for a contingent SN CRAC involved only a one-time recalculation of the Caps and Thresholds. McCoy, *et al*., SN-03-E-BPA-17, at 25. Having a contingent recalculation of the Caps and Thresholds annually presents some

problems that neither GPU nor WPAG have provided evidence or argument in their respective briefs. GPU and WPAG fail to explain how the recalculation of Caps and Thresholds would work. While the mechanics of recalculation based upon additional improvements is understandable, WPAG and GPU fail to provide any information as to what financial standard BPA is solving for when it recalculates the Caps and Thresholds. A TPP and even a TRP over three years is different from the same TPP or TRP percentages over one or two years. Given the absence of any evidence about what the appropriate financial standard should be, it is not possible to adopt the GPU and WPAG proposal for an annual contingent recalculation of Caps and Thresholds.

CRITFC and SOS/NWEC contend that BPA should look at both increases and decreases in BPA's cost levels. CRITFC Brief, SN-03-B-CR/YA-01, at 49, SOS/NWEC Ex. Brief, SN-03-R-01, at 8. In that way, if BPA's costs increase between the ROD and the August adjustment, those levels will be reflected in the recalculation.

As proposed by BPA, in August of 2003 the parameters of the SN CRAC (the three annual Thresholds and the three annual Caps) will be recalculated. BPA is proposing that, in the recalculation, BPA will modify the parameters of the SN CRAC if there are:

1. Reductions in BPA's forecasted budgets for FY 2004-2006 for Internal Operations (sum of PBL Internal Operations and Corporate Internal Services);

2. Reductions in BPA's forecasted O&M budgets for FY 2004-2006 for the Columbia Generating Station;

3. Reductions in BPA's forecasted O&M budgets for FY 2004-2006 for the Corps of Engineers;

4. Reductions in BPA's forecasted O&M budgets for FY 2004-2006 for the Bureau of Reclamation;

5. Reductions in BPA's forecasted budgets for FY 2004-2006 for the BPA Fish and Wildlife Program;

6. Actual and forecasted changes in PBL's net revenue for FY 2003 due to changes in hydro conditions or market prices;

7. Negotiated reductions in the magnitude of benefits payments to be made by BPA to the investor-owned utilities for FY 2004-2006.

CRITFC and SOS/NWEC are concerned that BPA is ignoring the "bad news" that may result from changes between now and August with regard to the first four items on the list. CRITFC Brief, SN-03-B-CR/YA-01, at 49; SOS/NWEC Ex. Brief, SN-03-R-01, at 8. While in theory it is possible that there could be changes to the budgets between now and the time of the contingent recalculation, it is a small risk. BPA has worked very hard over the last year to manage these cost levels and is confident they will not increase. As described in testimony, BPA has been

given assurances by ENW, the Corps and Reclamation that each will rigorously manage its expenses to established levels. Keep, *et al*., SN-03-E-BPA-04, at 9. BPA is continuing discussions with each of these parties to seek additional cost savings and plans on reflecting those savings in the recalculation. Given the effort that BPA and its cost partners have engaged in to assess their respective budgetary requirements, it is reasonable to assume that these levels will not increase appreciably between now and the August 2003 adjustment. BPA has changed item 6 above in recognition of "changes in PBL's net revenue" from the original recognition of "improvements in PBL's secondary revenue." This revision incorporates both the good and the bad news in the volatile secondary revenue arena into the contingent calculation. This is a partial adoption of the CRITFC and SOS/NWEC suggestion that BPA recognize both the good and the bad news in the contingent calculation. While it is possible that some "bad news" event may occur between ROD and the recalculation, that same risk exists after the Caps and Thresholds are recalculated. Major events can occur, and to the extent these cost events happen, the variable design, *force majeure* exception, or if necessary retriggering the SN CRAC, will allow BPA to cover these costs.

BPA has described in detail in section 2.8 on fish and wildlife why it believes the assumptions regarding fish and wildlife costs contained in BPA's proposal are sound. BPA has the benefit of several completed processes and years of actual implementation experience to guide its program spending levels for fish and wildlife. McNary and Lamb, SN-03-E-BPA-18, at 4-8. This experience includes successfully implementing both the NOAA Fisheries and US FWS biological opinion under the ESA to cover FCRPS operations. *Id.* Based on this experience and the Implementation Plan, BPA has developed and posted lists of the projects it will fund within its estimated expense accrual budget for 2003 and coordinated those lists with the Council and fish and wildlife managers to ensure the expenditures do not exceed $139 million. *Id.* To the extent that additional savings are realized in this area, BPA intends on reflecting those in the recalculation.

Underlying CRITFC and SOS/NWEC's concerns is the belief that some unplanned event will occur that will dramatically impact BPA's fish and wildlife obligations between now and the recalculation in August. CRITFC Ex. Brief, SN-03-R-CR/YA, at 16; SOS/NWEC Ex. Brief, SN-03-R-01, at 8. This is possible with or without the recalculation of the SN CRAC. CRITFC either does not understand the contingent recalculation or alternatively intentionally chooses to ignore the mechanics of how it would operate. They state that by the contingent adjustment only for "good news" BPA is "essentially committing to reduce fish and wildlife funding levels from levels that are not adequate to meet Bonneville's legal and Treaty responsibilities." *Id*. Contrary to the assumptions embedded in this statement, the contingent recalculation of Caps and Thresholds has nothing to do with determining the actual budget levels for fish and wildlife. The contingent recalculation will set Caps and Thresholds based upon any reductions in the fish and wildlife budget assumptions. As stated in the FRN, the fish and wildlife budget levels are determined in public processes outside of the rate case and the results imported into the rate case. Despite the repeated efforts by CRITFC to introduce fish and wildlife budget issues into the rate case, those matters are outside the scope of this proceeding. *See* Chapter 3. While CRITFC does not believe the budget levels are adequate, the contingent recalculation of Caps and Thresholds will only reflect decisions made in these other processes about appropriate budget assumptions

and are not related to any commitment to reduce fish and wildlife funding levels as CRITFC suggests.

BPA cannot, consistent with sound business practices, set rates in such a way that it is prepared at all times to deal with every uncertainty no matter how remote. If BPA were to set rates high enough to protect against every unknown event, the resulting rates would be extremely high. Given the current state of the regional economy, it is not reasonable nor is it consistent with sound business principles to set rates to provide this level of security. This is not to say that BPA should ignore the fact that events might occur that impact cost or revenue levels. BPA must put in place mechanisms that, if certain cost or revenue events occur, will allow BPA to adjust its rates to recover those costs. In the WP-02 rate case, BPA designed its rates to be flexible enough to adjust to changes in circumstances. The three CRACs (LB, FB, and SN) are major tools to protect the agency against impacts on its revenues and costs. In this proposal, BPA has retained the right to retrigger the SN CRAC if BPA meets the trigger criteria. In addition, BPA has noted an exception for budget levels if a *force majeure* event occurs. Keep, *et al*., SN-03-E-BPA-11, at 37. In addition, to the extent BPA's Fish and Wildlife costs exceed $139 million, the variable nature of the SN CRAC will allow BPA the opportunity to pick up the additional cost through the annual adjustment.

SOS/NWEC argue that the variable adjustment "is not designed to deal with unknown events outside certain limited parameters, and is not designed to ensure that 'BPA recovers its <u>total costs</u>.'" SOS/NWEC Ex. Brief, SN-03-R-01, at 10 (emphasis in original). The concern here apparently is that BPA could experience cost increases so much higher than anticipated, that it would necessitate an adjustment higher than the cap level in order to ensure recovery of BPA's costs. While this is theoretically possible, as explained above, given the level of cost control in place, the possibility of this happening appears small. However, even assuming some catastrophic cost event occurs that results in the need to collect more than the Cap levels to ensure total cost recovery in that particular year, BPA has retained the ability to retrigger the SN CRAC to adjust the Caps and Thresholds to collect additional revenues should that unanticipated event occur and has *force majeure* language in the GRSPs that would allow BPA to exceed the capped cost levels in some circumstances. While this may not guarantee the ability of BPA to fully recover costs in a particular year, it should assure BPA the ability to recover its costs over the balance of the rate period.

SOS/NWEC are concerned that while BPA has the ability to retrigger the SN CRAC, BPA is ignoring the year long gap between the retriggering the SN CRAC and imposing a rate adjustment. SOS/NWEC Ex. Brief, SN-03-R-01, at 3. While SOS/NWEC is correct there is a time lag between triggering the SN CRAC and the adjustment to rates which could result in a temporary revenue shortfall, this fact was understood when BPA adopted the SN CRAC in the WP-02 Supplemental rate case.

SOS/NWEC state that BPA can avoid the problem associated with the long time between retriggering the SN CRAC and imposing a rate adjustment by "triggering the contingent mechanism based upon a forecast of 'bad news,' instead of only accommodating 'good news' " *Id*. It is not clear what SOS/NWEC means by "triggering" the contingent recalculation of Caps and Thresholds. The contingent proposal adopted here will happen automatically in

August 2003, except for the possibility of a subsequent adjustment in the event of a settlement of the benefits for the investor owned utilities. There is no "trigger" of the contingent recalculation in subsequent years, so the problem associated with the lag time between retriggering SN CRAC and adjusting rates cannot be addressed by looking at the "good and bad news" associated with adjustments to budget levels as SOS/NWEC seems to suggest.

Under BPA's proposal, the recalculation of the SN CRAC parameters will meet the financial standards adopted for the SN CRAC. The recalculation of the SN CRAC parameters will result in expected values of total rates (May 2000 base rates plus any applicable CRACs) expressed as a percentage change from the total rates for 2003 that are as low as practical while still meeting the 80 percent three-year TPP.

The contingent recalculation in August 2003 has been designed carefully and will be performed in a very specific manner. Once the adjustments to the enumerated items listed above are known, the recalculation will provide an arithmetic solution as follows.

1. Determining the size of the annual Caps.

   A preliminary calculation of the SN CRAC adjustment will be made using the FB CRAC Thresholds from the June 2001 Final Studies and data from the June 2003 Final Studies except for those items described above that are to be updated. This calculation will use three fixed (deterministic) SN CRAC revenue amounts that yield a three-year TPP of 80 percent and expected values of the sums of the FB CRAC and SN CRAC non-Slice rate impacts, expressed as a percentage of May 2000 base rates, that are the same for each of the three years.

   The Caps for the SN CRAC will be set to be equal to the average of the three annual SN CRAC revenue amounts from step 1, rounded to the nearest $5 million, plus $100 million.

2. Synchronizing the SN CRAC, FB CRAC, and the Rebate.

   The thresholds for the FB CRAC will be set to be the same as the Thresholds for the SN CRAC, and the Thresholds for the SN CRAC Rebate will be set to be $15 million higher than the SN CRAC Threshold for each year.

3. Calibrating the Thresholds.

   The Thresholds for the SN CRAC will be adjusted until the FY 2004-2006 three-year TPP is 80 percent and the expected value of the sums of the FB CRAC and SN CRAC non-Slice rate impacts, expressed as a percentage of May 2000 base rates, are the same for each of the three years.

Because changes to the IOU benefits (item 6 above) would be critical to the overall rate level, additional allowances must be made in order to incorporate the impact of a settlement if it occurs sometime after mid-August 2003. The SN CRAC parameters and the thresholds for the FB

CRAC and the rebate will be recalculated if the Administrator receives sufficient assurance, such as the signing by the IOUs of unconditional contracts, that the benefits payable to the IOUs during 2004 through 2006 will be either reduced or deferred. The process by which such benefit reductions will be incorporated depends on the timing of the agreement as outlined below.

1. Agreement reached before approximately August 15, 2003.

   If an Agreement is reached with sufficient time before the contingent recalculation process described above, the cash impacts on BPA of the agreement will be incorporated through the contingent recalculation.

2. Agreement reached after approximately August 15, 2003, and by September 15, 2003.

   If an agreement is reached in this time period, a separate recalibration of the Thresholds for the SN CRAC, the FB CRAC, and the rebate will be made. In this recalibration, the cash impacts on BPA of the Agreement for FY 2004-2006 will be incorporated and the Thresholds adjusted following the methodology described above for use in the Contingent Recalculation (steps 2 and 3 from the description of the Recalculation above). The 2003 ANR projection from the second August workshop will then be used to recalculate the 2004 SN CRAC rate increases. The Administrator will release the revised rates on September 15, 2003, or as soon as practical thereafter, but no later than September 22, 2003.

3. Agreement reached after September 15, 2003, and by August 15, 2004, or after August 15, 2004, and by August 15, 2005.

   If an agreement is reached in these time periods, the thresholds for the SN CRAC, the FB CRAC and the Rebate for the remaining year(s) of the SN CRAC rate period will be adjusted downward by the cumulative total of the cash impacts on BPA. For an agreement reached by August 15, 2004, the SN CRAC, FB CRAC and Rebate Thresholds for 2005 will be reduced by the BPA cash impacts for FY 2005, and the Thresholds for 2006 will be reduced by the sum of the BPA cash impacts for FY 2005 and 2006; for an agreement reached by August 15, 2005, the SN CRAC, FB CRAC and Rebate Thresholds for 2006 will be reduced by the BPA cash impacts for FY 2006. The Caps will be reduced by the change in cash flow for each year (not cumulative cash flow). The Recalibrated Thresholds will be released to Parties at the first of the two workshops described below in August of 2004 or 2005.

GPU was concerned that BPA have a public process as a condition of the imposition of an SN CRAC. GPU Brief, SN-03-B-SG-01, at 5. As part of the SN CRAC process, BPA is proposing to hold at least two workshops on the recalculation. At the first workshop, held as soon as practical after completion of the Third Quarter Review, BPA will present the proposed Contingent Recalculation of the Thresholds for the FB and SN CRAC and the Caps for the CRACs. The estimated FB and SN CRAC revenue amounts and percentages for 2004 will also be presented. After this workshop there will be a comment period for interested parties to respond to BPA's analysis. In addition and as part of its overall cost management plan, PBL has

established informal monthly meetings with customers, customer representatives and constituents to review current year actual and forecast expense levels for both program and internal operations expenses charged to power rates. In these forums, PBL also reports on changes to expense levels including reductions taken to date. Keep, *et al*., SN-03-E-BPA-11, at 37. The parties have requested that BPA provide a more formal opportunity to review BPA's finances and spending levels. While not part of this rate proceeding, BPA will participate in more formal and frequent review meetings with customers and other interested parties and stakeholders and is currently working cooperatively to define the nature of these review meetings.

The SN CRAC contingent adjustment will set the ANR Thresholds and Caps for all three of the remaining years of the rate period (FY 2004-2006) using the repayment standards in the ROD. BPA proposes that the FB CRAC Threshold will be the same as the SN CRAC Threshold, but the FB CRAC Caps remain unchanged. GPU argues that Threshold should be recalculated every year. GPU Brief, SN-03-B-SG-01, at 5. This proposal is not necessary. The variable nature of the design will adjust the rate level if BPA reduces costs below the established levels. This fact, coupled with the Rebate mechanism that is adopted as part of this ROD, will ensure that BPA is not increasing revenues unnecessarily at the expense of the region.

Decision 9

BPA will have a variable SN CRAC with a one time recalculation of the Threshold and Caps in August 2003, with provisions for changing the Thresholds if an IOU-Public settlement is reached after the last opportunity to incorporate such a settlement in the August 2003 Contingent Recalculation.

Issue 10

Whether the $200 million of benefits that the IOUs agreed to forego in the event of a litigation settlement should be included in the calculation of the LB CRAC or as part of the contingent adjustment to the SN CRAC.

Parties' Positions

Canby argues that the $200 million of benefits that the IOUs agreed to forego in the event of a litigation settlement is contained in an unenforceable contract and cannot be included in the calculation of the LB CRAC and thus is an unnecessary contingent adjustment to the SN CRAC. Canby Ex. Brief, SN-03-R-CA-01, at 19.

BPA's Position

Questions regarding the enforceability of BPA's contracts not appropriate subjects for BPA's rate proceedings. To the extent issues exist that involve the validity of a contract, they are matters to be resolved in the courts and not in a BPA rate case. Furthermore, the $200 million are collected through the LB CRAC and not the SN CRAC. To the extent that a settlement of litigation impacts the SN CRAC, it would require the IOUs to defer or relinquish other financial

benefits that are unrelated to the $200 million. All of the $200 million is already factored into the calculation of the LB CRAC and absent a settlement or a continuation of the deferral of the payment of this amount by the IOUs, the LB CRAC will start collecting money to pay it in April 2004. Canby Ex. Brief, SN-03-R-CA-01 at 15.

Evaluation of Positions

Canby contends the $200 million of deferred IOU benefits is void because it impairs Canby's public interest in pursuing a legal claim. Canby Ex. Brief, SN-03-R-CA-01, at 19. As a result, Canby contends BPA cannot include the $200 million in the calculation of the LB CRAC nor can any contingency mechanism adjust the Caps and Thresholds for these deferred benefits. *Id*. BPA understands Canby's argument that the $200 million should not be included in the LB CRAC, but BPA is setting the SN CRAC in this proceeding, not the LB CRAC. The LB CRAC is adjusted in a separate process. With regard to the SN CRAC, this argument is difficult to understand because the $200 million are collected through the LB CRAC and not the SN CRAC. To the extent that a settlement of litigation impacts the SN CRAC, it would require the IOUs to defer or relinquish other financial benefits that are unrelated to the $200 million. This aspect of the settlement would be reflected in the SN CRAC, and a contingent adjustment addressing this occurrence is appropriate.

Furthermore, Canby has chosen the wrong forum to address this issue. To the extent Canby has a colorable claim with regard to the $200 million of deferred benefits included in the IOUs' contracts, it outside of this proceeding. The Administrator initiated this proceeding to establish the SN CRAC adjustment to rates. Issues regarding whether the IOUs' contracts violate public policy are outside the scope of this proceeding. For ratemaking purposes, BPA assumes its existing contracts are lawful.

Canby argues that payment of the deferred $200 million in benefits to the IOUs discourages public power utilities from pursuing litigation against BPA, and therefore is contrary to public policy. Canby Ex. Brief, SN-03-R-CA-01, at 16. While BPA is not deciding this issue here, because it can only be decided by the courts, BPA notes that Canby has mischaracterized the IOUs' contracts. The IOUs were entitled to the full amount of benefits agreed to by BPA and the IOUs in the contracts. The IOUs agreed to forego some of those benefits, to which they were entitled, in the event that litigation challenging the contracts was settled, and thereby reduced the IOUs' risk. This is not contrary to public policy. Because no court has concluded that the IOU contracts are invalid for any reason, BPA must assume they are valid for purposes of this rate proceeding.

Decision 10

The $200 million of benefits that the IOUs agreed to forego in the event of a litigation settlement should, in the event of such a settlement, be included in the calculation of the LB CRAC, and additional financial benefits in the settlement that are unrelated to the $200 million should be reflected in the contingent adjustment to the SN CRAC.

Issue 11

Whether BPA should adopt a rate design for the SN CRAC that yields roughly flat expected value total rate levels over the FY 2004-2006 period, or alternatively a rate design that yields a lower expected value total rate in FY 2004 than in FY 2005 and 2006.

Parties' Positions

WPAG contends that BPA should recognize the benefits of improved hydro conditions and relatively high market prices in FY 2003 and in the SN CRAC for 2004, rather than prorating the benefits of the improved conditions over the balance of the rate period. WPAG Brief, SN-03-B-WA-01, at 7. WPAG believes that spreading the improvements over the balance of the rate period deprives customers of two-thirds of the benefit of the increase in revenues and unnecessarily increases the size of the SN CRAC adjustment in FY 2004. *Id*. at 7.

WPAG argues that BPA is neither compelled nor required by statute, rule or policy to spread the improvements over the balance of the rate period. *Id*. WPAG contends, by choosing to spread the benefits over the balance of the rate period, BPA creates the highest near-term rate with the most adverse impact on the regional economy. *Id*.

NRU argues that BPA should not spread the revenues from higher MAF in 2003 over the rest of the rate period. NRU Brief, SN-03-B-NR-01, at 6. This would be an unnecessarily conservative treatment of the improvements and should be reflected in the rate levels for FY 2004. *Id*.

ICNU and ALCOA contend that BPA's decision to spread the benefits of the financial improvements over the balance of the rate period is inconsistent with the direction to design the SN CRAC to minimize the impact on customers and the economy. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 17.

PNGC argues that if an SN CRAC is imposed for years beyond FY 2004, BPA should not attempt to set a rate at this time. PNGC Brief, SN-03-B-PN-01, at 9. Instead, BPA should wait to determine what hydrological, financial, load, and market conditions exist just prior to the fiscal year in which the SN CRAC would take effect and set the surcharge as low as possible. *Id.* at 9-10.

In its Brief on Exceptions, NRU states that given the unanimity of support among customers for a "tilted" rate BPA should honor this preference. NRU Ex. Brief, SN-03-R-NR-01, at 2. NRU contends that the record does not support nor has BPA demonstrated why a flat rate is preferable to a tilted one. *Id*. Because BPA has not demonstrated a technical or financial reason for tilting the rate, NRU concludes that it must be based on convenience or policy reasons. *Id*. NRU believes that BPA seems to prefer a flat SN CRAC because it would keep rates relatively stable over the balance of the rate period and is administratively more convenient. *Id*. NRU states that BPA should not have an aversion to variable rate levels because they are entirely consistent with a CRAC mechanism. *Id.* at 3. Customers have demonstrated in their testimony that variable rates are in the best short and long-term interest of BPA's wholesale customers. *Id*.

NRU further contends that BPA needs to recognize the fragile state of the Northwest economy and the improvements in BPA's own financial health by foregoing an SN CRAC in FY 2004 through tilting the rate. *Id*. at 3-4.

NRU also contends that BPA's financial problem is not large enough to warrant a flat "peanut buttered" rate increase for the remaining years of the rate period. *Id*. at 5. NRU contends that it anticipates that the SN CRAC will generate an additional $517.5 million over the final three years of the rate period. *Id*. NRU believes that BPA will only collect half of that amount if the IOU litigation is settled. *Id.* NRU contends that this amount can be collected over the final two years of the rate period with no SN CRAC in FY 2004. *Id.*

NRU contends that BPA has portrayed it continued financial problems as associated with potential changes in hydro and market conditions. *Id.* at 6. NRU believes similar or improved financial conditions could occur in FY 2004 as they did in FY 2003. *Id*. at 7. NRU further contends that BPA has not substantiated its contention that BPA would need to collect additional revenues using an 80 percent TPP-only standard. *Id*. at 8.

NRU believes BPA has cash tools available that could be used during the rate period to increase reserve levels. *Id*. at 9.

PPC/IDEA argue BPA should not spread the improvements in its finances in FY 2003 over the balance of the rate period but rather should concentrate the benefits from those improvements over the near term. PPC/IDEA Ex. Brief, SN-03-R-PP-01, at 8.

ICNU and ALCOA argue in their Brief on Exceptions, that BPA should recognize the improvements in its financial condition in FY 2004 rather than delaying the recognition until FY 2005 and 2006. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 9.

GPU argues that the decision to flatten the rate is arbitrary because the record does not include any analysis to support the conclusion that revenues collected earlier in the period go toward lowering the overall rate, and that justification for a flat rate cannot be based upon the arbitrary decision to adopt an 80 percent TPP level. GPU Ex. Brief, SN-03-R-GP-01, at 8.

GPU further believes that a tilted rate should be adopted because such a design will minimize the impact on the regional economy. *Id*.

WPAG argues that the "good news" of BPA's improved financial condition should be recognized up front rather than prorate it over the balance of the rate period. WPAG Ex. Brief, SN-03-R-WA-01, at 11-12. WPAG believes the Administrator is not legally required to treat these additional revenues and cost reductions in the manner suggested by the DROD and it is within his discretion to recognize them in any particular manner. *Id*. at 12.

BPA's Position

BPA plans to include changes in hydro conditions, market price impacts, and certain expense reductions from FY 2003 in the contingent recalculation of the SN CRAC in August 2003. McCoy, *et al*., SN-03-E-BPA-17, at 9. These changes would be reflected in the calculation of

the variable SN CRAC revenue amount anyway, but incorporating them in the contingent recalculation of the SN CRAC parameters will spread the impact over three years instead of concentrating them in one year. *Id.*

Evaluation of Positions

Although they structure their arguments slightly differently, a number of parties argue that BPA should concentrate benefits from any improved conditions in FY 2003 on the FY 2004 rates. Under these proposals generally the total rate level in FY 2004 would have an expected value lower than the expected value of total rate levels for FY 2005 and 2006. Rather than spreading these benefits over the remaining three years of the rate period by recalculating the Thresholds and Caps in the contingent recalculation process, the parties argue for taking advantage of the improvements over the near term. WPAG Brief, SN-03-B-WA-01, at 7; ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 17; NRU Brief, SN-03-B-NR-01, at 6. BPA and the parties have generally referred to this concept as "tilting" the rate. On an expected-value basis, the rate level would increase or tilt over the rate period because the benefits of improved secondary revenues in FY 2003 are recognized only in the variable calculation of the SN CRAC rate for FY 2004, and the rate would be expected to increase from the FY 2004 levels in succeeding years. Parties believe that recognizing the benefits of the FY 2003 improvements in secondary revenues will result in a minimal or no SN CRAC increase in FY 2004 compared to the SN CRAC for FY 2003, and there would be a more significant increase in FY 2005 and FY 2006. *Id.* These parties contend that given the state of the economy in the region, they are willing to trade the risk of a higher increase in FY 2005 for a lower rate in FY 2004. WPAG Brief, SN-03-B-WA-01, at 8.

BPA has described in testimony a net revenue problem over the balance of the rate period. Keep, *et al*., SN-03-E-BPA-04, at 15. Because BPA faces a chronic as opposed to an episodic financial problem, it believes the solution should be multi-year. Therefore, if improvements in hydro conditions, market prices and expense levels in FY 2003 allow for decreasing the total size of the financial problem, the response should be reflected on a multi-year basis as well. McCoy, *et al*., SN-03-E-BPA-17, at 9.

In Briefs on Exceptions the commenting customer parties reargued their contention that the Administrator should tilt the SN CRAC rate adjustment. *See* NRU Ex. Brief, SN-03-R-NR-01, at 2-9; PPC/IDEA Ex. Brief, SN-03-R-PP-01, at 8; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 9; GPU Ex. Brief, SN-03-R-GP-01, at 8; WPAG Ex. Brief, SN-03-R-WA-01, at 11-12. They all generally believe that BPA has not demonstrated either a technical, legal or financial reason for the Administrator's decision not to tilt the rate. NRU Ex. Brief, SN-03-R-NR-01, at 2; WPAG Ex. Brief, SN-03-R-WA-01, at 11-12. Given the problems in the regional economy, the customer parties believe compelling reasons exist for the Administrator to compromise on this point. GPU Ex. Brief, SN-03-R-GP-01, at 8; NRU Ex. Brief, SN-03-R-NR-01, at 2.

Parties advocating for tilting the rate acknowledge the decision to tilt the rate is a discretionary decision by the Administrator. WPAG Ex. Brief, SN-03-R-WA-01, at 11-12. While the parties feel strongly that it is in their best interest to tilt the rate, a decision not to follow the wishes of

the customers is not *per se* arbitrary as suggested by GPU. GPU Ex. Brief, SN-03-R-GP-01, at 8. While there may be some disagreement about the need to tilt, there are sound financial reasons articulated during this proceeding for not tilting the rate. BPA described a net revenue shortfall over the balance of the rate period. NRU contends that this amount can be collected over the final two years of the rate period. NRU Ex. Brief, SN-03-R-NR-01, at 2. This does not seem prudent because even with the improvements, BPA still has a net revenue shortfall over the balance of the rate period of $250 million without any SN CRAC. This is a significant amount of money and collecting it over a two-year period rather than three does not seem prudent.

BPA's position has merit given BPA's current financial condition. Under the proposed three financial standards, the timing of when the revenues are collected matters less than it does when a TPP-only standard is applied. For example, with the zero net revenue and TRP financial standards, it does not matter as much when the revenues are collected as long as BPA collects the necessary revenues by the end of the rate period. In contrast, a TPP-only financial standard is more sensitive to the timing of revenue collection. Revenues collected earlier in the rate period go further to increasing the TPP than revenues that occur later in the rate period. Therefore, the SN CRAC would need to collect more revenue overall if rates were shaped in a tilt. Absent any significant change in BPA's cost exposure over the balance of the rate period, it would not be prudent to tilt the rate to minimize the SN CRAC in FY 2004 with resulting higher rates in FY 2005 and FY 2006.

It is important to note that while BPA has not adopted a formal mechanism to tilt the implementation of the SN CRAC at this time, the GRSPs provide the Administrator a certain amount of discretion regarding the application of the SN CRAC. Under the GRSPs, "the Administrator may elect at his discretion, to reduce the SN CRAC rate adjustment." *See* GRSPs SN-03-A-02, Appendix A. Given the significant comments by parties advocating a tilt in the implementation of the SN CRAC, it is important to clarify that this provision in the GRSPs may be used not only to decrease the actual SN CRAC rate level but also to create a tilt. As noted above, the Administrator does not believe conditions warrant tilting the implementation of the SN CRAC as the parties have requested. However, if, in the Administrator's opinion, circumstances change such that the Administrator believes some tilting of the rate in FY 2004, or FY 2005 is prudent, the Caps and Thresholds for the succeeding years will be adjusted to the extent necessary to allow BPA to maintain the equivalent of an 80 percent three-year TPP.

Decision 11

BPA will adopt a rate design that flattens the SN CRAC adjustment over the balance of the rate period.

Issue 12

Whether BPA's improved financial situation makes the SN CRAC unnecessary.

Parties' Positions

ICNU and ALCOA argue that no SN CRAC is necessary given BPA's improved financial condition. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 16. Given that BPA will make its treasury payment for FY 2003, no SN CRAC should be imposed for FY 2004. *Id.*

BPA's Position

BPA does not believe the evidence supports this conclusion. Keep, *et al*., SN-03-E-BPA-04, at 15. While the cost cuts and improved secondary revenues have had a dramatic impact on FY 2003, BPA still faces a net revenue problem over the balance of the rate period necessitating some rate adjustment. *Id.* Those who argue that the SN CRAC is unnecessary also view the SN CRAC as a year-to-year adjustment. As noted above, BPA is not limited to a single year or year-to-year look at the SN CRAC. The SN CRAC is designed to address the nature of the problem. *See* WP-02-A-09, at 2-7 (the "details of the adjustment will depend upon the particular circumstances that resulted in the triggering"). BPA faces a net revenue problem that has, to a certain degree, been masked by its cost cutting efforts and unusual improvements in secondary revenues in FY 2003. Keep, *et al*., SN-03-E-BPA-11, at 15.

BPA acknowledges that its near term finances have improved as a result of substantial cost cutting and improved secondary revenues, so that the liquidity issues BPA faced in FY 2003 at the time it filed the initial proposal are no longer as dramatic. However, absent some SN CRAC rate increase, BPA will not regain financial health nor will it have a high probability of making its treasury payments over the balance of the rate period.

Evaluation of Positions

This issue arises because ICNU and ALCOA believe the SN CRAC is a financial tool designed only to address near term financial problems. ICNU/ALCOA Brief, SN-03-B-IN/AL-01, at 23. From the perspective of these parties, the fact that BPA should be able to make its FY 2003 treasury payment on time and in full means that an SN CRAC is no longer necessary. *Id.* This perspective is an unnecessarily narrow interpretation of how BPA may implement the SN CRAC.

As BPA has described, there exists a net revenue shortfall over the balance of the rate period. To ignore this net revenue issue when the tools exist to address the shortfall would be inconsistent with sound business principles. The SN CRAC is designed to address the nature of the problem. *See* WP-02-A-09, at 2-7. As described earlier in this section, BPA is well aware of the impact of a rate increase on the region. BPA has adjusted its proposal to account for improvements in its finances, but, as noted, these improvements are not enough to solve the net revenue shortfall over the balance of the rate period. BPA has endeavored to adopt the lowest possible rate adjustment consistent with sound business principles. Consequently, an SN CRAC adjustment to rates is necessary to ensure that BPA regains its financial health, while minimizing the rate impact on the regional economy.

Decision 12

An SN CRAC adjustment is necessary to establish a high probability of BPA making its treasury payment in full during the remainder of the rate period.

Issue 13

Whether BPA should limit the spending levels it can collect from the SN CRAC and include a mechanism to reflect them in GRSPs.

Parties' Positions

In its brief, WPAG proposes a comprehensive set of spending limits to be included in the SN CRAC. The proposal is for all spending categories to be included in the cap, which would preclude BPA from automatically collecting through the SN CRAC actual spending in excess of the spending levels it is forecasting in this rate proceeding. WPAG Brief, SN-03-B-WA-01, at 14. GPU states that the SN CRAC should incorporate "strict spending controls." GPU Brief SN-03-B-GP-01, at 5. NRU recommends that BPA incorporate a mechanism in its GRSPs regarding the SN CRAC to assure that internal operations and corporate overhead costs do not exceed 2001 levels. NRU Brief, SN-03-B-NR-01, at 5.

CRITFC and NWEC argue that BPA should remove the spending limit caps from the SN CRAC. CRITFC Ex. Brief SN-03-R-CR/YA-01, at 17; NWEC Ex. Brief SN-03-R-SA-01, at 11.

The IOUs make two arguments. First, that the costs of the Residential Exchange should not be included in the cost adjustment spending limits because it is a benefit of the residential and small farm consumers and therefore not a cost. IOU Ex. Brief,. SN-03-R-PL/PS/GE/AC-01, at 4. Second, that if it is included, the line item should be clarified as to what costs are being limited. *Id*. at 3.

In its Brief on Exceptions, WPAG suggests a number of changes to the GRSP spending limits. Three of those issues are dealt with below: (1) whether BPA should revise the exception to the capped expenses for RTO costs allocated to PBL so that those exceptions must be ordered by FERC; (2) whether BPA should revise the exception to capped expenses for increases in the market development reimbursables program to be fully offset by increased revenues; and (3) whether to add a requirement that if BPA proposes to use one or more of the exceptions to capped expenses, it must explain to customers in writing the cause for such exception, and receive comments at the regular August workshops. WPAG Ex. Brief, SN-03-R-WA-01, at 16.

BPA's Position

In its initial proposal, BPA indicated it was considering other rate design options. Given the customer concern about BPA's internal operating expenses charged to power rates, and the particular concern that a variable multi-year SN CRAC rate design would reduce the pressure on BPA to control costs, BPA is open to the manner in which BPA could be precluded from recovering excess BPA internal operating costs in the SN CRAC rate design, if those costs

exceed the further-reduced limits for FY 2003-2006. Keep, *et al*., SN-03-E-BPA-04, at 17. BPA may need to consider the possibility of internal operating expense increases under extremely limited and defined circumstances (*e.g.*, costs related to *force majeure*, acts of war, etc.). Keep, *et al.*, SN-03-E-BPA-04, at 17. BPA generally agrees that the recovery of higher than planned internal operating expenses should be limited, but with modifications from what was proposed by WPAG in its direct case. McCoy, *et al.*, SN-03-E-BPA-11, at 66.

Evaluation of Positions

In its brief, WPAG reaffirms its direct case, where WPAG witnesses proposed a comprehensive set of spending limits to be included in the SN CRAC. This proposal addressed all spending categories (PBL Internal Operations; Corporate G&A/Shared Services; Residential Exchange Monetary Payments; Power Generation [Corps/Bureau/ENW/Other]; Renewable Projects; Transmission Acquisition; Civil Service Retirement System Catch-up; Terminated Projects [Trojan, WNP1&3]; Fish & Wildlife; and Non-Federal Debt Service), and by doing so precluded BPA from automatically collecting through the SN CRAC actual spending in excess of the spending levels it forecasted in this rate proceeding. Saleba, *et al*., SN-03-E-WA-01, at 17-20; SN-03-E-WA-01B. WPAG's proposal would not prohibit BPA from collecting spending in excess of forecast levels, but would require BPA to go through a section 7(i) rate proceeding, and the public scrutiny such a process entails, if it needs to adjust the SN CRAC for any reason to collect costs in excess of forecast levels. WPAG's rationale for this proposal was two-fold: first, that there must be more accountability between rate case spending forecasts and actual spending activity, not only for BPA but for its generating partners as well (Energy Northwest, the Army Corps of Engineers and the Bureau of Reclamation); and second, while public scrutiny of spending in excess of rate case forecast levels will permit BPA to collect additional costs when they are justified, it will operate to discourage excess spending that is not truly necessary. WPAG Brief, SN-03-B-WA-01, at 14.

GPU states that the SN CRAC should incorporate "strict spending controls." GPU Brief, SN-03-B-GP-01, at 5. NRU recommends that BPA incorporate a mechanism in its GRSPs regarding the SN CRAC to assure that internal operations and corporate overhead costs do not exceed 2001 levels. NRU Brief, SN-03-B-NR-01, at 5. However, neither party provides support for these statements in their briefs.

In its rebuttal testimony, BPA adopted this proposal in concept, but proposed to implement it in a manner that substantially limited the spending categories subject to the spending limits, and created exceptions to the spending caps. Keep, *et al*., SN-03-E-BPA-11, at 67 and 68.

While not specifically raised in its brief, WPAG's testimony argued that the purpose of its proposal was to impose spending "discipline" in each subtotal area. Saleba and Piliaris, SN-03-E-WA-01, at 18. WPAG's proposal would not allow the creation of spending categories in addition to those listed above (and in Table B of Attachment A of Saleba and Piliaris) in determining compliance with the subtotal categories that WPAG argues should be subject to spending limits. *Id.* WPAG did not want to allow "offsets" between subtotal areas. In addition, WPAG's proposal would not allow the use of revenue offsets in determining compliance with subtotal spending limits. *Id*. However, WPAG indirectly raises this issue in brief by referring to

Attachment B of the testimony of Saleba, *et al.*, SN-03-E-WA-01, at 17-20; SN-03-E-WA-01B, which included both cost categories and spending levels.

"BPA disagreed that the creation of spending categories in addition to those listed on Table B of Attachment A (*See* Saleba and Piliaris, SN-03-E-WA-01) should not be permitted." Keep, *et al*., SN-03-E-BPA-11, at 65. BPA identified several modifications. *Id*. at 66. BPA proposed to modify the line item for PBL Internal Operations by moving the following items from PBL Internal Operations to a new category called Conservation Initiatives: Energy Efficiency Development, Energy Web, Legacy Conservation and Low Income Weatherization, Market Transformation and Sponsored Energy Initiatives. *Id*. at 65. BPA agreed that the creation of categories, in addition to those described above, should not be permitted in determining compliance with spending limits. *Id.*

BPA also proposed that annual spending limits should apply to the sum of PBL Internal Operations and Corporate Internal Services. *Id*. at 65. BPA disagreed with the parties that spending limits should be placed on these two categories separately. The PBL Internal Operations and Corporate Internal Services categories are similar in nature in that they both support the internal operations of the PBL. Additionally, in order to advance efficient internal operations and create more transparent management and accountability of these costs, it may be necessary to move expenses between these two categories over time. *Id*.

In BPA's rebuttal testimony, BPA expressed four additional areas of concern related to placing annual spending limits on internal operations expenses now defined as the sum of PBL Internal Operations and Corporate Internal Services. *Id*. The first, *force majeure* language, is discussed later in this section. The second is that in order to fully allocate costs associated with a project or program, some corporate internal operations expenses (also called "direct charges") are currently reflected in categories other than one of the two internal operations categories. Therefore, if these "direct charges" are moved to either PBL Internal Operations or Corporate Internal Services, it may appear like an increase, but actually, there will be no net increase in expenses charged to power rates. In other words, the change would be a result of simply moving expenses from one category outside of internal operations expenses into either PBL Internal Operations or Corporate Internal Services. Therefore, if these "direct charges" are determined to support a different project or are combined with existing projects to gain efficiencies and management accountability and therefore move out of one category into the internal operating expenses, the annual spending limits should increase by the amount of the expense, which has been moved. *Id*. Third, the line item labeled "Slice" in PBL Internal Operations category should not be capped given that it is reimbursable to BPA and may increase at the specific request of Slice customers. Finally, expenses related to the RTO's development and implementation have not been forecast in any expense category. Therefore, increases in expenses related to RTO must not be considered as a breach of the annual spending limits and should simply increase the limits. SN-03-E-BPA-11, at 66-67. In its brief, WPAG did not specifically address the issues of reallocating direct charges that do not affect rate levels, excluding Slice reimbursable costs, nor excluding RTO expenses.

In its Brief on Exceptions, however, WPAG states that it added language to specify that the exception to capped expenses for RTO costs allocated to BPA must be made by FERC. WPAG

Ex. Brief SN-03-R-WA-01, at 16. It further described this as "[a]dded language to ensure that the reallocation of transmission costs to power rates was a regulatory requirement and not a voluntary act by BPA." WPAG Ex. Brief, SN-03-R-WA-01A, at 3. The actual language WPAG proposes is the underlined phrase in the following sentence: "(4) If there were any increase in the cost allocated by an order of FERC to power rates for the development and implementation of a Regional Transmission Organization, this increase shall be subtracted from the value of the Cost Adjustment Limit." *Id.* at A-17.

BPA disagrees with this suggested change. The primary reason BPA excluded RTO costs from the spending limits is that, at this time, FERC is not currently ordering any allocation of costs between BPA business lines. It is uncertain when FERC would have such a role. Moreover, the region has been successful in asking FERC to allow the region to set its own course regarding the best way to manage the region's transmission system. Thus, it would be imprudent to agree to the kind of limitation proposed by WPAG at this time since it is uncertain what future actions or role FERC might have as it pertains to the allocation of RTO costs between BPA's two business lines.

BPA summarized its position in rebuttal testimony by stating that the annual spending limits for internal operations expenses should be the sum of the PBL Internal Operations and Corporate Internal Services modified as described above, and at levels that will be updated in the Revenue Recovery Final Study. McCoy, *et al*., SN-03-E-BPA-11, at 67 (with errata).

In rebuttal testimony, BPA disagreed with creating annual spending limits for all other categories that WPAG proposed, specifically Residential Exchange Monetary Payments, Power Generation, Renewable Projects, Transmission Acquisition, Civil Service Retirement Payments, Terminated Projects, Fish and Wildlife and Non-Federal Debt Service and the new category of Conservation Initiatives. *Id*. These costs are not controllable or variable in the near-term by BPA without potentially violating BPA's ability to complete its mission and legal responsibilities. Keep, *et al.*, SN-03-E-BPA-11, at 68. With respect to Energy Efficiency Reimbursable (Market Development EE) costs within conservation spending, BPA explained in rebuttal these items are fully reimbursable to BPA and therefore do not have a net impact on rates. *Id*. at 65. Therefore, BPA did not propose spending level caps on this component of the Conservation Initiatives program.

In its brief, WPAG questions why BPA does not exercise control over some of these cost categories, such as Renewable Projects, Terminated Projects and Conservation Initiatives. WPAG Brief, SN-03-B-WA-01, at 15. But WPAG argues that whether BPA has "control" over a particular cost category is not determinative as to whether it should be subject to a spending limit in the SN CRAC. *Id*.

In its Brief on Exceptions, WPAG suggested that BPA add language to the GRSPs that clarifies that the exception to capped expenses for increases in the market development reimbursable program must be fully offset by increased revenues. WPAG Ex. Brief, SN-03-R-WA-01, at 16; WPAG Ex. Brief SN-03-R-WA-01A, at 3; Appendix A at A-17. This was BPA's intent and BPA will make this suggested modification to the GRSPs.

WPAG states that the "concept underlying the inclusion of cost caps in the SN CRAC is for BPA to make a reasonable forecast of the costs it expects to incur in these areas for purposes of setting rates, and then do all that it can to stay within those spending forecasts when it actually spends the money." WPAG Brief, SN-03-B-WA-01, at 15. Under WPAG's proposal, the penalty for exceeding the rate case spending forecast, whether exceeding the limit is caused by BPA or by a third party, is not a prohibition on collecting the additional amounts if they are really needed. Rather, it is a requirement that the excess spending sought be publicly justified through a section 7(i) rate process, rather than being collected automatically, and without public scrutiny, through the SN CRAC process. *Id.* at 15-16. As a consequence, these spending limits serve to bring transparency to the spending activities of both BPA and its generating partners, and to create a direct relationship between rate case spending forecasts and actual spending behavior. *Id*. at 16.

WPAG further argues that under this approach, inclusion of cost categories not under the control of BPA will not impinge on BPA's ability to complete its mission or fulfill its legal responsibilities because additional costs needed to fulfill BPA's legal obligations or complete its mission, whether caused by a third party, a legal obligation or an unforeseen event, can be collected through a rate increase after conducting a section 7(i) rate process. *Id.* The only requirement is that the collection of such additional amounts may only occur after they have been subject to public scrutiny. WPAG claims it is difficult to understand why BPA would object to including more public scrutiny of spending in excess of rate case forecast levels. *Id*. at 16.

BPA notes that section 7(i) hearings are to establish BPA's rates, which are approved by FERC. FERC does not approve BPA's budgets, only BPA's rates. Keep, *et al.*, SN-03-E-BPA-11, at 13. BPA also noted in rebuttal testimony that WPAG and GPU are incorrect that BPA's SN CRAC initial proposal does not contain an opportunity for a public process. In August of each year BPA will hold a workshop where it will explain the assumptions behind the forecast of ANR and its calculation of the SN CRAC. Customers will have an opportunity through this workshop to test and question both the assumptions and data BPA uses in the calculation of the SN CRAC. McCoy, *et al*., SN-03-E-BPA-17, at 8-9. The parties have requested that BPA provide a more formal opportunity to review BPA's finances and spending levels. Therefore, in addition to the formal public process workshops for the SN CRAC described in the GRSPs, BPA is committed to provide an ongoing intensive process of cost disclosure by BPA and opportunities for customers and others to review costs and provide input to BPA. Though not part of the rates process, BPA agrees to provide these opportunities.

WPAG argues for a revision to the GRSPs requiring that if BPA proposes to use one or more of the exception to capped expenses, it must explain to customers in writing the cause for such exception and receive comments at the regular August workshops. WPAG Ex. Brief SN-03-R-WA-01, at 16; WPAG Ex. Brief SN-03-R-WA-01A, at 3. The specific language they propose is "[i]f BPA proposes to make any adjustments to the Cost Adjustment Limit pursuant to the preceding paragraph, it shall notify all customers and rate case parties in writing prior to the first August workshop explaining: (1) the causes of its proposed adjustments; and (2) its efforts to minimize the rate impact of its proposed adjustments. At the August workshops, BPA will receive comments on whether its proposed adjustments are appropriate." WPAG Ex. Brief

SN-03-R-WA-01, Appendix A at A-17. BPA does not agree with this additional requirement. BPA already will host two workshops in August. The first will be to explain all of the information and data going into the SN CRAC calculation. The second workshop will follow, allowing time for public comment. It is an unnecessary procedural step to require BPA to send out one set of information ahead of time, in order to take comment at the first workshop, when the process already provides parties and customers that opportunity.

WPAG's proposal in its Initial Brief, subjects BPA's budget-setting process to the standards of a rule-making procedure. These processes are time consuming and expensive, both for BPA and rate case parties. WPAG claims it is difficult to understand why BPA would object to having more public scrutiny via a 7(i) process. WPAG Brief, SN-03-B-WA-01, at 16. However, the reason BPA objects is the very same reason that the rate case parties suggest might be the potential outcome of adopting such a proposal. As NRU stated in their direct case "the only effective mechanisms [that would preclude BPA from recovering costs that are higher than 2001 actuals in any future SN CRAC] we can suggest are ones that create an onerous set of circumstances for the Agency, if spending caps are disregarded. Saven, *et al*., SN-03-E-NR-01, at 9.

WPAG expressed concern that BPA's proposal [to limit the categories of costs subject to automatic adjustment through the SN CRAC] along with the *force majeure* proposal (*see* Appendix A in this ROD) will materially reduce the effectiveness of these spending caps, and increase the likelihood of a repeat of the spending in excess of rate case forecast levels that occurred in the last three fiscal years. WPAG Brief, SN-03-B-WA-01, at 15.

BPA is sensitive to WPAG's concern that the "structure of the SN CRAC adopted in this proceeding will be a telling indication to BPA's customers about how committed BPA really is to learning the lessons of the past, and engaging in meaningful cost control in the future." WPAG Brief, SN-03-B-WA-01, at 17. WPAG contends that adopting an SN CRAC that includes spending limits on all of BPA's major spending categories, and foregoing the opportunity to include an expansive exception to these spending limits, will do much to re-establish the trust between BPA and its customers in this important area for both the present and the future. *Id.* In the ROD, BPA added to the categories of costs that BPA would cap for inclusion in automatic adjustments of the SN CRAC. They were: Conservation Initiatives, Corps, Reclamation, Residential Exchange Financial Payment, Other Generating Projects (excluding ENW), Renewables Projects, and Civil Service Retirement and post-retirement benefits.

The IOUs argue that the Residential Exchange Financial Payment should be excluded from the spending limit, because it is "erroneous to refer to or consider BPA's providing a share of the benefits of the FCRPS to residential and small farm consumers served by the region's investor-owned utilities to be a BPA 'cost' or 'expense.'" IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 4.

The IOUs argue that the Residential Exchange Program settlement agreements provide regional IOUs a share of the benefits of the Federal system, but BPA refers to the provision of such benefits as a "cost." *Id.* The IOUs argue that their benefits bear costs through the SN CRAC.

Id. at 3. The IOUs argue that reducing benefits to the IOUs is not a cost reduction but a shift in benefits among regional consumers. *Id*. at 2. BPA agrees that the IOUs' Residential Exchange Program settlement benefits represent a share of the benefits of the Federal system provided to the residential and small farm customers of the IOUs and are not simply a cost to the Federal system. BPA also agrees that these benefits are subject to the SN CRAC and thereby contribute to the recovery of BPA's costs. Nevertheless, because of the manner in which benefits are provided to the IOUs, i.e., primarily through monetary payments rather than power sales, they constitute money that BPA must pay and must recover through rates. BPA is statutorily required to recover its costs through rates. 16 U.S.C. § 839e(a)(1). Because BPA must expend money for the IOU benefits, such benefits constitute part of BPA's costs of implementing the Northwest Power Act. While this general characterization is necessary for purposes of ratemaking, BPA recognizes the unique nature of these benefits.

The IOUs argue that if the Residential Exchange is not eliminated from the items that have spending limits placed on it, then it should be clarified as to what is being limited. IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 3-4. BPA agrees and is adding the following footnote to Table C: Cost Adjustment Limits by Category for Residential Exchange: "Residential Exchange are the amounts of the 900 aMW of financial benefits provided under the financial portion of the REP settlement, excluding any payments by BPA to the IOUs repaying Residential Exchange expenses deferred by contract from a prior fiscal year."

The spending limits for these cost categories will be set at levels shown in the final Revenue Recovery study and can be found in the GRSPs included in Appendix A. BPA will continue to exclude Slice and RTO costs from combined PBL Internal Operations and Corporate Operations and will allow the amount that may be recovered to adjust for changes to direct charges from one category to another where the change does not affect overall expenses charged to rates. In addition, BPA will not limit the recovery in SN CRAC rate design of ENW O&M costs, Transmission Acquisition, Terminated Projects, Fish and Wildlife (including Fish and Wildlife related expenses in Corp and Reclamation O&M), nor Non-Federal Debt Service. BPA is not agreeing to cap the costs associated with the above referenced items primarily because they involved items BPA does not directly control. While these items are only partly within BPA's control, BPA will continue to work toward managing these items to the levels assumed in the rate case.

SOS/NWEC's Brief on Exceptions takes issue with imposing caps on particular cost categories because of the risks it poses to fish and other public purpose programs. SOS/NWEC Ex. Brief, SN-03-R-SA-01, at 11. They believe that any spending limits effectively increase BPA's risk and lower TPP. *Id*. Costs not recovered through the contingent adjustment will lower BPA's TPP and make it more likely that a treasury payment will be missed or the SN CRAC retriggered. *Id*.

CRITFC argues that the draft ROD ignored their concerns that caps on expense categories could force BPA to reduce its reserves and jeopardize payment to the treasury. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 17. They contend that BPA does not need these self-imposed limits to operate in a sound business manner. *Id*. at 18.

BPA disagrees that imposing spending limits on certain categories (as described in the ROD) will lower BPA's TPP, increase risks, reduce reserves and jeopardize payments to treasury. BPA is willing to impose spending limits on those categories that BPA can control. As described above, BPA is not proposing to limit those cost categories over which BPA does not exercise direct control. CRITFC and SOS/NWEC's concerns are based primarily on their concern that BPA adequately fund its fish and wildlife obligations. BPA has specifically excluded from the spending limits costs related to fish and wildlife (including those of the Corps and Reclamation). BPA is confident it can control those costs for which spending limits are proposed.

Decision 13

BPA will propose limiting the recovery of spending levels in the SN CRAC design for certain categories. These are: (1) Combined PBL Internal Operations and Corporate Internal Service (Corporate G&A and Shared Services); (2) Conservation Initiatives; (3) Residential Exchange Financial Payments; (4) Combined Power Generation (Corp and Reclamation O&M, excluding fish and wildlife related expense); (5) Power Generation (Other Generating Projects); (6) Renewable Projects; and (7) Civil Service Retirement. PBL Internal Operations spending limits will not include limits to costs associated with Slice and RTO. Conservation Initiatives spending limits will not include limits to Energy Efficiency Reimbursable costs and the language will be clarified that these costs must be fully offset by increased revenues. A footnote will be added to the Residential Exchange line item clarifying what costs related to the Residential Exchange will have spending limits placed on them. In addition, increases in PBL Internal Operations and Corporate Internal Services will be allowed if "direct charges" occurring in a different category are moved to this category and do not have an impact on overall PBL costs. The mechanism to implement these spending limits, the specific line items, and the spending level limits are included in the General Rate Schedule Provisions in Appendix A.

Issue 14

Whether BPA should incorporate the Cumulative Cost Adjustment Limit into the definition of Accumulated Net Revenues.

Parties' Positions

WPAG proposes to modify the definition of Accumulated Net Revenues to include the cost adjustment limit. WPAG Ex. Brief, SN-03-R-WA-01, at 15. It argues this will "consolidate adjustment in one location." WPAG Ex. Brief, SN-03-R-WA-01A, at 1.

BPA's Position

WPAG raised this issue for the first time in its Brief on Exceptions, thereby denying BPA and other parties any opportunity to develop a record on this matter.

Evaluation of Positions

WPAG raised this issue for the first time in its Brief on Exceptions, thereby denying BPA and other parties any opportunity to develop a record on this matter. WPAG argues that BPA should change the definition of Accumulated Net Revenues to include the Cumulative Cost Adjustment Limit in order to consolidate this adjustment in one location. WPAG Ex. Brief, SN-03-R-WA-01A, at 1. However, the effect of this change is to apply the Cost Adjustment Limits to both the FB CRAC and the Dividend Distribution Clause (DDC). Without having any analysis, nor evidentiary hearing, BPA is unwilling to impose these spending limits on the FB CRAC, nor to revise the amount of refund customers would get if the DDC were to occur, based on these spending limits.

Decision 14

BPA will not incorporate the Cumulative Cost Adjustment Limit into the definition of ANR.

Issue 15

Whether BPA should limit the recovery in SN CRAC rate design of spending levels in the event that a force majeure-type condition occurs and whether the language should be modified based on changes proposed by parties in their Briefs on Exceptions.

Parties' Positions

WPAG expresses concern that since BPA has not provided the parties with a revised set of GRSPs reflecting the *force majeure* language proposal, it is difficult to assess precisely how expansive this exception is likely to be, and how it will actually operate. WPAG Brief, SN-03-B-WPAG-01, at 16. WPAG suggests that based on the information provided to date, it is reasonable to assume that BPA intends for cost increases that fall within this exception to be collected automatically and without public scrutiny, and that the exception will be read so expansively that events such as litigation settlements voluntarily entered into by BPA will be considered *force majeure* events. *Id.* at 16-17. WPAG further suggests that if the proposed exception operates in such a fashion, it will render the proposed spending limits essentially meaningless. *Id*. at 17.

WPAG suggests changes to the *force majeure* language to reflect standard provisions for such exceptions. WPAG Ex. Brief, SN-03-R-WA-01, at 16; Appendix A, at A-16 and A-17.

BPA's Position

The annual spending limits must allow for *force majeure*-type conditions that may require an increase to internal operations expenses, such as court rulings, litigation settlements, changes in legal requirements, changes in security requirements, mandated regulatory requirements, and natural or man-made disasters. Keep, *et al.,* SN-03-E-BPA 11, at 67.

Evaluation of Positions

WPAG argues that the *force majeure* exception to the spending limits proposed by BPA is unnecessary and will do lasting damage to BPA's credibility with its customers. WPAG Brief, SN-03-B-WA-01, at 17. WPAG feels the proposed exception is unnecessary for two reasons. First, a true *force majeure* event, such as a generator damaged in a severe earthquake, will likely be such a major financial event that it will result in a retrigger of the SN CRAC based on current criteria. Since such a retriggering of the SN CRAC will permit BPA to recover the costs of such an event, the proposed *force majeure* exception is redundant and unnecessary. *Id*. And even if such an event is insufficient to retrigger the SN CRAC, BPA would be able to initiate a section 7(i) rate proceeding to collect additional amounts under such circumstances. *Id*.

To propose spending limits for inclusion in the SN CRAC, and then include an exception that could be interpreted to make virtually any overspending eligible for automatic collection under the SN CRAC, will only confirm the worst fears of some customers regarding BPA's commitment to meaningful cost control. WPAG Brief, SN-03-B-WA-01, at 17.

BPA has had *force majeure*-type language in previous automatic adjustment clauses that had spending level caps, specifically the Interim Rate Adjustment included in the 1993 rates. That adjustment clause included the following language: "Controllable expenses also exclude legally mandated Endangered Species Act (ESA) implementation expense, court ordered legal judgments against BPA including settlements formally accepted by a court in connection with dismissal of litigation, and costs already covered by other rate adjustment mechanisms, such as the Energy Tax Adjustment." 1993 Administrator's ROD, WP-93-A-02, at 85. In that ROD, BPA also expressed concern that the customers' proposal would "limit BPA's ability to trigger the IRA to changes in revenues and changes in those costs that would be predetermined as "uncontrollable." *Id*. at 83. BPA continues to have the same concern. BPA must set rates to recover its costs, and excluding these types of uncontrollable costs from the SN CRAC spending limits would, as WPAG states, require BPA to re-trigger the SN CRAC and conduct another 7(i) proceeding. The time and effort required to conduct another 7(i) hearing make it very difficult to recoup these costs in a timely way.

Finally, BPA agrees that the overall reason for limiting the recovery of certain spending amounts in the SN CRAC rate design is about the need to demonstrate BPA's commitment to meaningful cost control. The operative phrase here is "meaningful cost control." A standard definition of *force majeure* is an unpredictable condition or event beyond the reasonable control of the affected party. A natural disaster, war, or a third party may cause such a condition or event. In its rebuttal testimony, BPA is not relying upon the strict definition of *force majeure*, but rather is considering a *force majeure*-type condition, the list provided by BPA gives some specific examples of conditions that are clearly outside BPA's control, but it is not intended to be exhaustive. Keep, *et al.*, SN-03-E-BPA 11, at 67. BPA included specific *force majeure* language in the ROD.

WPAG proposed modifications to the *force majeure* language in the GRSPs. WPAG's proposed language is:

> In addition, the Cost Adjustment Limit for a fiscal year shall be adjusted to reflect any or all of the following situations. (1) If during that fiscal year, BPA experienced a *force majeure* condition which increases expenses in categories subject to the spending limits, the costs of such condition or conditions that are in the spending limit categories shall be subtracted from the value of the Cost Adjustment Limit, to the extent that BPA has made commercially reasonable efforts to alleviate such *force majeure* and mitigate the related increased expenses. For purposes of the General Rate Schedule Provisions, a *force majeure* condition shall be defined as (a) court ordered legal judgments against BPA and settlements formally accepted by a court in connection with dismissal of litigation; (b) additional security or legal obligations imposed by statute, rule or regulation; (c) regulatory requirements (including but not limited to Endangered Species Act implementation expenses) imposed by statute, rule or regulation; and (d) natural or man-made disasters, but not including BPA decisions that do not otherwise qualify as a *force majeure* condition.

WPAG Ex. Brief, SN-03-R-WA-01, Appendix A, at A-16 and A-17. For the most part BPA finds these suggestions reasonable. There are two exceptions. First, under section (1) above, BPA will exclude the word "commercially." While BPA follows sound business practices, BPA's status as a Federal agency and its need to address a range of stakeholder interests may limit the types of "commercially reasonable efforts" available to BPA, when compared to other, strictly, commercial entities. BPA does agree that it should take "reasonable efforts" to mitigate any *force majeure* conditions but leaves the determination of what "reasonable efforts" are to the sole discretion of the Administrator.

The second exception is the sentence in (d) "natural or man-made disasters, but not including BPA decisions that do not otherwise qualify as a *force majeure* condition." While BPA does not disagree with the intent of this language, BPA feels the following language is clearer: "natural or man-made disasters, excluding BPA decisions that do not otherwise qualify as a *force majeure* condition." BPA believes that this language gets to the point WPAG was trying to make, that decisions that BPA makes that would not be determined as *force majeure*, should not be able to be deemed "man-made disasters" and therefore become *force majeure* conditions.

Decision 15

BPA has included the following force majeure language in the GRSPs included in Appendix A.

In addition, the Cost Adjustment Limit for a fiscal year shall be adjusted to reflect any or all of the following situations. (1) If during that fiscal year, BPA experienced a force majeure condition which increases expenses in categories subject to the spending limits, the costs of such condition or conditions that are in the spending limit categories shall be

subtracted from the value of the Cost Adjustment Limit. This Limit may be reduced to the extent that BPA has made reasonable efforts, in the Administrator's sole determination, to alleviate such force majeure conditions and mitigate the related increased expenses. For purposes of the General Rate Schedule Provisions, a force majeure condition shall be defined as (a) court ordered legal judgments against BPA and settlements formally accepted by a court in connection with dismissal of litigation; (b) additional security or legal obligations imposed by statute, rule or regulation; (c) regulatory requirements (including but not limited to Endangered Species Act implementation expenses) imposed by statute, rule or regulation; and (d) natural or man-made disaster, excluding BPA decisions that do not otherwise qualify as a force majeure condition.

Issue 16

Whether the ToolKit model BPA employed in the SN-03 rate case is inconsistent with the WP-02 ROD, thereby violating the scope of the SN-03 rate case as defined in the Federal Register Notice by revisiting issues decided in the WP-02 rate case.

Parties' Positions

SUB contends that when BPA removed the "floor" in the ToolKit model in the SN-03 rate case it abandoned its position in the WP-02 rate case. SUB Brief, SN-03-B-SP-01, at 14-15. The WP-02 ROD states that "BPA does not need to remove the 'floor' in the ToolKit." *Id.*

BPA's Position

SUB raises the issue of incompatibility with the WP-02 Supplemental ROD for the first time in its Initial Brief.

BPA believes that the deferral logic change it has made in the ToolKit is consistent with all policy decisions made in the WP-02 supplemental rate case. BPA is not bound by previous rate cases to use older models and never update them.

Evaluation of Positions

SUB argues that the WP-02 rate case binds BPA to not remove the "floor" in the ToolKit. However, a close reading of the WP-02 decision reveals that the issue was not the removal of the floor. In the WP-02 case, SOS/NWEC and SUB had both argued that the appropriate level of working capital for BPA (the PBL part of BPA) should be $300 million, not the $50 million that was modeled in the ToolKit. *See* 2002 Supplemental ROD, WP-02-A-09, at 4-47. The ToolKit used in the WP-02 rate case reflected the need to maintain $50 million of working capital by assuming that at the end of each year BPA (PBL) would retain at least $50 million in reserves and would defer as much of its scheduled payment to the U.S. Treasury as was needed to maintain that level of reserves. Upon careful reading, the complete decision SUB cites is actually a decision not to change the level of working capital assumed in BPA's modeling of TPP. *Id.* BPA has not changed the modeling assumption of the amount of working capital

needed for the SN-03 rate case, except to add $20 million for TBL to the $50 million for PBL, for a total of $70 million.

The WP-02 ROD decision that "BPA does not need to remove the 'floor' in the ToolKit" does not imply that BPA may not remove the floor.

Decision 16

The SN-03 version of the ToolKit is not inconsistent with the WP-02 Supplemental ROD, and differences between that version and the version used in the WP-02 rate case do not violate the scope of the SN-03 rate case.

Issue 17

Whether BPA's removal of the "floor" in the ToolKit model caused an understatement of TPP, thereby creating cost shifts and additional burdens on ratepayers.

Parties' Positions

SUB contends that the ToolKit model BPA is using in the SN-03 rate case removes the "floor" on reserves, and that this causes an understatement of BPA's real TPP. SUB Brief, SN-03-B-SP-01, at 15. SUB asserts that this understatement of TPP creates cost shifts and additional burdens on ratepayers. *Id.* at 15-16. Their arguement is repeated in their Brief on Exceptions. SUB Ex. Brief, SN-03-R-SP-01, at 4.

BPA's Position

BPA believes the only way in which the removal of the floor – the fundamental change in the "new deferral logic" compared to the "traditional deferral logic" – affects TPP in the SN-03 rate case is as follows. The TPP at issue is a three-year TPP – the probability that BPA will be able to make its payments to treasury in full and on time for FY 2004 and FY 2005 and FY 2006. *See*, McCoy, *et al.,* SN-03-E-BPA-17, at 22-23. If in one game of the Monte Carlo modeling of TPP the treasury payment is missed in FY 2004, it does not matter to the TPP whether the reserve calculations allow reserves to become negative, as the new deferral logic permits, or they are truncated at a floor of $50 million (or any other floor value), because that game has already been consigned to the non-success category by virtue of the deferral in FY 2004. *Id.* Therefore, the only time the change in deferral logic can matter to the three-year TPP is when there is a deferral in FY 2003. *Id.* If there is a deferral in FY 2003, the traditional deferral logic pushes some treasury payment out to the next rate period, and FY 2004 starts with the minimum working capital level (which for the SN-03 rate case, using the reserves of both TBL and PBL, is $70 million). *Id.* Under the new deferral logic required to calculate the Treasury Recovery Probability, the ending reserves for FY 2003 are allowed to go below the minimum working capital level, and therefore FY 2004 can start, in some games, with less than $70 million. *Id.* However, this is moot, because the SN-03 final studies data does not contain any games with a deferral in FY 2003, so there are no games in which the three-year 2004 - 2006 TPP would differ depending on the version of deferral logic used.

Evaluation of Positions

BPA has shown that the difference in deferral logic, that is, the removal of the "floor" in the ToolKit, has not affected the final studies three-year TPP. *Id.* Therefore, this cannot have created cost shifts or additional burdens on ratepayers. *Id.*

It is noted that one of SUB's proposed remedies for the purported flaw is the adoption of an "SN CRAC refund." SUB Brief, SN-03-B-SP-01, at 16. Because BPA is adopting an SN CRAC Rebate as part of this ROD it would appear to meet the objectives for which SUB raised this concern.

Decision 17

The SN-03 version of the ToolKit is not understating TPP, and therefore cannot be creating the cost shifts and additional burdens on ratepayers.

2.8 Fish and Wildlife

CRITFC and SOS/NWEC raise a number of issues related to BPA's fish and wildlife obligations. They express a concern that BPA's initial proposal did not provide the level of security necessary to cover its costs, and in particular, those costs associated with its Fish and Wildlife program. In response to these concerns and other significant factors addressed elsewhere in this Record of Decision (ROD), BPA has raised the TPP in this ROD to an 80 percent three-year TPP.

A number of budgetary and funding issues have been raised that are beyond the scope of the rate case. They are, therefore, not addressed here. BPA is committed to working with these parties, as well as the Council and others to discuss these issues in the appropriate forums outside the rigid confines of a rate case. BPA believes its budget provides the funding necessary to adequately fund its fish and wildlife obligations and intends to manage to these budgets. However, if it is determined in these alternative forums that BPA's funding obligations need to be increased, the current SN CRAC proposal has the flexibility to allow BPA to increase rates to account for these additional expenses.

Issue 1

Whether BPA has a fiduciary duty to provide additional funding for the fish and wildlife mitigation requested by the tribes.

Parties' Positions

CRITFC argues that Bonneville's fiduciary duty to the Treaty Tribes to protect their treaty secured interests dictate that a higher standard of care must be exercised in this proceeding as it affects these tribal interests. CRITFC Brief, SN-03-B-CR/YA-01, at 4 and 45. CRITFC refers to its testimony in the WP-02 rate case for supporting argument of its position. CRITFC contends that the Department of Energy (DOE) and BPA have both acknowledged the duty to uphold obligations of the federal government to Indian tribes. *Id.* at 46. CRITFC notes that BPA's rebuttal testimony (McNary and Lamb, SN-03-E-BPA-18, at 14) states that CRITFC did not identify any actions BPA should be taking to ensure the United States complies with its treaties with Tribes. *Id.*

In its Brief on Exceptions, CRITFC states that BPA "has ignored virtually all of" its recommendations and made important decisions about fish and wildlife restoration and Treaty rights in other forums without any consultation with CRITFC tribes. CRITFC, Ex. Brief, SN-03-R-PP-01, at 2. Such actions, according to CRITFC are contrary to BPA's Tribal Policy and trust responsibility. *Id.* CRITFC believes such behavior is inconsistent with a government-to-government relationship. *Id.*

BPA's Position

BPA consistently keeps its trust responsibility as a Federal agency in mind when making decisions. McNary and Lamb, SN-03-E-BPA-18, at 3. BPA fulfills its share of the trust

responsibility by fully complying with the laws governing its activities, such as, but not limited to, the Northwest Power Act (protect and mitigate fish and wildlife and their habitats, provide equitable treatment), NEPA (impacts of proposed actions on tribes and trust resources), ESA (protection of trust and treaty resources), Native American Grave Protection and Repatriation Act (protection of cultural resources), and the Clean Water Act (water quality). *Id.* CRITFC has not identified a statute applicable to BPA that broadens BPA's general trust responsibility to include the requirement to take specific fish and wildlife mitigation actions on behalf of the tribes. *Id.* None of BPA's rate setting directives call for the type of analysis sought by CRITFC. *Id.* Therefore, by setting its rate proposal to meet its obligations under its enabling acts and other pertinent laws, BPA will also have adequate rate levels to support trust and treaty obligations. *Id.* at 14-15.

Evaluation of Positions

CRITFC claims the trust responsibility imposes a strict fiduciary standard on the conduct of executive agencies. In its WP-02 briefing, CRITFC relied on the following judicial decisions to support its position. *Seminole Nation v. United States*, 316 U.S. 286 (1942); *Navajo Tribe of Indians v. United States*, 364 F.2d 320 (Ct.Cl 1966). CRITFC pointed to DOE and BPA tribal policies, and the decision in *Morton v. Mancari*, 417 U.S. 535 (1974), to argue BPA should treat the tribes differently.

BPA does not believe the law cited by CRITFC stands for the proposition that BPA is under a specific trust responsibility to either fund the tribes' specific project requests or make additional funding available for projects proposed by or supporting tribes. BPA's general trust responsibilities are not broadened by law to include the requirement to take specific fish and wildlife mitigation actions on behalf of the tribes.

BPA agrees that the federal government recognizes the "undisputed existence of a general trust relationship between the United States and the Indian people." *United States v. Mitchell*, 463 U.S. 206, 225 (1983). BPA shares the Government's trust responsibility to Indian tribes. However, neither Congress nor the Executive branch has delegated BPA specific trust-related duties to manage an Indian resource on behalf of Indian beneficiaries. When such a specific trust responsibility is established, an agency must fulfill this responsibility as a "moral obligation of the highest responsibility" to be "judged by the most exacting fiduciary standards." *Seminole Nation v. United States*, 316 U.S. 286, 297 (1942). BPA's power marketing statutes lack any expression of intent by Congress to impose a fiduciary duty on BPA to treat Indian tribes or their resources differently when mitigating for fish and wildlife. BPA's choice to treat Indian tribes or their resources with a higher degree of care is done as a matter of discretion and in tandem with the fulfillment of one or more of its statutory purposes. BPA is not under a specific trust responsibility for purposes of increasing funding levels to benefit Indian tribes. "[A]lthough the United States does owe a general trust responsibility to Indian tribes, unless there is a specific duty that has been placed on the government with respect to Indians, this responsibility is discharged by the agency's compliance with general regulations and statutes not specifically aimed at protecting Indian tribes." *Morongo Band of Indians v. Federal Aviation Administration*, 161 F.3d 569, 574 (9th Cir. 1998); *see also Pawnee v. United States*, 830 F.2d 187, 191 (Fed. Cir. 1987) *Skokomish Indian Tribe v. FERC*, 121 F.3d 1303, 1308-09 (9th Cir. 1997) (FERC

exercises its trust responsibility in the context of the Federal Power Act and is not required to afford Indian tribes greater rights than they would otherwise have under that Act).

CRITFC states disappointment at BPA's refusal to change the scope of this proceeding to accommodate the issues CRITFC and SOS/NWEC wish to address here.[1] CRITFC Ex. Brief, SN-03-R-PP-01, at 2. Nothing in any Executive Order, BPA's Tribal Policy, or cases articulating the government's trust responsibility requires BPA to alter procedural rules for evidentiary hearings to allow tribes to raise issues that are not germane to the agency's rate-making process. Beginning in WP-02 and throughout this proceeding, BPA staff has attempted to offer guidance and assistance to CRITFC in how to participate in rate proceedings. Such efforts were undertaken as both a professional courtesy and an attempt to follow the spirit of the Tribal Policy. CRITFC's decision not to follow that advice, or adhere to the procedures, does not constitute a breach of BPA's duty. These procedural concerns notwithstanding, CRITFC admits through "months of BPA-hosted meetings" "and the volumes of tribal testimony," CRITFC Ex. Brief, SN-03-R-PP-01, at 7, BPA did indeed make its policy decisions regarding fish funding outside this proceeding with extensive tribal input.

Decision 1

BPA shares the federal government's general trust responsibility and in fulfilling that duty it has fully considered CRITFC's views and requests in this proceeding. While BPA does not have a fiduciary duty to provide additional funding for fish and wildlife mitigation, or procedural accommodations in this rate case, as requested by CRITFC, BPA welcomes the opportunity to work closely with CRITFC and tribes generally to ensure that through the implementation of its statutory duties, including the Integrated Program, BPA consistently considers the interest and needs of tribes.

Issue 2

Whether BPA has adequately addressed the costs associated with its fish and wildlife obligations.

Parties' Positions

CRITFC and SOS/NWEC contend that BPA has erred by ignoring the 2000 Biological Opinion, a recent court decision, and Provincial Review in its SN-03 rate proposal. CRITFC Brief, SN-03-B-CR/YA-01, at 8; SOS/NWEC Brief, SN-03-B-SA-01, at 7-8. CRITFC contends that ignoring these matters places additional risk on BPA that is not adequately addressed in its rate

[1] SOS seemed to raise similar concerns, but not in a trust context, when it stated in its Brief on Exceptions that "we were very disappointed in the quality and integrity of the draft ROD's arguments. The document either fails to address several significant issues raised by SA or distorts them so critically that BPA's replies are irrelevant to the real issues SA presented. We find this behavior professionally dishonest." SOS Ex. Brief, SN-03-R-PP-01, at 2. As with CRITFC, any party who raises issues outside the scope of the proceeding and violates the procedural rules should expect BPA to address these issues in a manner which preserves the integrity of the statutory ratesetting process.

proposal. SN-03-B-CR/YA-01, at 8. This risk undermines BPA's ability to repay the treasury and fully fund fish and wildlife measures in order to comply with federal law. *Id*.

BPA's Position

Both BPA's published reports (FCRPS Progress Reports by the three Federal Action Agencies) documenting the extent to which BPA has met its obligations under the ESA, and the NOAA Fisheries findings for FCRPS operations indicate the Action Agencies are on track implementing the 2000 FCRPS Biological Opinion. McNary and Lamb, SN-03-E-BPA-18, at 4. (NOAA Fisheries Findings: Fish Recovery Efforts Off to a Solid Start (July 2002) http://www.salmonrecovery.gov/Citizen_Update_9.pdf). BPA fulfilled its Northwest Power Act and ESA obligations using funding levels at or below the levels assumed in this rate case for FY 2004-2006. *Id.* at 7.

Based on this experience and the Implementation Plan, 68 Fed. Reg. 12051, BPA developed and has posted lists of the projects it will fund within its estimated expense accrual budget for 2003 and coordinated those lists with the Council and fish and wildlife managers to ensure the expenditures do not exceed $139 million. *Id.* at 4. This list includes the actions NOAA Fisheries deemed critical for biological opinion compliance. The Action Agency review of Biological Opinion implementation progress, http://www.bpa.gov/corporate/kc/home/nreleases/NewsRelease.cfm?ReleaseNo=355, and NOAA Fisheries' findings letter, http://www.nwr.noaa.gov/1hydrop/hydroweb/docs/FindingsReport.pdf, indicate BPA is on track to meet the standards set for the Biological Opinion 2003 check-in. *Id.*

Evaluation of Positions

BPA has not ignored the Biological Opinion or recent court decisions in setting these rates. BPA has the benefit of several completed processes and years of actual implementation experience to guide its program spending levels for fish and wildlife. This experience includes successfully implementing both the NOAA Fisheries and USFWS Biological Opinions under the ESA to cover FCRPS operations. McNary and Lamb, SN-03-E-BPA-18, at 4-8. In addition, this experience includes implementation of the Council's 2000 program and the Provincial Reviews that it has by and large completed. CRITFC asserts that Sarah McNary, BPA's Fish and Wildlife Division Director, stated that the Council had not identified budget levels for FY 2004-2006. CRITFC Brief, SN-03-B-CR/YA-01, at 15-16. This was simply a statement of fact. The Council has not provided BPA with its recommendations for how to prioritize the expenditure of the $139 million annually in FY 2004-2006. As McNary testified, BPA sets the annual budget levels for the Integrated Program. Tr. at 118. The Council helps guide the prioritization of actions or measures within the established budget. McNary and Lamb, SN-03-E-BPA-18, at 12. The absence of out-year prioritizations does not implicate a need for BPA to set a higher annual expense accrual level for the Integrated Program.

Similarly, the number of projects that receive a positive Independent Scientific Review Panel and Columbia Basin Fish and Wildlife Authority review in the Council's Provincial Review process does not define BPA's funding level or obligations. *Id*. at 9-10. Having more projects than

necessary allows the Council to prioritize its recommendations to better achieve the requirements of the program, including the requirements that its recommendations complement the existing and future activities of the region's fish and wildlife agencies and tribes, be based on and supported by the best available scientific knowledge, utilize alternatives with the minimum economic cost, and are consistent with tribal rights. 16 U.S.C. § 839b(h)(6)(A)-(D). Having more projects than necessary allows BPA to accept recommendations that best help it fulfill its statutory purposes to protect, mitigate, and enhance fish and wildlife while providing the Pacific Northwest with an adequate, efficient, economic, and reliable power supply. *Id.* at § 839(2); § 839b(h)(10)(A); SN-03-E-BPA-18, at 9-10.

With regards to the NOAA Fisheries 2000 Biological Opinion, both BPA's published reports (FCRPS Progress Reports by the three Federal Action Agencies) documenting the extent to which BPA has met its obligations under the ESA, and the NOAA Fisheries findings for FCRPS operations indicate the Action Agencies are on track implementing the 2000 FCRPS Biological Opinion. *Id.* at 4 (NOAA Fisheries Findings: Fish Recovery Efforts Off to a Solid Start (July 2002) http://www.salmonrecovery.gov/Citizen_Update_9.pdf). BPA fulfilled its Northwest Power Act and ESA obligation using funding levels at or below the levels assumed in this rate case for FY 2004-2006. *Id.* at 7.

CRITFC and SOS/NWEC also imply that the court decision by Judge Redden in *National Wildlife Federation v. National Marine Fisheries Service*, or other ongoing litigation, may increase BPA's costs. CRITFC Brief SN-03-B-CR/YA-01, at 27; SOS/NWEC Brief, SN-03-B-SA-01, at 7-8. It is speculative at this point to assume that the Biological Opinion will impose greater costs on BPA, that those costs will arise in the remainder of this rate period, and that Judge Redden's order is not appealed or it is upheld on appeal. As indicated previously, if BPA does experience increased costs, the SN CRAC is designed to ensure BPA recovers its total costs.

Insofar as relevant to this proceeding, BPA is providing greater funding certainty for fish and wildlife and is reducing the financial risks to both the Integrated Program and BPA. McNary and Lamb, SN-03-E-BPA-18, at 4-5. In this way, the funding levels BPA sets help assure the agency's overall expenditures will be within planned levels and maintain the high likelihood that BPA will make its annual treasury payments.

CRITFC states that BPA has painted "a bull's-eye on reductions to the fish and wildlife program" by considering fish and wildlife funding reductions. CRITFC Ex. Brief, SN-03-R-PP-01, at 16, citing SN-03-A-01 at 2.7-18. BPA included savings in the fish and wildlife program among many other options as a possible source of reductions. Draft ROD, SN-03-A-01 at 2.7-18. Specifically, to the extent that BPA can achieve its ESA and Northwest Power Act objectives at a lesser cost, BPA intends to reflect those savings in its August 2003 SN CRAC recalculations. *Id.* at 18-19. It appears CRITFC is concerned that fish and wildlife funding may be subject to a different standard than BPA's other program areas. Sound business principles support BPA's cost cutting challenge to all program areas, including fish and wildlife, to achieve objectives in the most cost effective manner. McNary and Lamb, SN-03-E-BPA-18, at 3-4.

Decision 2

To the extent CRITFC and SOS/NWEC testimony and briefing was not stricken and is relevant to this proceeding, BPA properly considered the costs related to its fish and wildlife obligations, including those costs resulting from implementation of the NOAA Fisheries 2000 Biological Opinion on FCRPS Operations, ongoing litigation, and the Council's Provincial Reviews for the Integrated Program.

Issue 3

Whether BPA failed to consider the costs and risks associated with implementing the ESA and the Council's Fish and Wildlife Program.

Parties' Positions

CRITFC notes that the ESA protects species listed either as endangered or threatened and imposes substantive duties on BPA to ensure that its activities do not: 1) jeopardize the continued existence of listed species, or 2) adversely modify the critical habitat of such species. CRITFC Brief, SN-03-B-CR/YA-01, at 9. CRITFC also notes that the Council also develops a fish and wildlife program that addresses all fish and wildlife affected by the construction and operation of the FCRPS. *Id*. CRITFC contends that BPA failed to consider evidence on the costs and risks associated with the implementation of the ESA and Council Fish and Wildlife Program. *Id*. at 10; *see also* SOS/NWEC Brief, SN-03-B-SA-01, at 7-8. CRITFC contends that federal agencies have stated the Biological Opinion is an aggressive effort to improve habitat, reform hatcheries, and reduce harvest, yet they have delayed breaching the Snake River dams because they thought other measures would be sufficient. CRITFC Brief, SN-03-B-CR/YA-01, at 10.

In its Brief on Exceptions, CRITFC contends BPA's assertion that it is meeting the requirements of the Biological Opinion are premature because the check-ins have not begun and some actions have not been initiated under the RPA. CRITFC Ex. Brief, SN-03-R-PP-01, at 21-23. CRITFC further asserts that BPA has provided no evidence it is implementing the Council's program. *Id.* at 21.

BPA's Position

The Hearing Officer struck from the evidentiary record the testimony and exhibits associated with CRITFC's testimony regarding implementing the ESA and the Council's Fish and Wildlife Program. Order, SN-03-O-011; SN-03-O-017. BPA funding levels for fish and wildlife were determined in public processes outside of this proceeding and the results of those processes were imported into this proceeding. To avoid having matters determined in public processes outside of this rate proceeding relitigated in this proceeding, the Administrator directed the Hearing Officer to exclude from the record evidence and argument associated with "the related operations, assumptions, and program spending level forecasts" for the fish and wildlife program. 68 Fed. Reg. 12052. Nevertheless, BPA believes that it did adequately consider the

costs associated with implementing the ESA and the Council's Fish and Wildlife Program outside the rate case.

Evaluation of Positions

Measures or actions for improving habitat, reforming hatcheries, and reducing harvest are already part of both the FCRPS Action Agencies' Implementation Plan and the Council's program. SN-03-E-CR-01QQ. BPA does not expect to raise its fish and wildlife program expense levels during the remainder of the rate period, but the SN CRAC is designed to accommodate unexpected, uncontrollable costs. BPA has suggested a $139 million annual expense accrual funding level for FY 2004-2006 and asked the Council to review and if possible reduce Integrated Program needs to below that level. SN-03-E-BPA-18, at 4-5. The Northwest Power Act, along with other substantive statutes, establishes BPA's fish and wildlife obligations. *Northwest Info. Resource Ctr v. NW Power Planning Council*, 35 F.3d 1371, 1378-79 (9th Cir. 1994).

Similarly, subbasin planning is meant to help focus the region's mitigation efforts, not just BPA's, on ecosystem-based restoration and recovery activities. McNary and Lamb, SN-03-E-BPA-18, at 6. The plans will help focus entities like BPA on where to mitigate and how best to mitigate by providing a vehicle for prioritizing actions that most effectively and efficiently address factors that limit mitigation and recovery. *Id.* The plans will also help identify others responsible for mitigation and their obligations relative to the limiting factors. The plans will provide a basis to help the Council prioritize its funding recommendations to BPA and the other agencies owning or regulating hydroelectric facilities in the basin. *Id.* Subbasin planning will not change BPA's legal or funding obligations.

The Biological Opinion check-ins are unlikely to increase legal risk and financial exposure. *Id*. at 7. The check-in for 2008 occurs after the current rate period, and the 2005 check-in is not likely to result in cost increases during the current rate period. *Id*. If the 2005 check-in results in the need for BPA to increase its expenditures, then those costs may be considered either with an automatic adjustment or when BPA sets its rates for the post-2006 period. *Id.* In addition, as of 2002 NOAA Fisheries was satisfied with the implementation by BPA and the other Action Agencies of 176 out of 199 actions under the Biological Opinion's Reasonable and Prudent Alternative. *Id.* To the extent the Action Agencies have modified or not begun implementation of fourteen actions, nine of them are research, monitoring, and evaluation actions that BPA has planned to include in the annual expense accrual budgets. *Id* . at 4, citing http://www.nwr.noaa.gov/1hydrop/hydroweb/docs/FindingsReport.pdf. The remaining actions are either operational or matters for another agency. *Id.* The 2003 check-in is largely procedural—to see that the Action Agencies are making appropriate progress in implementing the actions under the Reasonable and Prudent Alternative—so it is unlikely BPA's obligations will change at that time but may instead result in some reprioritization of work in any areas determined by NOAA Fisheries to require adjustment. *Id.*

Dam breaching costs are highly unlikely during this rate period. Breaching, and an allocation of the costs of breaching to BPA, would require additional legislation.

CRITFC alleges BPA has not provided evidence of implementing the Council's program. BPA believes it has implemented the program and CRITFC itself provided the evidence in Exhibit SN-03-E-CR-01QQ, Second Annual Report to the Northwest Governors On Expenditures of the Bonneville Power Administration to Implement the Columbia River Basin Fish and Wildlife Program of the Northwest Power Planning Council (September 2002). The report notes that the "grand total of Bonneville's fish and wildlife expenditures, 1978 through 2001, now stands at $6.01 billion." *Id.* at 3.

Decision 3

Insofar as relevant to this proceeding, BPA reasonably considered the costs and risks associated with implementing the ESA and Integrated Program in establishing this rate.

Issue 4

Whether BPA improperly balanced its legal obligations when it considered ratepayer opposition to the fish and wildlife funding obligations in this proceeding.

Parties' Positions

CRITFC contends that BPA is improperly holding down fish and wildlife costs to improve liquidity and keep rates down. CRITFC Brief, SN-03-B-CR/YA-01, at 18. CRITFC believes that BPA's concern that it cannot further increase fish and wildlife funding when other programs are taking deep cuts is not relevant to BPA's statutory duties. *Id*. CRITFC contends that BPA's utility customers have not analyzed the costs of meeting BPA's fish and wildlife funding obligations and BPA therefore cannot rely on their opposition because it is not based on factual evidence. *Id*. CRITFC believes BPA is required to coordinate its actions with fishery managers and has failed to do so. *Id*. By failing to address these matters BPA has increased the risk of failing to make its treasury payment. *Id*. at 19.

CRITFC asserts its rebuttal testimony showed that Bonneville's utility customers have not analyzed the costs of meeting Bonneville's fish and wildlife and related legal responsibilities. CRITFC, SN-03-E-CR/YA-02O. Therefore, CRITFC concludes, Bonneville should not rely on ratepayer opposition to fish and wildlife funding when the opposition is not based on factual evidence. Rather, according to CRITFC, BPA is required to coordinate its actions with the fishery managers, citing 16 U.S.C. § 839b(h)(11)(B).

BPA's Position

BPA's proposal allows it to meet its funding obligations. BPA continues to support its 40 percent increase in fish and wildlife expense accrual funding since 2001. McNary and Lamb, SN-03-E-BPA-18, at 9. The fish and wildlife costs included in BPA's SN-03 proposal are expected to meet the requirements of the Biological Opinions and the Northwest Power Planning Council's Fish and Wildlife Program. Lefler, *et al*, SN-03-E-BPA-06, at 9, lines 5-9. BPA's decision supports full implementation of the NOAA Fisheries' and USFWS' Biological Opinions. McNary and Lamb, SN-03-E-BPA-18, at 11.

Evaluation of Positions

One of CRITFC's conclusions is that absent independent analysis of BPA's fish and wildlife costs, the political and economic concerns of ratepayers should be secondary to the mandate that BPA coordinate its implementation actions with the tribes. CRITFC Brief, SN-03-B-CR/YA-01, at 31; but *see* CRITFC Ex. Brief SN-03-R-PP-01, at 24-25 (arguing BPA mischaracterized CRITFC's intent). CRITFC appears to be blending BPA's power marketing and rate setting mandates with the requirement to provide fish and wildlife equitable treatment with the other purposes for which the FCRPS is managed. In its exceptions, CRITFC also states Bonneville has failed to consult with fisheries managers by limiting the application of section 4(h)(11)(B) to coordination with fish management agencies and tribes when addressing hydrosystem management, operations, and regulation. According to CRITFC, this law is not limited to equitable treatment. CRITFC Ex. Brief, SN-03-R-PP-01, at 25.

The statutes do not support CRITFC's reliance on the coordination requirement when the setting is a rate proceeding. Section 4(h)(11)(B) applies to BPA in carrying out the provisions of "this paragraph," that is, Section 4(h)(11). 16 U.S.C. § 839b(h)(11)(B). "This paragraph" has two subsections to which the consultation and coordination mandate applies. Section 4(h)(11)(A)(i) outlines the equitable treatment mandate. *Id.* at § 839b(h)(11)(A)(i). Section 4(h)(11)(A)(ii) requires the consideration of the Council's program in the process of managing, operating, and regulating those facilities. *Id.* at § (A)(ii). "This paragraph" does not require BPA consult with fish management agencies and tribes to set its rates. Therefore, the parties' testimony on this issue is not germane to this rate case, particularly since fish and wildlife program funding levels have been expressly excluded from consideration in the rate proceeding. 68 Fed. Reg. 12048, at 12052. For there to be full and open consideration of budget issues, they must be dealt with outside the narrow confines of a rate case.

BPA must implement and harmonize many statutory obligations. A purpose of the Northwest Power Act is that BPA ensure the Pacific Northwest an adequate, efficient, economical and reliable power supply. 16 U.S.C. § 839(2). BPA must also adhere to sound business principles, 16 U.S.C. §§ 825s; 838g; 839e(a)(1); 839f(b), while striving to encourage "the widest possible use of all electric energy that can be generated and marketed and to provide reasonable outlets therefore." 16 U.S.C. § 832a(b). BPA must also protect, mitigate and enhance fish and wildlife, especially anadromous fish, affected by the construction and operation of the FCRPS. 16 U.S.C. §§ 839(6), b(h)(10)(A). BPA must undertake this obligation in a manner consistent with the Council's program and the other purposes of the Northwest Power Act. *Id.* at § 839b(h)(10)(A). BPA must provide fish and wildlife equitable treatment, *id.* at § 839b(h)(11)(A)(i), and in the process of doing so coordinate with fish management agencies and tribes. *Id.* at § 839b(h)(11)(B). A principle of the program is that "Consumers of electric power shall bear the costs of measures designed to deal with adverse impacts caused by the development and operation of electric power facilities and programs only." *Id.* at § 839b(h)(8)(B).

With these contrasting mandates in its core enabling acts, BPA must construe the provisions together in a way that avoids contradiction and provides meaning to all. *Ass'n of Pub. Agency Customers v. Bonneville Power Admin.*, 126 F. 3d 1158, 1164, 1170-71 (9th Cir. 1997); Sutherland, *Statutory Construction* § 51.02 (5th ed. 1992). Part of this balance is considering the

interests and concerns of customers in rate proceedings who seek to ensure BPA is operating under sound business principles and assuring the Pacific Northwest an adequate, efficient, economical and reliable power supply. Therefore, BPA believes it is reasonable to consider ratepayer concerns regarding the political and economic risks the agency may be taking if it raises its rates to provide additional funding to any program areas—including fish and wildlife. Similarly, when BPA does set rates, it must ensure that cost recovery is assured.

CRITFC misinterprets BPA's testimony to say that: BPA based the funding level on its own judgment and the need to hold down fish and wildlife funding to increase liquidity. CRITFC Brief, SN-03- B-CR/YA-01, at 18; CRITFC Ex. Brief, SN-03-R-PP-01, at 26. McNary and Lamb actually testified that "With the agency-wide need to conserve reserves, holding fish and wildlife expense funding to $139 million increases the BPA's liquidity." McNary and Lamb, SN-03-E-BPA-18, at 6. When reserves are low and rates are higher than they have ever been before, the need to preserve liquidity is a paramount concern. BPA is managing to budgets established in 2001 that are 40 percent higher than earlier levels. *Id.* at 5. These current levels are an increase that is within the mid-range established in WP-02. *Id.*

Decision 4

Insofar as relevant to this proceeding, BPA did not err in its consideration and balancing of both customer and tribal concerns about the need for and impacts of fish and wildlife funding increases.

Issue 5

Whether BPA's proposal adequately addresses non-listed species.

Parties' Positions

CRITFC contends that BPA has not adequately addressed species not yet listed under the ESA. CRITFC Brief, SN-03-B-CR/YA-01, at 19. CRITFC contends that there is evidence species not listed are not getting adequate funding and this problem will likely result in additional listings and cost exposure for BPA. *Id*. In its Brief on Exceptions, CRITFC observed that it cited the example of a decline in lamprey eel and BPA ignored that concern. CRITFC Ex. Brief SN-03-R-PP-01, at 26, citing SN-03-B-CR/YA-01, at 19.

BPA's Position

Bonneville witnesses indicate: (1) many actions listed in the Critical Elements list benefit non-listed as well as listed species; and (2) a significant number of projects identified in the Critical Elements were initiated under the Council's program prior to the 2000 Biological Opinion and were assumed in the Biological Opinion as part of the baseline. McNary and Lamb, SN-03-E-BPA-18, at 8. (The Council has noted this in its 2000 Program. *See* http://www.nwcouncil.org/library/2000/2000-19/Default.htm.)

Evaluation of Positions

BPA's fish and wildlife funding obligations are addressed and decided outside of the rate case. This includes the issue whether BPA funding adequately addresses non-listed species.

BPA did not provide a listed versus non-listed species breakdown of expenditures or anticipated costs for several reasons. First, ESA projects often benefit unlisted species also, especially when the project is for anadromous fish. The CRITFC direct testimony appears to acknowledge this fact. CRITFC Brief, SN-03-E-CR/YA-01, at 25. Second, because relatively few of the listed species BPA mitigates are resident fish or wildlife, a good idea of BPA's non-listed species funding for resident fish and wildlife is in Figure 3 of the Second Annual Report to the Northwest Governors on Expenditures of the Bonneville Power Administration, SN-03-E-CR-01QQ. McNary and Lamb, SN-03-E-BPA-18, at 8. This shows from 1978 through 2000 BPA spent $127,896,767 on wildlife and $131,584,484 on resident fish. These figures closely approximate the funding directed at non-listed species. Finally, as the program moves more to ecosystem-based mitigation guided by subbasin plans, BPA expects the Council's recommendations to move somewhat away from species-specific projects to suites of projects that focus on overall ecosystem improvement. *Id.*

Ultimately, CRITFC appeals to the fact that there are many more actions proposed and recommended for BPA than it funds; therefore, BPA is not meeting current mitigation needs. Sheets *et al*., SN-03-E-CR/YA-01, at 12. This argument does not acknowledge the distinction between what BPA is authorized to fund for fish and wildlife and what it is required to fund. For example, the Provincial Review process focused primarily on what fish and wildlife managers thought would be beneficial for BPA to fund. The Provincial Review was not limited to what BPA is required to fund. McNary and Lamb, SN-03-E-BPA-18, at 9. Historically, the broad suite of projects recommended by fish and wildlife managers and others is not the basis for defining BPA's obligations. *Id.*

CRITFC's lamprey eel example is no exception. CRITFC Ex. Brief SN-03-R-PP-01, at 26, citing SN-03-B-CR/YA-01, at 19-20. This is one of many areas in which BPA has the authority to invest its resources, but it is not per se obligated to do so. CRITFC's data response suggests on its face that over harvest is a likely culprit to decreased lamprey numbers. *See* SN-03-E-CR-02F. There is no indication in CRITFC's testimony of the impact of ocean or weather conditions on lamprey, or of the kind of action required to mitigate lamprey, or whether such actions are complementary, redundant, or contradictory to the actions BPA takes for other species. This single example has too many uncertainties to provide a clear indication of the additional costs, if any, BPA is likely to incur, and CRITFC has not shown that the lamprey eel example accurately represents the class of actions CRITFC believes BPA has failed to consider in its proposal.

Decision 5

While BPA believes it has adequately considered the outcomes of the Provincial Review process and fully incorporated into its proposal the mitigation needs of species that are not listed under the ESA, those are funding and budget issues that are beyond the scope of this rate case.

Issue 6

Whether BPA's proposal is based upon overly optimistic river operation assumptions.

Parties' Positions

CRITFC contends that BPA's proposal assumes significant changes in operations for the FCRPS. CRITFC Brief, SN-03-B-CR/YA-01, at 20. CRITFC states that BPA assumes the Corps and Bureau will decrease flow and spill operations. This assumption increases the risk that BPA's rates are not sufficient to meet its costs and repay the treasury. *Id*. at 21. CRITFC believes these flow and spill levels are at the low end of levels likely to avoid high mortality for listed species. *Id.*

BPA's Position

It is BPA's position that these issues are beyond the scope of this proceeding.

Evaluation of Positions

The SN-03 Federal Register Notice addressed these questions directly, and appropriately placed them beyond the scope of this rate case. Because the policy, funding, and operational decisions accompanying Biological Opinion compliance were being made in other processes, the Administrator directed the Hearings Officer to exclude them from the record. *Id.* at 12052. CRITFC raised those issues, and upon motions by BPA and other parties, the Hearings Officer struck them. SN-03-O-011; SN-03-O-17.

In its Brief on Exceptions, CRITFC reasserts its belief that BPA's spill and flow assumptions increases the risk that revenues will be lower than assumed. CRITFC Ex. Brief, SN-03-R-PP-01, at 26. CRITFC also expresses concern that BPA apparently ignored this issue. *Id.* CRITFC further states that BPA should be more risk averse in assuming revenues from FCRPS operations that it does not control and that it is also a loads and resources issue. *Id*. at 9. BPA addresses this issue procedurally and does not ignore it. BPA addresses the issue here and will not separately address it in section 2.2, Loads and Resources.

CRITFC is correct that some issues regarding the potential changes to the hydrosystem operations for fish will be resolved after BPA issues the SN-03 final ROD. 68 Fed. Reg. 12048, at 12051-52. BPA will include in the decision those hydrosystem operations that have been resolved by that time and will also include those considered to be most likely—again, as viewed by the Action Agencies and NOAA Fisheries and USFWS—to avoid being overly optimistic or overly conservative when assessing the power production capability of the hydrosystem.

Decision 6

The Federal Register Notice appropriately excluded FCRPS operational and funding issues such as this one from this proceeding.

Issue 7

Whether BPA's proposal fails to give fish and wildlife equitable treatment with the other purposes for which the FCRPS is managed and operated.

Parties' Positions

CRITFC and SOS/NWEC contend that BPA did not analyze its equitable treatment obligations in this proposal. CRITFC Brief, SN-03-B-CR/YA-01, at 24; SOS/NWEC Brief, SN-03-B-SA-01, *passim*. They contend that BPA has taken the position that it relies upon its implementation of the Council's Fish and Wildlife Program as a significant contribution to meeting its equitable treatment responsibilities. CRITFC Brief, SN-03-B-CR/YA-01, at 24. The parties contend that BPA's desire to balance power needs with the needs of fish and wildlife is done to the detriment of fish. CRITFC Brief, SN-03-B-CR/YA-01, at 24; SOS/NWEC Brief, SN-03-B-SA-01, *passim*. The rates are in CRITFC's estimation 16 percent below market. CRITFC and SOS/NWEC believe that BPA has reduced fish and wildlife funding and reduced the probability of repaying treasury to minimize the rate increase. *Id.* This action keeps rates below market and shifts the risk to fish and wildlife. *Id*. Similarly, SOS/NWEC in its exceptions states that BPA did not substantively address its argument that use of emergency operations to provide a financial shock absorber for the rest of the system is not fair to fish. NWEC/SOS Ex. Brief SN-03-R-PP-01, at 3. This according to the parties is inconsistent with equitable treatment under the Northwest Power Act. 16 U.S.C. § 839b(h)(11)(A)(i).

In their Brief on Exceptions, CRITFC and SOS assert that BPA has an affirmative obligation to "demonstrate, by means that allow for meaningful review, that it has treated fish and wildlife equitably" in reaching its ratemaking decisions. *NW Environmental Defense Ctr. v. BPA*, 117 F.3d 1520, 1534 (9th Cir. 1997). CRITFC Ex. Brief, SN-03-R-PP-01, at 27; NWEC/SOS Ex. Brief SN-03-R-PP-01, at 4. They are concerned because BPA did not make such a demonstration in this proceeding, *id.*, and seek a comparison between how Bonneville treats fish and how it treats power and other uses of the system. CRITFC Ex. Brief SN-03-R-PP-01, at 29; NWEC/SOS Ex. Brief, SN-03-R-PP-01, at 5. They further believe BPA misinterprets its responsibilities for equitable treatment by considering the mandate in only its hydrosystem management and operation decisions. CRITFC Ex. Brief, SN-03-R-PP-01, at 27; NWEC/SOS, Ex. Brief SN-03-R-PP-01, at 4.

BPA's Position

The Hearing Officer struck from the evidentiary record the testimony and exhibits associated with CRITFC's testimony regarding costs associated with equitable treatment of fish and wildlife. Order, SN-03-O-011. Decisions related to BPA's equitable treatment of fish and wildlife are determined in processes outside of this proceeding and the results of those processes are imported into this proceeding. To avoid having matters determined in public processes outside of this rate proceeding relitigated in this proceeding, the Administrator directed the Hearing Officer to exclude from the record evidence and argument associated with "the related operations, assumptions, and program spending level forecasts" for the fish and wildlife program. 68 Fed. Reg. 12048, at 12052.

The Northwest Power Act includes a duty for Federal agencies that manage, operate, or regulate hydroelectric facilities in the Basin to provide "equitable treatment" for fish and wildlife with the other purposes for which the hydro facilities are managed and operated. 16 U.S.C. § 839b(h)(11)(A)(i). BPA provides equitable treatment on a system-wide basis primarily by implementing the Council's program, the relevant NOAA Fisheries and USFWS Biological Opinions, and the Basinwide Recovery Strategy (All H Paper) including revisions and supplements to these documents. *Northwest Environmental Defense Center v. BPA*, 117 F.3d 1520, 1533-34. BPA does not believe it has a duty to further demonstrate in a rate case that it provides equitable treatment to fish and wildlife. *Id.*

Evaluation of Positions

Issues related to equitable treatment raised by CRITFC in testimony were stricken from the record. Order, SN-03-O-11. As a consequence it is not necessary to specifically address these issues in this ROD. However, BPA does wish to note that equitable treatment applies to the regulation, management, and operation of the hydrosystem, not funding per se. 16 U.S.C. § 839b(h)(11)(A)(i). By implementing the Council's program, the relevant NOAA Fisheries and USFWS Biological Opinions, and the Basinwide Recovery Strategy, BPA is providing equitable treatment to fish and wildlife on a system-wide basis as Congress intended. In response to litigation in 1994, NOAA Fisheries wrote a new 1995 FCRPS Biological Opinion and subsequently issued its 2000 Biological Opinion. Both Biological Opinions have resulted in significant and far-reaching changes to hydrosystem operations. *See, e.g.,* Council, Second Annual Report to Northwest Governors at 21 (showing increased costs incurred subsequent to ESA listings and resulting changes in operations); SN-03-E-CR-01QQ. As for equitable treatment, the System Operations Review Environmental Impact Statement (SOR EIS) documented a comprehensive review of operating alternatives and their impacts on all operating purposes. The SOR EIS documents how BPA, in conjunction with the Corps and Reclamation, balances the multiple purposes of the FCRPS. The primary focus of the SOR EIS was fish and wildlife protection, and balancing the needs of fish and wildlife under the Northwest Power Act and ESA with energy production and other project purposes. In its SOR Record of Decision, BPA along with the Corps and Reclamation determined that conflicts between power and fish would be resolved in favor of fish by adopting the environmentally preferred alternative to implement the applicable NOAA Fisheries Biological Opinion to insure hydrosystem operations will comply with these statutory responsibilities. McNary and Lamb, SN-03-E-BPA-18, at 14.

In their exceptions the parties argue the phrase, "managing, operating or regulating" in section 4(h)(11)(A) only identifies which agencies are covered by the equitable treatment requirement, and it does not to restrict their responsibilities. CRITFC Ex. Brief, SN-03-R-PP-01, at 27-28; NWEC/SOS Ex. Brief, SN-03-R-PP-01, at 4. This argument discounts the language that follows: the agencies so identified must "exercise *such responsibilities*.…" Such responsibilities are to manage, operate, or regulate the hydrosystem. Anticipating this, the parties then contend BPA "is not responsible for "regulation, management, and operation" of the hydrosystem, but instead addresses only "power marketing and related decisions such as rate setting, and use of ratepayer dollars for public purposes." *Id.*

If BPA has express responsibilities under a statute governing hydrosystem managers, operators, and regulators it must necessarily be a hydrosystem manager, operator, or regulator. Section 1 of the Bonneville Project Act establishes BPA's role as a hydrosystem manager. It states "The Secretary of the Army shall provide, construct, operate, maintain, and improve at Bonneville project such machinery, equipment, and facilities for the generation of electric energy *as the Administrator may deem necessary* to develop such electric energy as rapidly as markets may be found." Bonneville Project Act, 16 U.S.C. 832 (emphasis added). Following this lead, the Ninth Circuit recognizes BPA as a hydrosystem manager. *Dept. of Water and Power of the City of Los Angeles v. BPA*, 759 F.2d 684, 686 (9th Cir. 1985) (BPA manages water levels consistent with seasonal water flows and electricity demands).

The parties also make several other equitable treatment claims. SOS/NWEC contends that *Northwest Environmental Defense Center v. BPA*, "requires" BPA to develop a mechanism to show how it is providing equitable treatment. SOS/NWEC Brief, SN-03-B-SA-01, at 16-18. SOS/NWEC errs in citing this as an order or requirement; it is not—it is dicta. There is no procedural requirement in section 4(h)(11)(A) of the Northwest Power Act imposing such an obligation on Bonneville.

CRITFC is further concerned that it is not equitable for BPA to have "provided all of the economic benefits to its customers and shifted the risk to our treaty fish and wildlife resources." CRITFC Ex. Brief, SN-03-R-PP-01, at 30. BPA raised its rates 46 percent two years ago and is raising them again. All program areas BPA supports have been cut recently—except fish and wildlife, which has been retained at a 40 percent increase above previous rate case levels. McNary and Lamb, SN-03-E-BPA-18, at 9.

Lastly, CRITFC and SOS/NWEC contend that by continuing to allow for emergency operations to affect fish operations, BPA is relying on fish to absorb the influences of fluctuating market and weather conditions. CRITFC Brief SN-03-B-CR/YA-01, at 24-25; SOS/NWEC Brief, SN-03-B-SA-01, at 16-18; CRITFC Ex. Brief, SN-03-R-PP-01, at 29; NWEC/SOS Ex. Brief, SN-03-R-PP-01, at 6. Emergency operations have been part of both the 1995 and 2000 NMFS Biological Opinions. The emergency criteria establish a limited exception to the normal rules in favor of fish protection that is only invoked in the direst situations. Emergency operations are a last resort, and BPA must seek to avoid and reduce the extent of any emergencies by pursuing adjustments in other programs before and during any emergency operations. McNary and Lamb, SN-03-E-BPA-18, at 14. Even if the equitable treatment obligation applied to every BPA funding decision—and it does not, *Northwest Environmental Defense Center v. BPA*, 117 F.3d, at 1533-34—CRITFC and SOS/NWEC have not shown how an emergency exception to the fish first rule is inequitable, and they appear to minimize the multiple purposes the FCRPS serves and the balance BPA must maintain to fulfill them all. *See Ass'n of Pub. Agency Customers v. Bonneville Power Admin.*, 126 F. 3d 1158, 1164, 1170-71 (9th Cir. 1997). BPA believes that what these parties consider an unfair burden on fish is actually the necessary tradeoff required when balancing management of the FCRPS for both fish and power needs as Congress intended.

Decision 7

Operation of the Federal system is determined outside the rate case and consistent with the equitable treatment mandate. BPA's rates are set to recover the costs of operating the system. To the extent the issues raised by CRITFC and SOS/NWEC are not stricken and are relevant to this proceeding, BPA properly balanced its financial needs for various program areas as a reflection of its balance of how to fulfill competing statutory obligations. While the equitable treatment provision does not directly pertain to the formulation of rates, the evidence shows that BPA has fully satisfied its responsibility to provide equitable treatment to fish and wildlife on a system-wide basis with other project purposes.

Issue 8

Whether BPA should consider changing its capitalization policy to include in the class of assets it will capitalize land and interests in land, water or water rights, and the construction of capital facilities and improvements to land including, but not limited to, buildings, roads, culverts, stream bank stabilization, fences, utilities, sewage treatment and discharge, diversion screens and ladders, instream structures, fish propagation facilities, and other tangible improvements.

Parties' Positions

The Hearings Officer struck CRITFC's direct testimony regarding capitalization in SN-02-O-011. CRITFC argues that the Administrator needs to reconsider this stricken material because it directly relates to issues raised in BPA's testimony. CRITFC argues the Federal Register Notice specifically excluded such material from exemption. CRITFC Brief, SN-03-B-CR/YA-01, at 34. CRITFC believes BPA staff invited such material at the SN CRAC workshops. CRITFC fears BPA may interpret FAS 71 to require that non-revenue producing facilities like fish and wildlife facilities must be identified in the rate case as facilities for which rates will be collected. In this case BPA must set forth the fish and wildlife facilities including property interests in land and water that it intends to acquire. *Id*. at 33-37.

In its Brief on Exceptions, CRITFC reiterated that it wants BPA to broadly define allowable fish and wildlife investments to include land and water interests. "Alternately BPA could deem all of its fish and wildlife capital investment as revenue producing since Bonneville's share of such investments include only those costs that are directly attributable to the development and operation of the power purposes and to federal dams." CRITFC Ex. Brief, SN-03-R-PP-01, at 31, citing SN-03-B-CR/YA-01, at 33. CRITFC further believes limiting capital access to projects over $1 million is a misinterpretation of section 4(h)(10)(B) of the Act, *Id.* at 31, and that BPA should verify that access to capital for fish and wildlife is available even in instances where the costs are less than $1 million. *Id.* at 32. Moreover, CRITFC takes exception to BPA's need to have crediting system that is not expressly required by FAS 71. *Id.* CRITFC also seeks clarification regarding BPA's statements that on the one hand, capitalization is a policy issue outside the rate case, but on the other hand, capitalization must be addressed in the rate case. *Id.* at 33.

BPA's Position

This is a question that will be addressed as a fish and wildlife program area policy decision. During cross-examination, BPA's witness McNary testified that "there is nothing [in BPA's testimony or rebuttal] that goes to th[e] issue" of what BPA will capitalize in the future. Tr. 124. BPA's witness Lamb then added that "there is language in the rate proceeding, it's not in our testimony, that is creating the opportunity to modify our capital policy to allow us to capitalize land acquisition, if they meet a certain standard of obligation, definition of obligation and credit against that obligation." *Id.* at 125. BPA may include capitalization of investment in land acquisition for fish and wildlife, provided such costs exceed $1 million, and such investment provides a creditable/quantifiable benefit against a defined obligation for BPA. SN CRAC Study, SN-03-FS-BPA-01, at 3-9.

Evaluation of Positions

The Federal Register Notice allows for the parties to submit testimony on "capital recovery matters such as interest rate forecasts, scheduled amortization, depreciation, replacements, and interest expense." 68 Fed. Reg. 12048, at 12051. CRITFC's brief raises a question of what to capitalize. The notice invites testimony related to capital recovery matters, not testimony on what to capitalize. The capital recovery matters listed as examples all presume an asset is already capitalized or eligible for capitalization. The testimony invited in the Federal Register and by staff at public meetings needed to address how to recover capitalized costs. CRITFC's testimony concerns what to capitalize and has nothing to do with capital recovery questions.

Moreover, BPA has not proposed an increase to its capital spending in the remaining years of this rate period. All that is at stake is whether BPA, as a policy matter outside of this rate proceeding, is willing to expand the class of intangible assets eligible for capital treatment in the fulfillment of its fish and wildlife responsibilities. Because no additional revenue considerations are required for BPA to make its fish and wildlife policy decision regarding what class of assets to capitalize, this issue is not germane to the ratemaking process. If agreement is reached on a creditable/quantifiable benefit against a defined obligation for BPA, BPA may include capitalization of investment in land acquisitions for fish and wildlife exceeding $1 million in the $36 million annual capital amount for the BPA fish and wildlife program.

Defining what real property interests may be capitalized is a policy question outside this proceeding. BPA is considering the capitalization of only land because BPA understood the region's interest was for a different way to fund wildlife habitat. Because there is neither a crediting mechanism nor an established obligation to guide water rights acquisitions, BPA preserved the ability to capitalize land, not water, in the SN-03 process. *See* Tr. at 125 (reiterating policy criteria for when BPA may consider capitalizing habitat acquisitions). The rate proceeding does not set the threshold or any other aspect of the policy; it notifies customers of capital costs that may be included in their rates.

From an accounting standpoint, fish and wildlife investments cannot be considered revenue producing—unless the investments are part of the structure at a hydroproject, such as a fish ladder built during construction of a dam. What allows BPA to capitalize such

non-revenue-producing investments is Statement of Financial Accounting Standard (FAS) number 71. This standard requires that if it is treating an asset as capital under FAS 71, BPA be able to demonstrate that it can recover the cost of the investment over time. To do so, BPA must set its rates to recover such costs.

BPA's $1 million threshold for the capitalization policy is not set as a matter of law to comply with section 4(h)(10)(B). Instead, BPA uses that provision to inform its policy and, outside of this proceeding, has a longstanding policy that uses the $1 million threshold.

With regard to crediting and what FAS 71 does or does not require, BPA believes it is necessary to have a concrete verifiable consideration or deliverable that is objectively measurable as a means of ensuring BPA has capitalized fish and wildlife assets in a manner that will have value to the future ratepayers who must help pay for it. Tr. at 125. Without this ability to consistently provide the certainty of the benefit and its term, BPA believes it would be difficult to consistently apply the policy. Compliance with policy is one aspect of the audit process that helps auditors determine consistency in financial statements.

Decision 8

To the extent such issues are not stricken and are relevant to this proceeding, BPA has allowed for the final ROD to reflect the fish and wildlife program area policy decision on whether to include capitalization of investment in land acquisition for fish and wildlife if it meets the requirements of exceeding $1 million and providing a creditable /quantifiable benefit against a defined obligation for BPA over time.

Issue 9

Whether BPA's proposal meets Fish and Wildlife Funding Principle No. 1.

Parties' Positions

The first Principle states that "Bonneville will meet all of its fish and wildlife obligations once they are established, including its trust and treaty responsibilities." CRITFC notes that BPA is not meeting this because the "federal agencies failed to meet the flow and spill standards in the Biological Opinion 40 percent of the time." CRITFC Brief, SN-03-B-CR/YA-01, at 41. CRITFC also claims that BPA is not meeting the offsite mitigation and propagation measures defined by the Provincial Review and the proposal does not address the trust and treaty responsibilities at all. *Id.*

SOS/NWEC contends that BPA's proposal sets rates based upon a very low (50-60 percent) TPP. A TPP of this level violates the Fish and Wildlife Funding Principles. SOS/NWEC Brief, SN-03-B-SA-01, at 7. CRITFC states that draft ROD ignores their argument that fish and wildlife and trust and treaty obligations are not being met. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 33.

BPA's Position

BPA believes that it is meeting its fish and wildlife obligations including its trust and treaty responsibilities. McNary and Lamb, SN-03-E-BPA-018, at 15. Principle No. 1 required BPA to meet these obligations in the context of its WP-02 rate proposal. Part of the rates proposal involved the risk mitigation tools, that included the LB, FB, and SN CRACs that allow BPA to meet all of its financial obligations under the WP-02 rates, including its fish and wildlife obligations. *Id*. at 16. The CRACs provide BPA with the ability to adjust rates to ensure BPA maintains or regains its financial health. *Id*. Triggering the SN CRAC goes a long way to ensure that BPA will be able to meet its fish and wildlife obligations. *Id*. CRITFC's claim that river operations do not meet flow objectives under the Biological Opinions are directed at the operational objectives with which they disagree rather than with any particular design element of the SN CRAC. *Id.*

Evaluation of Positions

The Fish and Wildlife Funding Principles created the obligation for TPP levels in the WP-02 proceeding. The Principles were developed in the context of BPA's proposal in the WP-02 proceeding. As described in detail in the WP-02 ROD, BPA's proposal met its obligations under the Principles. WP-02-A-02 at Section 5.4.

CRITFC claims that BPA is not meeting Principle No. 1 because the "federal agencies failed to meet the flow and spill standards in the Biological Opinion 40 percent of the time." CRITFC Brief, SN-03-B-CR/YA-01, at 41. Although not cited, the document referencing this 40 percent "failure," SN-03-E-CR-01U, was stricken from the record. SN-03-O-011. CRITFC cannot rely upon stricken material as evidence to support their argument.

CRITFC also misinterprets the obligations under Principle No. 1. The Principles required BPA to set rates high enough so that it could meet its fish and wildlife and trust and treaty responsibilities. CRITFC's argument about the flow and spill requirements addresses the operational issues objectives under the Biological Opinion which are distinct from BPA's obligation to fund certain fish and wildlife programs. Principle No. 1 does not address the issues surrounding BPA's operational objectives under the Biological Opinion, but rather is limited to the establishment of rates sufficiently high enough to ensure funding of fish and wildlife programs.

Decision 9

By proposing to set its rates high enough to fulfill its fish and wildlife and other obligations, BPA has met its obligations under Fish and Wildlife Funding Principle No. 1.

Issue 10

Whether BPA's proposal meets Fish and Wildlife Funding Principle No. 2.

Parties' Positions

Principle No. 2 requires BPA to "take into account the full range of fish and wildlife costs." CRITFC contends that there is uncertainty regarding the costs of implementing the Biological Opinions. CRITFC Brief, SN-03-B-CR/YA-01 at 41-42. They note that in the WP-02 proceeding, BPA adopted a range for direct program costs of between $109 and $179 million per year, but has assumed a spending level of $139 million in this proceeding. *Id.* at 42. CRITFC argues that by adopting this spending level, BPA has abandoned the range of alternatives developed by the region in Principle No. 2. *Id.*

CRITFC states that the BPA ignored its argument that fish and wildlife costs could be significantly higher than assumed. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 34. Given the uncertainties detailed in CRITFC's testimony, the costs assumptions are not reasonable or appropriate. *Id*.

BPA's Position

BPA set rates in the WP-02 proceeding to recover the equally weighted costs of the 13 Fish and Wildlife Alternatives in Principle No. 2. McNary and Lamb, SN-03-E-BPA-18, at 16. The 13 Fish and Wildlife Alternatives represented the best judgment based on regional input, of a reasonable range of costs for the possible decisions on the reconfiguration and operation of the FCRPS. *Id.* BPA stated in the WP-02 proceeding that the cost estimates would continue to evolve as analysis, planning, and decisions related to the system were made. *Id.* BPA believes that given the evolution of the decisionmaking process for the system, there is a great deal more clarity related to the cost and expenses related to BPA fish and wildlife obligations. *Id.* at 16-17. BPA does not believe it is necessary to now model the 13 Fish and Wildlife Alternatives given the evolution of this decision making process and the fact that BPA is not setting base rates as it was in the WP-02 proceeding. *Id.* at 17.

Evaluation of Positions

CRITFC's argument is based upon BPA's decision not to model the 13 Fish and Wildlife Funding Alternatives in this proceeding. In the WP-02 proceeding BPA set rates based upon an equal weighting of the 13 Fish and Wildlife Alternatives. McNary and Lamb, SN-03-E-BPA-18, at 16. At that time, these Alternatives represented the range of costs for the possible decisions on the reconfiguration and operation of the FCRPS. *Id.* The 13 Alternatives were used because at that time they represented a range of assumptions about implementation that resulted from regional discussion and the Administration's direction. WP-02-A-02, at 5.4. The equal weighting was based upon the lack of knowledge about what a fish and wildlife plan will entail for the region. *Id*.

The 13 Alternatives are not applicable in setting an SN CRAC rate. BPA modeled the 13 Alternatives as part of the establishment of its base rate. Part of the base rates included imposing an SN CRAC if BPA's financial condition deteriorated to the point that it missed a treasury payment or forecasted a less than 50 percent chance it would miss its next treasury payment. The GRSPs required BPA to conduct a 7(i) hearing before implementing the

adjustment to the rates. CRITFC assumes that because this adjustment is conducted pursuant to the requirements of 7(i) that BPA should again model the 13 Alternatives. In the WP-02 proceeding BPA modeled the risk around the 13 Alternatives and factored the costs associated with an equal weighting of the Alternatives into the base rates. If BPA were to factor these costs associated with 13 Alternatives into the SN CRAC adjustment BPA would be collecting revenues twice for the same risk. (Once for the dollars factored into base rates in the WP-02 proceed and again in this proceeding).

Even if BPA was not collecting twice for the risks around the 13 Alternatives, the need to collect for this risk does not exist in the fashion it did in the WP-02 proceeding. Since the WP-02 proceeding, there have been significant developments regarding BPA's obligations under the Biological Opinion. These developments have brought a great deal more clarity regarding the level of BPA's obligations. McNary and Lamb, SN-03-E-BPA-18, at 16-17. As a result the need to model the 13 Alternatives no longer exists. When BPA submitted its Supplemental Proposal to FERC in June 2001, a range of uncertainty existed regarding the extent of BPA's fish and wildlife obligations. Because of this uncertainty, BPA chose to model 13 Alternatives to capture the costs associated with the various alternatives. Since that time, the issuances of the Biological Opinions for salmon, sturgeon, and bull trout in the FCRPS and the issuance of the November 2002 Five-Year Implementation Plan have narrowed that uncertainty enough to obviate the need to model the various alternatives. Conger, *et al.*, SN-03-E-BPA-07, at 3.

CRITFC's argument in the Brief on Exceptions does not address the issues surrounding the modeling of the 13 Fish and Wildlife Alternatives and instead focuses on the cost assumptions in BPA's initial proposal. CRITFC Brief on Ex. SN-03-R-CR/YA-01, at 34. CRITFC contends it provided detailed testimony on the reasonableness and appropriateness of the cost assumptions for fish and wildlife expenses. *Id.* However, CRITFC did not cite this detailed testimony. Much of the "detailed testimony," related to fish and wildlife costs was stricken from the record. *See* Order SN-03-O-11 and SN-03-O-17. The Administrator directed the Hearings Officer to "exclude from the record any material attempted to be submitted or arguments attempted to be made in the hearing which seek in any way to revisit the policy merits or wisdom of implementation of the Biological Opinion, or the related operations, assumptions, and program spending level forecasts included in BPA's rate proposal, as discussed above." Proposed Safety-Net Cost Recovery Adjustment Clause Adjustment to 2002 Wholesale Power Rates," 68 Fed. Reg. 12051.

Additionally, CRITFC's argument in its Brief on Exceptions changes the purpose behind Principle No. 2 which was to incorporate into the WP-02 rate case the 13 Fish and Wildlife Funding Alternatives. CRITFC participated in the development of the range of costs identified in Principle No. 2, and its views at the time were largely reflected, especially the projections representing the high end of the range developed. CRITFC's argument in its Brief on Exceptions changes Principle No. 2 from modeling the 13 Alternatives to an obligation to assume their new and additional proposed cost assumptions for fish and wildlife funding. These new and additional assumptions for fish and wildlife funding obligations are not part of obligation behind Principle No. 2.

Decision 10

There have been significant developments regarding BPA's obligations under the Biological Opinions since 1998 when the Fish and Wildlife Funding Principles were developed. These developments have refined the level of BPA's obligations. BPA set its 2002-2006 base rates using the 13 Alternatives, so there is no need to account again for the same risks the Alternatives addressed. Therefore, BPA has met its obligations under Fish and Wildlife Funding Principle No. 2.

Issue 11

Whether BPA's proposal meets Fish and Wildlife Funding Principle No. 3.

Parties' Positions

CRITFC contends that BPA has not met Fish and Wildlife Principle No. 3 because it has lowered the TPP target to 50 percent. CRITFC Brief, SN-03-B-CR/YA-01, at 42. CRITFC is concerned that given the many uncertainties related to BPA's fish and wildlife obligations that could increase its costs, BPA will increase the risk of missing a treasury payment, or alternatively will push for cuts in fish and wildlife costs and river operations to avoid a missed treasury payment. *Id*.

BPA's Position

Fish and Wildlife Funding Principle No. 3 provides that "Bonneville will demonstrate a high probability of treasury payment in full and on time over the 5-year rate period." *See* Revenue Requirements Study Documentation, Volume 1, WP-02-FS-BPA-02A, Chapter 13. To the extent the Principles remain applicable in this proceeding, BPA believes that the combination of TPP, TRP and accumulated net revenue targets will put BPA on a path to meet the intent of the Fish and Wildlife Funding Principles, given the state of the economy. Keep, *et al.*, SN-03-E-BPA-04, at 15.

The TPP standard in the Fish and Wildlife Funding Principles was 80-88 percent. BPA believes that this standard was met with the conclusion of the 2000 rate proceeding. Keep, *et al.*, SN-03-E-BPA-11, at 32. BPA contends the rates set in that proceeding included the three CRACs to deal with additional uncertainty not covered in base rates. *Id*. The availability of the CRACs led, in part, to the WP-02 rates meeting Principles 3. *Id*. BPA believes the GRSPs do not require any of the individual CRACs to independently meet the Fish Funding Principles. *Id*. Therefore, the availability, and now implementation of, the CRACs allows BPA's rates to meet the Fish Funding Principles. *Id*. The Fish Funding Principles do not dictate the specific level of the CRACs, in particular the SN CRAC. *Id*.

In addition, BPA reserves the ability to adjust rate levels under the SN CRAC again if revenues from the first adjustment under the SN CRAC prove inadequate. *See* GRSPs, SN-03-E-BPA-03.

BPA is setting the SN CRAC at a level, given market and other risk factors, to achieve a high probability of making the remainder of the treasury payments in full. *Id*. at 33. Implementing the SN CRAC is creating a more risk averse portfolio. *Id*.

Under the GRSPs BPA must consider market and other risk factors in establishing the TPP. *Id*. Given the current economic circumstance in the Pacific Northwest, BPA believes the 50 percent TPP in conjunction with the 80 percent TRP and zero net revenue standards is appropriate and gives sufficient security that BPA will meet its treasury payment and payments for its fish and wildlife obligations. *See* Section 2.7 of this ROD.

Evaluation of Positions

CRITFC has not characterized the financial standards BPA is using to measure its proposal in the same manner as BPA. CRITFC's issue suggests that the 50 percent TPP is the sole standard in the initial proposal. Rather than be the lone financial standard by which BPA measured the SN CRAC rate adjustment, BPA's initial proposal contained a combination of three standards by which to measure the proposal: 50 percent TPP, 80 percent TRP and zero net revenues. The three standards in BPA's proposal, taken together, reflect BPA's concern for the economic condition of the Northwest and also provide a high level of assurance that BPA's obligations to the U.S. Treasury will be satisfied by the end of FY 2006. Keep, *et al.*, SN-03-E-BPA-11, at 29. As part of this ROD, the Administrator is not adopting the combination of the three financial standards. *See* Section 2.7 for those reasons. In place of the combination of the three standards, BPA's proposal has an 80 percent TPP. While the 80 percent TPP is based upon agency as opposed to PBL reserve levels, the increase from the levels in BPA's initial proposal is consistent with the Fish and Wildlife Funding Principles.

BPA believes the Fish and Wildlife Funding Principles guided the development of the WP-02 Proposal, which included provisions for this SN-03 rate adjustment process. BPA believes the GRSPs do not require any of the individual CRACs to independently meet the Funding Principles. Keep, *et al.*, SN-03-E-BPA-11, at 32.

Decision 11

With the 80 percent TPP BPA is proposing, which is based upon agency as opposed to PBL reserve levels, the final proposal is consistent with the Fish and Wildlife Funding Principles. Therefore, BPA satisfied its obligations with regard to Fish and Wildlife Funding Principle No. 3 and meets the request of CRITFC to provide a high TPP.

Issue 12

Whether BPA's proposal meets Fish and Wildlife Funding Principle No. 4.

Parties' Positions

Principle No. 4 states: "Given the range of potential fish and wildlife costs, Bonneville will design rates and contracts which position Bonneville to achieve similarly high treasury payment

probability for the post-2006 period by building financial reserve levels and through other mechanisms." CRITFC believes that expected value for ending reserves ($348 million) in BPA's initial proposal is too low given the higher fish and wildlife costs in the future. CRITFC Brief, SN-03-B-CR/YA-01, at 43.

CRITFC argues the rate proposal in the draft ROD does not meet Fish and Wildlife Funding Principle No. 4. CRITFC Brief on Ex. SN-03-R-CR/YA-01, at 36. They contend that fish and wildlife costs in the next rate period will be significantly higher and that the volatility in the West Coast power markets together require BPA to have higher reserve levels than currently forecasted. *Id*. at 36-37.

BPA's Position

BPA believes it is rebuilding reserves to appropriate levels that are consistent with the Fish and Wildlife Funding Principles given the state of the regional economy.

Evaluation of Positions

Under the proposal adopted in this ROD, BPA will have, on an expected value basis, ending reserve levels that total $354 million. Final Study Documentation, SN-03-FS-02, chapter 7. These reserve levels will place BPA on much sounder financial footing than would be the case absent the imposition of an SN CRAC adjustment. While CRITFC apparently desires a higher level of reserves, it does not identify what the appropriate level is or what level of expected future costs for which BPA should be accumulating reserves. CRITFC contends that BPA faces higher fish and wildlife costs in the next rate period and volatility experienced in the West Coast power markets necessitate higher reserve levels. CRITFC raised issues related to the risks associated with higher fish and wildlife costs in the next rate period and the volatility in the West Coast energy market. The dispute here in not over the appropriate level of reserves but rather is a disagreement between the parties over the level of risk associated with these two factors. As explained in detail in Chapter 2.6 (on Risk), BPA does not agree with CRITFC's conclusion that there are material and quantifiable risks that BPA is not addressing in either of these areas. Given BPA's mandates to operate using sound business principles and to provide the Pacific Northwest an adequate, efficient, economical, and reliable power supply, and acknowledging the problem with the regional economy, BPA does not believe it is reasonable to increase reserves to levels assumed in the WP-02 proceeding.

Decision 12

BPA's proposal is based on sound business principles and will help provide the Pacific Northwest an adequate, efficient, economical and reliable power supply, and therefore it meets Fish and Wildlife Funding Principle No. 4.

Issue 13

Whether BPA should include an additional $100 million in costs to meet the Provincial Review estimates.

Parties' Positions

CRITFC believes that BPA should include in its forecast of costs an additional $100 million for direct program expenses based upon the recommendations from the Provincial Review. CRITFC Brief, SN-03-B-CR/YA-01, at 52. CRITFC contends that including this additional amount to BPA's fish and wildlife estimates will add only $1.90 to the average residential customer bill and still have BPA's rates 12 percent below projected market rates. *Id.*

BPA's Position

BPA does not believe it is appropriate to assume an additional $100 million in fish and wildlife costs. BPA believes that CRITFC has not distinguished between what BPA is authorized to fund for fish and wildlife and what it is required to fund. McNary and Lamb, SN-03-E-BPA-18, at 9. The Provincial Review process initially defined a list of what fish and wildlife managers thought would be beneficial to fish and wildlife for BPA to fund. *Id.* The Provincial Review was not limited to what BPA is required to fund. *Id.* The broad suite of projects recommended by fish and wildlife managers and others does not define the scope of BPA's obligations. *Id.* The Council takes those recommendations and submits them for review by the Independent Scientific Review Panel. *Id.* The ISRP reduces the suite of proposals based on scientific and technical merit. The Council then reduces the suite further by focusing its recommendations on the region's priorities and BPA's obligations. *Id.* at 10. In addition, the Council's recommendations consider financial and policy issues. *Id.* Finally, BPA in some instances revises the suite of recommendations further to ensure it is meeting its legal obligations and financial constraints. For these reasons, the slate of projects the ISRP and CBFWA recommend through the Provincial Reviews is not an appropriate estimate of BPA's budgetary needs to fulfill its fish and wildlife obligations. *Id.*

Evaluation of Positions

CRITFC's proposal to include an additional $100 million in fish and wildlife program expenses is not appropriate. The slate of projects the ISRP and CBFWA recommend through the Provincial Review does not reflect BPA's obligations or the actual costs associated with BPA's fish and wildlife programs. The Provincial Review involved a broad spectrum of possible projects that is refined through several layers of review by the Council and ISRP. As a result the initial Provincial Review do not establish BPA's costs or obligations.

BPA does not agree with CRITFC's contention that adding these costs to the proposed rate adjustment adds only $1.90 per residential customer. The document relied upon for this statement (SN-03-E-CR/YA-01TT) was stricken from the record pursuant to the Hearing Officer's order. Order, SN-03-O-011. CRITFC nevertheless believes it preserved this estimate through SN-03-E-CR-01VV.

Decision 13

The slate of projects the ISRP and CBFWA recommend through the Provincial Reviews does not reflect BPA's obligations or the actual costs associated with BPA's fish and wildlife programs.

Therefore, BPA will not include an additional $100 million in costs to meet the Provincial Review estimates.

Issue 14

Whether BPA should use its fish and wildlife funding to improve the economies of tribal communities.

Parties' Positions

CRITFC believes BPA has not evaluated its proposal and the impacts of reducing fish and wildlife funding on tribal communities. In its Brief on Exceptions, CRITFC contends that BPA misstates this issue by characterizing it as whether BPA should use its fish and wildlife funding to improve the economies of tribal communities. CRITFC Ex. Brief, SN-03-R-PP-01, at 40.

BPA's Position

BPA believes these issues are beyond the scope of this proceeding.

Evaluation of Positions

CRITFC Brief, SN-03-B-CR/YA-01, at 54-55. CRITFC believes that BPA could add the $100 million to rates to fund the Provincial Review budgets without significantly impacting residential rates. *Id.* at 54. Studies show that tribal communities have high unemployment and very low average incomes. By adding $100 million additional funds for fish and wildlife programs, BPA could aid the economic recovery of the reservations. *Id*. at 55.

BPA funding levels for fish and wildlife were determined in separate public processes outside of this proceeding and the results of those processes were imported into this proceeding. BPA is not cutting fish and wildlife funding in this proposal, but rather BPA is proposing to hold fish and wildlife funding levels constant over the balance of the rate period. McNary and Lamb, SN-03-E-BPA-18, at 6. The decision whether to add monies to BPA's budget is a matter to be determined outside the rate case. The purpose of the rate case is to establish BPA's rates to recover its costs, not to establish BPA's costs.

BPA's statutory obligations require it to protect, mitigate and enhance fish and wildlife and their habitats affected by the FCRPS and to provide equitable treatment for fish and wildlife for the other purposes for which the system is operated. 16 U.S.C. §§ 839b(h)(10)(A), (11)(A)(i). BPA is aware of the economic benefits its mitigation projects may bring to Indian people and rural economies, but BPA is not required to raise its rates above what is required to meet its fish and wildlife obligations to also provide a unique economic benefit to tribal and rural communities. BPA's rate directives are limited to covering its total system costs and repaying treasury. 16 USC § 839e. BPA funding levels for fish and wildlife were determined in separate public processes outside of this proceeding and the results of those processes were imported into this proceeding. This proceeding is not the proper forum for raising concerns about BPA funding levels for fish and wildlife.

In evaluating potential economic impacts to tribes, BPA undertakes such evaluations consistent with its BPA Tribal Policy. BPA, April 1996. In addition, BPA takes into consideration as appropriate the disparate impact that its actions may have on minority and low-income populations (including tribes as applicable), consistent with the President's Executive Order concerning Environmental Justice. Executive Order 12898 (Feb. 11, 1994). Where appropriate, these considerations are reflected in environmental documentation for these actions prepared under the National Environmental Policy Act (NEPA).

It is an added benefit when fish and wildlife mitigation efforts also benefit tribes and rural economies, such benefits are the indirect result of protecting, mitigating, and enhancing fish and wildlife and their habitats. Nonetheless, BPA is concerned about potential impacts of its policies and actions on tribes and is committed to considering these impacts in the appropriate processes.

Decision 14

While BPA is sensitive to the economic value of its actions to tribal communities and rural economies as it fulfills fish and wildlife responsibilities, funding and budget decisions are beyond the scope of this rate case.

3.0 PROCEDURAL ISSUES

3.1 Trigger of the SN CRAC 7(i) Process

Issue 1

Whether the Administrator's determination to "trigger" the SN CRAC process, that is, to conduct a section 7(i) formal evidentiary rate hearing to determine whether to apply an SN CRAC, is made in a section 7(i) hearing.

Parties' Positions

Golden Northwest, ICNU/ALCOA, GPU, NRU, PPC/IEA, and PNGC raised arguments in BPA's SN-03 formal evidentiary hearing that BPA should not have triggered the SN CRAC process. Golden Northwest Brief, SN-03-B-GN-01, 2-6; Golden Northwest Ex. Brief, SN-03-R-GN-01, at 2-5; ICNU/ALCOA Brief, SN-03-B-IN-01, at 3; ICNU/ALCOA Ex. Brief, SN-03-R-IN-01, at 1-3; GPU Brief, SN-03-B-GP-01, at 6-8; GPU Ex. Brief, SN-03-R-GP-01, at 14-16; NRU Brief, SN-03-B-NR-01, at 3; PPC/IEA Brief, SN-03-B-PP-01, at 10; PNGC Brief, SN-03-B-PN-01, at 3.

BPA's Position

Pursuant to the GRSPs, the Administrator's determination to trigger the SN CRAC process was made prior to the formal evidentiary hearing that determines whether to implement an SN CRAC. Keep, *et al*., SN-03-E-BPA-04, at 3. The trigger determination is supported by documentation generated prior to the evidentiary hearing. This is consistent with the GRSPs for the SN CRAC, which divide the SN CRAC process into three phases. The first phase is comprised of a determination by the Administrator that the CRAC has triggered. The second phase is the subsequent "SN CRAC Notification Process." The third phase is the "SN CRAC Hearing Process." The trigger determination is the first phase of the SN CRAC process because it is the phase where BPA determined that an evidentiary ratemaking hearing was necessary. A later phase, the SN CRAC Hearing Process, is the evidentiary hearing itself. Although the phase one trigger determination is based on documentation generated prior to the evidentiary hearing and is separate from the evidentiary hearing record, the phases are all part of BPA's SN CRAC process.

Evaluation of Positions

The SN CRAC is one of three CRACs that are part of BPA's power rate design. Keep, *et al*., SN-03-E-BPA-04, at 2. The other two CRACs are the LB CRAC, which is designed to recover augmentation costs, and the FB CRAC, which is designed to recover limited net revenue shortfalls. *Id*. The SN CRAC is designed to provide a "safety net" in case BPA's financial situation continues to deteriorate despite implementing the LB and FB CRACs. *Id*. Together, these CRACs, as established in BPA's Supplemental Proposal of June 2001, allowed BPA to adopt a general approach of keeping base rates low and addressing financial shortfalls, as

needed, through the implementation of the CRACs. *Id*. These tools provided BPA the risk mitigation necessary to establish an acceptable level of Treasury Payment Probability (TPP) for BPA's proposed 2002 power rates. *Id*.

The SN CRAC is said to "trigger," that is, the Administrator may begin a section 7(i) hearing to determine whether or not BPA requires an SN CRAC adjustment, upon a finding by the Administrator regarding the likelihood of making Treasury payments. Section II.F.3 of BPA's 2002 GRSPs provides:

> The SN CRAC will be available if the Administrator determines that, after the implementation of the FB CRAC and any Augmentation True-Ups, either of the following conditions exist:
>
> - BPA forecasts a 50 percent or greater probability that it will nonetheless miss its next payment to Treasury or other creditor, or
>
> - BPA has missed a payment to Treasury or has satisfied its obligation to Treasury but has missed a payment to any other creditor.

Id. Under section II.F.3.b, entitled "SN CRAC Hearing Process," triggering the SN CRAC starts an expedited 40-day section 7(i) hearing to establish changes to the FB CRAC parameters. *Id*.

On February 7, 2003, the Administrator sent a letter to customers, tribes, constituents, and interested parties advising them of his determination that the SN CRAC had triggered, based on the first of the above criteria. Keep, *et al*., SN-03-E-BPA-04, at 3. That same day, BPA's Manager of Power Products, Pricing, and Ratemaking sent a second letter to interested parties and customers informing them of this determination. *Id*. This letter included a table summarizing the documentation used by BPA to determine that the SN CRAC had triggered, the amount of the forecasted shortfall, and the time and location for a workshop on the SN CRAC. *Id*. This workshop was held February 11, 2003. *Id*. Those letters reflected BPA's financial condition at that time. *Id*. BPA therefore met the requirements of the GRSPs to start the SN CRAC process: BPA forecasted a 50 percent or greater probability that it would miss its next payment to Treasury; and it sent written notification of the determination to customers with documentation used by BPA to determine that the SN CRAC process had triggered, including the amount of the forecasted shortfall, and the time and location of the SN CRAC workshop. Keep, *et al*., SN-03-E-BPA-11, at 42.

As noted previously, the Administrator's trigger determination calls for a workshop to be scheduled. *See* Keep, *et al*., SN-03-E-BPA-11, at 44. The workshop, therefore, occurs after the Administrator has made the trigger determination. *Id*. As provided in the GRSPs, the purpose of the SN CRAC workshop is to discuss the cause of the shortfall and any proposed changes to the FB CRAC that will achieve a high probability that the remainder of Treasury payments for the rate period will be made in a timely manner. *See* 2002 GRSPs, section II.F.3.a. The GRSPs provide that "[i]n determining which proposal to include in its initial proposal in the SN CRAC Section 7(i) proceeding, BPA will give priority to prudent cost management and other options that enhance Treasury Payment Probability while minimizing changes to the FB CRAC." *Id*.

The GRSPs, therefore, do not require that these actions be incorporated *before* the Administrator triggers the SN CRAC process, but rather in the development of BPA's initial proposal. Keep, *et al*., SN-03-E-BPA-11, at 44-45.

BPA does not have a trigger determination for implementing the LB or the FB CRACs. The trigger determination for the SN CRAC is purely procedural. The trigger determination only decides whether BPA will hold a hearing under section 7(i) of the Northwest Power Act. The trigger determination does not propose an SN CRAC or establish an SN CRAC. Instead, the section 7(i) hearing determines whether BPA should have, or should not have, an SN CRAC. This decision is made based on the evidence presented at the hearing regarding the many factors related to the SN CRAC, for example, the applicable TPP standard, secondary revenues, etc. Keep, *et al*., SN-03-E-BPA-04, at 13. The hearing therefore determines whether BPA will implement an SN CRAC and, if so, the size of the SN CRAC.

The trigger determination thus precedes the beginning of BPA's section 7(i) evidentiary hearing, and is based on materials relied upon at the time, not materials developed during the evidentiary hearing phase. The trigger determination, while noted to have occurred in Keep, *et al*., SN-03-E-BPA-04, at 2-3, was not included as part of BPA's initial rate proposal because the determination had already been made; BPA was conducting a section 7(i) hearing. Nevertheless, certain parties in BPA's SN-03 rate hearing filed testimony regarding whether BPA properly triggered the SN CRAC process. In BPA's rebuttal testimony, BPA noted that the trigger determination had already been made. Keep, *et al*., SN-03-E-BPA-11, at 41-42. When certain parties argued that if BPA's trigger assumptions were updated, the trigger would not have occurred, BPA noted:

> *This argument has little bearing on the triggering of the SN CRAC process.* The Administrator's determination to trigger the SN CRAC process must be made at a specific time. This trigger determination does not establish or require the implementation of an SN CRAC. Instead, it simply begins a process in which BPA must determine whether to implement an SN CRAC and, if so, the extent of that SN CRAC. *The fact that costs, revenues, water, or prices may change over time does not affect the trigger determination, but instead is considered in determining whether an SN CRAC should be implemented and, if so, the level of such a CRAC.* The Joint Customers' arguments regarding costs, revenues, water, and prices are addressed elsewhere in BPA's rebuttal testimony.

Id. (emphasis added). Similarly, certain parties cited BPA's GRSPs, which provide that "[i]n determining which proposal to include in its initial proposal in the SN CRAC 7(i) proceeding, BPA will give priority to prudent cost management and other options that enhance Treasury Payment Probability while minimizing changes to the FB CRAC." Bliven, *et al*., SN-03-E-JC-01, at 2. In response, BPA noted:

> While *this argument has little bearing on triggering the SN CRAC process*, it relates to development of BPA's SN-03 initial proposal. As noted previously, the Administrator's trigger determination schedules a workshop. The workshop, therefore, occurs after the Administrator has made the trigger determination. As provided in the GRSPs, the

> purpose of the SN CRAC workshop is to discuss the cause of the shortfall and any proposed changes to the FB CRAC that will achieve a high probability that the remainder of Treasury payments for the rate period will be made timely. *See* 2002 GRSPs, section II.F.3.a. As the Joint Customers correctly note, "[i]n determining which proposal to include in its initial proposal in the SN CRAC Section 7(i) proceeding, BPA will give priority to prudent cost management and other options that enhance Treasury Payment Probability while minimizing changes to the FB CRAC." *Id*. *The GRSPs therefore do not require that these actions be incorporated before the Administrator triggers the SN CRAC process, but rather in the development of BPA's initial proposal.*

Id. at 44-45 (emphasis added). Certain parties also raised issues that applied not only to a trigger argument, but also to BPA's substantive SN CRAC proposal. BPA responded to these arguments. In summary, BPA noted that the trigger determination was, in effect, a separate phase of the SN CRAC rate process, made under the GRSPs, that preceded BPA's substantive SN CRAC evidentiary rate hearing. Because of this fact, there was no reason to revisit the trigger determination during the evidentiary hearing, and it would have been inappropriate to do so.

ICNU/ALCOA argue that the issue of the SN CRAC trigger determination should be reviewed in this proceeding because the Federal Register Notice did not expressly exclude the trigger determination from review, and no party filed a motion to strike related testimony. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 1-2. As noted previously, however, the decision of whether to trigger the SN CRAC process is fundamentally different from ratemaking issues. For ratemaking issues, the Administrator must review evidence and make a decision based on such evidence, which then becomes a part of BPA's establishment of rates. The Administrator does not make a final decision on ratemaking issues until the Final ROD. The trigger determination is completely different. The Administrator is *required* by the GRSPs to make a decision on the trigger determination in the absence of a formal evidentiary record (although this is not a final action for purposes of judicial review), and this decision must be made before the rate hearing can begin. The trigger determination has already been made, therefore it cannot be made in the SN-03 section 7(i) hearing. At best, parties are asking BPA to reconsider its previous final decision. This decision, however, cannot be not made in the SN-03 formal rate hearing.

Decision 1

As outlined in the GRSPs for the SN CRAC, the SN CRAC process is comprised of three phases. While the phases are integrally related and part of a single process, they are different in their purpose and make-up. The first phase is comprised of a determination by the Administrator that the SN CRAC has triggered. This is followed by an "SN CRAC Notification Process." The Notification Process is intended to inform customers and interested third parties of the Administrator's determination, and the basis for it. The final phase is the "SN CRAC Hearing Process," which is governed by the procedural requirements of section 7(i) and has as its purpose the establishment of an SN CRAC. The Administrator's determination to "trigger" the SN CRAC, that is, to conduct a section 7(i) hearing to determine whether an SN CRAC should be imposed, was the first phase of the rate proceeding that initiated the SN-03 section 7(i) hearing.

Although the phase one trigger determination is based on documentation generated prior to the evidentiary hearing and is separate from the evidentiary hearing record, the phases are all part of BPA's SN CRAC process.

Issue 2

Whether, assuming arguendo parties may revisit the Administrator's trigger determination, the Administrator properly triggered the SN CRAC process.

Parties' Positions

Golden Northwest and ICNU/ALCOA argue that BPA's forecasts used to trigger the SN CRAC failed to take into account its prepayment of Treasury obligations, and ignored funds available to make payments arising from the refinancing of Energy Northwest ("ENW") bonds. Golden Northwest Brief, SN-03-B-GN-01, 2-6; Golden Northwest Ex. Brief, SN-03-R-GN-01, at 2-5; ICNU/ALCOA Brief, SN-03-B-IN-01, at 3; ICNU/ALCOA Ex. Brief, SN-03-R-IN-01, at 1-3. Golden Northwest, ICNU/ALCOA, and GPU argue that BPA's decision to trigger the SN CRAC is inconsistent with BPA's GRSPs and the purpose of the SN CRAC. *Id*., GPU Brief, SN-03-B-GP-01, at 6-8; GPU Ex. Brief, SN-03-R-GP-01, at 14-16. NRU argues that the conditions for triggering SN CRAC are not present, given updated information. NRU Brief, SN-03-B-NR-01, at 3. PPC/IEA and PNGC argue that BPA's forecasted secondary revenues used in its SN CRAC analysis are based on a dated version of the AURORA model and erroneous inputs that should not be relied upon to impose a multi-year SN CRAC. PPC/IEA Brief, SN-03-B-PP-01, at 10; PNGC Brief, SN-03-B-PN-01, at 3. Canby argues BPA improperly triggered the SN CRAC. Canby Ex. Brief, SN-03-R-CA-01, at 2.

BPA's Position

The Administrator properly determined that, after the implementation of the FB CRAC and any Augmentation True-Ups, BPA forecasted a 50 percent or greater probability that it would nonetheless miss its next payment to Treasury or another creditor. Keep, *et al*., SN-03-E-BPA-04, at 2-3; Keep, *et al*., SN-03-E-BPA-11, at 41-46.

Evaluation of Positions

Golden Northwest argues that BPA seems to take the position that the GRSPs describe a purely mechanistic requirement such that the lack of any basis for BPA's forecasts is wholly irrelevant to whether the SN CRAC has properly triggered:

> BPA met the requirements of the GRSPs to start the SN CRAC process: BPA forecasted a 50 percent or greater probability that it would miss its next payment to Treasury; and it sent written notification of the determination to customers with the documentation used by BPA to determine that the SN CRAC process had triggered . . .

Golden Northwest Brief, SN-03-B-GN-01, at 6, citing Keep, *et al*., SN-03-E-BPA-11, at 42. Golden Northwest argues that if BPA could trigger the SN CRAC process by simply announcing that it meets the 50 percent test regardless of the merits of the "forecast," then the requirement that there be a forecast would be rendered meaningless. *Id*. Similarly, GPU argues that BPA did not provide any information or data that supported its assertions that it made a proper decision in triggering the SN CRAC process. GPU Brief, SN-03-B-GP-01, at 7. GPU argues BPA has not submitted to the record the forecasts or the material that BPA relied upon to demonstrate its need to trigger the SN CRAC rate adjustment. GPU Brief, SN-03-B-GP-01, at 7. GPU argues that BPA witnesses merely provided unsupported assertions that BPA had conducted forecasts and concluded from those forecasts that the criteria in the GRSPs had been met. *Id*., citing Keep, *et al*., SN-03-E-BPA-11, at 41-42. These arguments are not persuasive.

First, as noted previously, the trigger determination does not occur in the current section 7(i) evidentiary hearing. Instead, the trigger determination occurred prior to the section 7(i) evidentiary hearing. The trigger determination is not based on the section 7(i) evidentiary record but rather is supported by documentation that existed at the time the determination was made. This documentation fully supports the Administrator's determination. Because the trigger determination precedes and is separate from the section 7(i) evidentiary hearing, BPA did not file the record for that separate determination in the section 7(i) evidentiary hearing.

Furthermore, BPA documented its determination. Section II.F.3 of the GRSPs provides that "[t]he SN CRAC will be available if the Administrator determines that, after implementation of the FB CRAC and any Augmentation True-Ups, … BPA forecasts a 50 percent or greater probability that it will nonetheless miss its next payment to Treasury or other creditor…." Section II.F.3.a of the GRSPs provides that "[a]t the time the Administrator determines that the SN CRAC has triggered, BPA will send written notification of the determination to customers that purchase power under rates subject to the FB CRAC and to interested parties. Such notification shall include the documentation used by BPA to determine that the SN CRAC has triggered, the amount of any forecast shortfall, and the time and location of a workshop on the SN CRAC." BPA sent customers and interested parties two letters notifying such parties that the Administrator determined that BPA forecasted a 50 percent or greater probability that it would miss its next payment to Treasury or another creditor. Keep, *et al*., SN-03-E-BPA-11, at 42. One letter included a table summarizing the documentation used by BPA to determine that the SN CRAC process had triggered. *Id*. BPA also afforded all interested parties the opportunity to participate in a workshop. *Id*. This is all the GRSPs require and BPA has complied with such requirements. The requirements for making the trigger determination are very limited, which is perfectly consistent with the nature of the trigger determination. As noted above, the trigger determination has no substantive effect on any customer or interested party. It is a purely procedural determination that decides whether or not to conduct a hearing. The actual determination of whether BPA will have an SN CRAC and, if so, the nature of the SN CRAC rate adjustment, is determined in the section 7(i) hearing.

Second, in its argument above, Golden Northwest quotes BPA's testimony, but fails to complete its quotation. Such testimony notes not only that BPA provided customers and interested parties with documentation used by BPA to determine that the SN CRAC process had triggered, but that such documentation "include[d] the amount of the forecasted shortfall, and the time and location

of *the SN CRAC workshop*." Keep, *et al*., SN-03-E-BPA-11, at 42 (emphasis added). Pursuant to the GRSPs, BPA held a workshop "*to discuss with customers and interested parties the cause of [the] shortfall*, and any proposed changes to the FB CRAC that will achieve a high probability that the remainder of Treasury payments during the FY 2002-2006 rate period will be made timely." 2002 GRSPs, Section II.F.3.a (emphasis added). It was in this workshop where BPA explained the trigger determination, responded to questions regarding the trigger determination, and responded to requests for written information regarding the trigger determination. Indeed, the parties acknowledge that they were capable of running the computer model relied upon for the trigger decision and made changes to the assumptions. Golden Northwest Brief, SN-03-B-GN-01, at 6, citing Faddis, *et al*., SN-03-E-CC-01, at 6, Attachment SN-03-E-CC-01E.

Golden Northwest argues that a forecast based upon assumptions known to be false (*e.g.*, that the ENW funds are not available to make scheduled payments to Treasury) is no forecast at all. *Id*. This, however, is simply not the case. As discussed in greater detail in a separate subsection below, BPA does not include ENW funds in its forecasts because it is imprudent to do so. Also as discussed in a separate subsection below, BPA's other assumptions were appropriate, given the time at which the trigger determination was made.

Early Treasury Payments and ENW Debt Extension. Golden Northwest argues that in making a trigger determination, BPA must assess the level of its obligations to the Treasury, taking into account any "prepayments," because BPA's governing statutes confirm that payments BPA has previously made with the funds made available by refinancing ENW bonds constitute advance payments of Treasury obligations. Golden Northwest Brief, SN-03-B-GN-01, at 3. Golden Northwest and ICNU/ALCOA argue that, specifically, section 13(a) of the Federal Columbia River Transmission System Act, 16 U.S.C. § 838k(a), requires that principal payments be made at any time before the end of the fiscal year for which they are scheduled in the rate case repayment studies, or BPA may be penalized with higher interest rates. *Id*.; ICNU/ALCOA Brief, SN-03-B-IN-01, at 2. (Golden Northwest and ICNU/ALCOA note that BPA is not liable for any interest penalty if the late payment has been the result of low water conditions or other factors outside of its control. *Id*.)

The referenced statute, however, does not refer to BPA's "rate case repayment studies." The referenced statute also refers to interest penalties but does not refer to credits against current payments. Golden Northwest argues that BPA may also pay amounts in excess of the principal obligations, just as a private individual can prepay a mortgage, and section 13(a) declares that "the Secretary of the Treasury shall take into account amounts that the Administrator has repaid in advance of any repayment criteria in determining whether to increase [the interest] rate [on BPA obligations]." *Id*. Golden Northwest argues that, furthermore, BPA has already prepaid the Treasury and is currently at least $262 million ahead of scheduled payments in the rate period (not including the $315 million available in FY 2003). Golden Northwest Brief, SN-03-B-GN-01, at 5, citing Faddis, *et al*., SN-03-E-CC-01A, 2.

BPA has made extra amortization payments in recent years, largely with proceeds from extending the maturities of ENW bonds as part of BPA's debt optimization program. Keep, *et al*., SN-03-E-BPA-11, at 43. Extra or advance repayments, however, are not synonymous with "prepayments." Golden Northwest's reference to a mortgage appears to be speaking to the

practice of making extra principal payments on a mortgage, which is not a prepayment. Paying extra principal typically reduces the mortgagee's final payments, and the mortgage is satisfied earlier than the original term, but it is not regarded as a prepayment of the next installment of the payment schedule that is due from the mortgagee. Failure to pay subsequent installments in whole or in part can still result in foreclosure. Similarly, Treasury does not view BPA's payments in prior years as available to satisfy BPA's current-year obligations. Keep, *et al*., SN-03-E-BPA-11, at 43. It is an important clarification that BPA's extra amortization is not being viewed as prepayment of the annual amortization scheduled in rate filings. BPA is not the final arbiter of whether early extra payments can be used to offset current payments. Treasury and others in the Administration would view any attempt to claim the additional payments as having satisfied this year's payment as a deferral. *Id*. at 43-44. The statute requires the Secretary of Treasury to consider a penalty if BPA has failed to pay the amount expected in the year prior to payment. The words clearly indicate that penalties can be applied without regard to cumulative rate period payments. While it is quite possible that the interest penalty discussed above would not be applied, BPA believes there still could be serious repercussions resulting from such an action. *Id*. at 44.

ICNU/ALCOA argue that BPA's draft ROD admitted that "it is quite possible" that early or advance payments in prior years reduce current obligations, but BPA will not make such an interpretation because there could be "political repercussions." ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 2. ICNU/ALCOA's argument has mischaracterized BPA's statements and is incorrect. First, BPA did not state that "it is quite possible that early or advance payments in prior years reduce current obligations." BPA simply noted that an interest penalty might not be applied. As Golden Northwest and ICNU/ALCOA note, BPA is not liable for any interest penalty if the late payment has been the result of low water conditions or other factors outside of its control. Golden Northwest Brief, SN-03-B-GN-01, at 3; ICNU/ALCOA Brief, SN-03-B-IN-01, at 2. Second, BPA's draft ROD noted that there could be "serious repercussions" from attempting to treat early payments as prepayments. BPA did not limit these repercussions to "political" repercussions, although BPA's testimony noted there could be political repercussions. ICNU/ALCOA Brief, SN-03-B-IN-01, at 2. ICNU/ALCOA argue that "political repercussions" are an insufficient basis for BPA to violate its enabling statutes and refuse to recognize early Treasury payments in calculating the appropriateness of triggering the SN CRAC. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 2. First, there has been no demonstration that BPA has violated any statute. ICNU/ALCOA fail to cite any statutory provision that requires BPA to treat early payments as prepayments. Furthermore, ICNU/ALCOA's argument fails to appreciate the importance of repercussions from BPA's actions. As noted above, Treasury does not agree that these payments should be treated as meeting current year obligations, and would likely view an attempt to treat them as such as a deferral of BPA's Treasury payment. Logically, an action viewed as a deferral of Treasury payment would result in greater financial scrutiny of BPA. During the early 1980's, when BPA missed some Treasury payments, FERC expressed concern about the longer-term impacts of such misses, referring to the "bow wave" of debt service obligations created by such deferrals. *See U.S. Department of Energy – Bonneville Power Admin.*, 23 FERC ¶ 61,378, 61,799 (1983). Another potential result would be to put BPA on a fixed repayment schedule, which would greatly decrease BPA's financial flexibility and would likely increase rates. Certainly BPA's credit rating would be at risk. As BPA has noted elsewhere in this ROD, a deferral could

jeopardize bond rating agencies' views of BPA's financial condition, resulting in bond downgrades. Thus, there are a number of very negative outcomes associated with Golden Northwest and ALOCA's proposed use of ENW funds. Additionally, using the advanced amortization payments as "prepayments" is inconsistent with the Debt Optimization Program. As noted below, BPA believes the Debt Optimization Program has value to BPA and the region, for numerous reasons.

ICNU/ALCOA argue that the BPA Administrator's statements, and BPA's data responses in this proceeding, confirm that BPA's Treasury "prepayments" reduce its required Treasury payment from FY 2003-2006. *Id*., citing Faddis, *et al*., SN-03-E-CC-01, Attachment SN-03-E-CC-01B, at 5; SN-03-E-CC-01C; SN-03-E-CC-01D. BPA has reviewed the referenced material. There is nothing in the material to confirm this assertion. BPA has made no such pronouncement or even implied that extra amortization payments reduce BPA's current repayment obligations.

A number of parties argue BPA should have included a reduction of $315 million in ENW costs when making the trigger determination. ICNU/ALCOA Brief, SN-03-B-IN-01, at 2; ICNU/ALCOA Ex. Brief, SN-03-R-IN-01, at 1-3; Golden Northwest Brief, SN-03-B-GN-01, at 2-6; Golden Northwest Ex. Brief, SN-03-R-GN-01, at 2-5; GPU Brief, SN-03-B-GP-01, at 8. ICNU/ALCOA note that in FY 2003, BPA intends on paying the Treasury approximately $315 million in addition to its already scheduled Treasury payment. ICNU/ALCOA Brief, SN-03-B-IN-01, at 3, citing SN-03-E-CC-01, at 5. ICNU/ALCOA argue that BPA intends to pay the $315 million because it incurred the obligations for a similar amount of low-cost ENW debt and BPA intends to pay off higher-cost Federal debt due in FY 2003. *Id*. Golden Northwest and GPU argue that simply recognizing the $315 million in reduced ENW costs produces a 100 percent Treasury Payment Probability for the FY 2003 payment. Golden Northwest Brief, SN-03-B-GN-01, at 2-6, citing Faddis, *et al*., SN-03- E-CC-01E; GPU Brief, SN-03-B-GP-01, at 6, citing Faddis, *et al*., SN-03-E-CC-01, at 5-6. The foregoing arguments are inconsistent with responsible financial practice.

First, BPA had not yet acquired the referenced $315 million in debt extension benefits at the time of the trigger determination. The parties recognized that these benefits were "expected" to occur but were not certain. Golden Northwest Brief, SN-03-B-GN-01, at 4. Because they were not available at the time of the trigger determination, it would have been irresponsible to rely on benefits that might not occur. The parties argue that BPA should have assumed it would not pay the $315 million ENW refinancing savings to pay Treasury debt in its trigger study. BPA believes this would have been financially irresponsible. BPA will have $315 million from extending ENW principal due this year into the 2013–2018 period. Keep, *et al*., SN-03-E-BPA-11, at 56-60. BPA intends to make payments on higher-interest Treasury debt with these funds, consistent with the Debt Optimization Program. *Id*. BPA acknowledges that these funds could be applied in other ways. *Id*. Just as the Administrator stated in the letter cited in the Coalition Customers testimony, "extraordinary cash tools, such as use of ENW refinancing proceeds or the Treasury note, are BPA's last line of financial defense." *Id*. The Administrator also noted that "[e]ven with an SN CRAC in FY 2004, there is a high probability that BPA will need these last-defense tools to meet obligations both in the fall of 2003 and the fall of 2004. *Id*. Using $100 million of ENW debt extension proceeds to avoid an SN CRAC means that the last line of defense is that much smaller." *Id*. at 5. In other words, using these proceeds to decrease

rates (or avoid increasing them) means they are unavailable for other purposes. *Id*. BPA recognizes that these funds may be necessary for short-term liquidity purposes, such as making the scheduled year-end Treasury payment or for cash flow in October or November. *Id*. Because of this, and because other actions and factors are acting to decrease the proposed expected rate increase, BPA does not plan to use these tools in rate setting. *Id*.

Furthermore, if needed, at the end of this year, BPA may need to hold some proceeds "as a reserve of last resort." *Id*. at 57-58. The following are reasons for continuing the Debt Optimization Program as originally intended:

- BPA has already employed several financial tools that it considers prudent;

- Use of the proceeds as proposed by the customers will jeopardize the future of the program, which BPA believes provides value to the region. The understanding with ENW does not envision a long-term use of these funds even under serious financial conditions;

- Use of the proceeds as proposed will jeopardize bond ratings on BPA-backed bonds;

- Recently issued bond Official Statements state that "[t]he possible financial tools Bonneville may rely on to meet cash flow needs in early fiscal year 2004 include among other items: (i) deferring all or a portion of planned early repayments and amortization of about $315 million in bonds issued by Bonneville to the United States Treasury and appropriations repayment obligations by Bonneville to the United States Treasury at the end of fiscal year 2003 in great part under the Debt Optimization Proposal, (ii) seeking access to short-term borrowing with the United States Treasury under Bonneville's existing borrowing authority, or (iii) deferring scheduled interest and/or principal payments to the United States Treasury, meaning planned payments to the United States Treasury as scheduled under applicable repayment criteria in contrast to the advance amortization payments described in clause (i)." *Id*. BPA does not interpret this statement as giving BPA the ability to expand that interpretation to include using debt extension proceeds to reduce rates. *Id*. BPA believes the Official Statements give BPA some flexibility with regard to use of the proceeds, but they do not permit the type of use parties have advocated.

Id. Also, BPA is very concerned about moving costs into the next rate period. *Id*. at 58. Using the ENW debt extension proceeds as a reserve fund in FY 2004 or FY 2005 would require a larger SN CRAC in FY 2006 or a higher rate in post-2006 period. *Id*. While it could be preferable for short-term impacts to move these repayment costs beyond the current rate period, such actions will be difficult to defend to the financial community and with ENW and may have a material adverse impact on BPA's Debt Optimization Program. *Id*. ENW allowed the initial debt extensions with the expectation that the Debt Optimization Program would be pursued. Frustration of that expectation through use of the funds for other purposes could result in ENW's disapproval of future debt extensions. BPA's Debt Optimization Program and the rating agencies' perception of BPA's creditworthiness both provide value to BPA's customers and the region. *Id*.

In this regard, Standard and Poor's has said, as noted in the SN-03 Study, SN-03-E-BPA-01, Attachment 1-1: "Rating concerns that could prompt a downgrade include: the use of any debt restructuring savings to offset current operating expenses which would constitute a deferral of the cost recovery needed into future years." *Id*. at 59-60. BPA interprets this statement to mean *any* level of deferral, not simply the entire $315 million. *Id*. BPA may be able to make a reasonable case to the rating agencies, but BPA cannot assume that they will agree that it does not merit a downgrade. *Id*.

Golden Northwest argues that BPA can (and, if necessary, intends to) use these funds to make up any expected shortfall in its September 30, 2003, Treasury payment and subsequent Treasury payments. Golden Northwest Brief, SN-03-B-GE-01, at 4. Golden Northwest argues that, as stated in the Administrator's March 26, 2003, letter to his customers:

> Extraordinary cash tools, such as use of ENW refinancing proceeds or the Treasury note, are BPA's last line of financial defense. Even *with* an SN CRAC in FY04, there is high probability that BPA will need these last-defense tools to meet obligations both in the fall of 2003 and the fall of 2004. Using $100 million of ENW refinancing proceeds to avoid an SN CRAC means that the last line of defense is that much smaller. The SN CRAC is important to replenishing this tool. Without it, BPA's risk of illiquidity and failure to pay Treasury or other creditors could be substantially increased.

Id., citing Faddis, *et al*., SN-03-E-CC-01B, at 6. While BPA agrees that the Administrator's statement indicates that he believes these funds could potentially be used to avoid missing a scheduled Treasury payment, the Administrator also indicates that doing so increases BPA's financial risk. BPA's testimony notes that "[i]n other words, using these proceeds to decrease rates (or avoid increasing them) means they are unavailable for other purposes." Keep, *et al*., SN-03-E-BPA-11, at 56-60. BPA recognizes that these funds may be necessary for short-term liquidity purposes, such as making the scheduled year-end Treasury payment or for cash flow in October or November. *Id*. Because of this, and because other actions and factors are acting to decrease the proposed expected rate increase, BPA does not plan to use these tools in rate setting. *Id*.

Golden Northwest argues the use of these funds for BPA financial emergencies is recognized in the Official Statements of the bond issues. Golden Northwest Brief, SN-03-B-GN-01, at 4, citing, *e.g.*, Faddis, *et al*., SN-03-E-CC-01D. The Administrator, however, did not and has not determined that BPA is experiencing a financial emergency that would justify such use in order to avoid an SN CRAC process or to minimize or eliminate an SN CRAC rate adjustment. Also, the Official Statements give BPA some flexibility with regard to the use of the proceeds, but they do not permit the type of use the parties have advocated. Keep, *et al*., SN-03-E-BPA-11, at 57-58. Furthermore, the Administrator's statements indicate that, by definition, there remains some risk that BPA will be unable to pay all intended payments to Treasury in September of 2003 or 2004. In those cases BPA may be able to delay some of the payment for a short period, but would not intend that the delay would be for a year or longer. Therefore, the potential short-term use of those funds would not help TPP, and therefore would not lower rates, since the potential delay would only be of short duration.

ICNU/ALCOA and Golden Northwest note that BPA concluded that ENW payments should not have been included in BPA's trigger determination because it would not have been consistent with prudent financial practice, noting that BPA had not acquired the funds at the time of the trigger determination and that including the funds means they would not be available for other purposes. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 2-3; Golden Northwest Ex. Brief, SN-03-R-GN-01, at 2-3. Golden Northwest argues that the GRSPs make the question of financial prudence irrelevant to triggering the SN CRAC process. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 3. Golden Northwest argues the GRSPs require the Administrator to make a good faith forecast of BPA's costs and revenues, and a good faith estimate of the resulting TPP. *Id*. Golden Northwest argues the GRSPs do not permit the Administrator to arbitrarily single out some costs or revenues and exclude them from the forecast in order to reduce TPP and trigger the SN CRAC. *Id*. This, however, is not what BPA has done. To the contrary, BPA's reference to responsible financial practice relates to the prudence of assuming both sides of the Debt Optimization Program, both the extension of ENW debt and the commensurate repayment of Federal debt. BPA has not "arbitrarily single[d] out some costs" and excluded them. Rather, BPA included the effect of the refinancing by reducing the ENW debt service in the SN CRAC modeling. BPA properly assumed the proceeds would go toward Federal debt, as the program is designed, and as is a responsible business practice. This reflects BPA's intention, and was the best forecast at the time.

ICNU/ALCOA and Golden Northwest argue that the majority of the ENW finds were reasonably foreseeable to occur. *Id*. at 3, 2-3. Golden Northwest argues that the trigger determination was based entirely upon forecasts of costs and revenues that had not been realized at the time of the trigger determination, that staff acknowledged that the benefits were available, and the ENW cost reductions were more certain to occur than most other elements of the forecasts used to make the trigger determination. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 3. BPA did, however, reflect the forecast of ENW debt-extension refinancings in its modeling, along with the commensurate payment to Treasury for an equal amount of Federal debt. So, to the extent that not-yet-attained refinancings did not occur, BPA's rates would be unaffected. There would be less refinancing "proceeds" available, and less advanced amortization would be paid to Treasury. On the other hand, if BPA reflected the forecast of the refinancings in its modeling, and assumed that the proceeds would be available in reserves to lower rates, there are two potential negative consequences. First, if the refinancings did not occur to the full extent forecasted, BPA would have lowered rates based on cash receipts that did not materialize, significantly hurting BPA's cash flow. Second, all ENW refinancings must be approved by the ENW Board. If the Board had known BPA was planning to use the proceeds of planned refinancings to lower rates, it may well not have approved the refinancings, making the first event all but certain. *See* Keep, *et al.*, SN-03-E-BPA-11, at 58-59. So while BPA believes it is appropriate to forecast the full, expected Debt Optimization Program, with both sides of the transaction, it is not prudent to forecast that cash is available to lower rates based on refinancings that had not yet occurred, and might not occur.

ICNU/ALCOA also argue that the majority of ENW funds would be available for other purposes because only part of the $315 million would have been needed to demonstrate a greater than 50 percent probability of making the next scheduled Treasury payment. ICNU/ALCOA Ex. Brief, SN-03-R-IN-01, at 3. ICNU/ALCOA also argue that BPA admits that ENW funds are

available to the Administrator (they "could potentially be used to avoid missing a Treasury payment") but BPA refuses to include them in the trigger determination because they might be needed as a reserve of last resort. *Id.* ICNU/ALCOA argue that BPA must consider its actual risk of failure to pay the Treasury and cannot withhold the ENW funds in making the trigger determination. *Id.* First, as noted above, it is inappropriate to use all or a part of the ENW funds for other than their intended purpose. BPA agrees that these funds could be used as a reserve of last resort. In the trigger study, however, BPA assumed the funds would be used for their planned purpose. If BPA had assumed the use of the funds was proper solely as a reserve in planning, it would have been used that way. This was not the case. BPA planned to use the ENW funds consistent with its existing Debt Optimization Program. Therefore, it would have been inappropriate for BPA to assume use of the ENW funds as a reserve, which is different from BPA's planned use. BPA should not assume an aberration from BPA's existing responsible financial practice in its modeling.

BPA's 2002 GRSPs. Golden Northwest argues that for purposes of forecasting its probability of missing its Treasury payment in FY 2003, BPA included among the amounts that must be paid the full Treasury payment (without regard to the $262 million in advance payments), and included among the costs it expected to incur (thus reducing amounts available to pay the Treasury) $315 million of principal payments on ENW debt that, due to refinancing, it did not actually expect to incur in FY 2003. Golden Northwest Brief, SN-03-B-GN-01, at 5. A number of parties argue this was inconsistent with the GRSPs, as seen through contrast with the FB CRAC language. *Id.*; ICNU/ALCOA Brief, SN-03-B-IN-01, at 3; GPU Brief, SN-03-B-GP-01, at 6-8.

Golden Northwest and ICNU/ALCOA argue that section II.F.2.a of the GRSPs provides that, "for purposes of determining if the FB CRAC threshold has been reached, actual and forecasted expenses will include BPA expenses associated with Energy Northwest debt service as forecasted in the WP-02 Final Studies." (Emphasis added). Golden Northwest Brief, SN-03-B-GN-01, at 5; *see* ICNU/ALCOA Brief, SN-03-B-IN-01, at 3. They argue that, in other words, improvements in actual net revenues from expense reductions due to the ENW refinancing do not affect the FB CRAC. *Id.* They argue that the FB CRAC can be imposed notwithstanding BPA's plan to prepay Treasury debt with ENW refinancing proceeds. *Id.* They argue that, in contrast, the SN CRAC language contains no similar qualification for ENW refinancing because it is triggered by actual expectations, not hypothetical calculations. *Id.*

Golden Northwest argues that the difference between the SN and FB CRACs was intentional. Golden Northwest Brief, SN-03-B-GN-01, at 5. Golden Northwest argues that the FB CRAC contains express rate limits because customers were willing to bear limited rate increases to permit BPA to meet its financial goals (as opposed to obligations). *Id.* Golden Northwest provides no authority to support this claim. Golden Northwest argues that, on the other hand, the SN CRAC is a potentially unlimited rate increase that was designed as a tool of last resort to ensure that BPA did not fall behind in the pace of its required Treasury payments or default on other debts. *Id.* at 5-6. Golden Northwest argues that BPA's inability to prepay Treasury obligations is not an event that was designed to trigger the SN CRAC, and none of BPA's customers so understood it. *Id.* at 6. Golden Northwest also provides no authority to support this claim. This argument is unconvincing in any event. The parties acknowledge the GRSPs

for the SN CRAC do not state that actual and forecasted expenses will include BPA expenses associated with Energy Northwest debt service as forecasted in the WP-02 Final Studies. The SN CRAC GRSPs also do not state that actual and forecasted expenses will not include BPA expenses associated with Energy Northwest debt service as forecasted in the WP-02 Final Studies. The SN CRAC GRSPs are silent on this issue. Furthermore, this argument is misplaced, as discussed in greater detail below.

In its initial brief, Golden Northwest argued that, for purposes of forecasting its probability of missing its Treasury payment in FY 2003, BPA included among the amounts that must be paid the full Treasury payment (without regard to the $262 million in advance payments), and included among the costs it expected to incur (thus reducing amounts available to pay the Treasury) $315 million of principal payments on ENW debt that, due to refinancing, it did not actually expect to incur in FY 2003. Golden Northwest Brief, SN-03-B-GN-01, at 5. This allegation is not true. The SN CRAC is triggered based on BPA's TPP, which reflects BPA's cash position, not its net revenues. In determining its cash position, BPA included the forecast of actual payments it expects to make on ENW debt, including a forecast of FY 2003 refinancings that have been reflected in ENW budgets. BPA did not include "principal payments on ENW debt that ... it did not actually expect to incur." BPA also reflects the second side of the ENW Debt Optimization Program refinancing transaction, the payment of those savings to the Treasury. This is, as Golden Northwest calls for, "a good-faith forecast of BPA's costs." *See* Golden Northwest Ex. Brief, SN-03-R-GN-01, at 3. As described earlier, BPA believes there are numerous sound financial reasons for BPA to hold true to its Debt Optimization Program, and has reflected that belief in its forecasts. On the other hand, the FB CRAC language, which calls for using ENW debt service as forecasted in the WP-02 Final Studies, specifically applies to the calculation of accumulated net revenues. This is appropriate because there are different treatments in net revenues of the two kinds of debt involved in the Debt Optimization Program. The ENW debt service is included in net revenues as an expense, so the debt extension results in lower expense and therefore higher net revenues. On the other hand, net revenues do not include principal and interest payments on Treasury debt. Rather, they include depreciation, the annual write down of the Federal assets associated with the Federal debt, which is unaffected by advanced amortization payments. Because of this, without the adjustment for ENW debt service, the net revenue calculation would reflect the decrease in ENW debt service in a year based on the Debt Optimization Program refinancings, and there would be no counter-balancing adjustment to the Federal depreciation. Because of the anomalous treatment of the two kinds of debt, the two sides of the transaction are not reflected equally. The result would be an artificially higher net revenue. This explains the FB CRAC GRSP language adjusting the ENW debt service in ANR. This situation does not hold for the cash calculation used in the SN CRAC trigger, however. Both sides of the Debt Optimization Program transactions are treated the same in the cash flow statement, so there is no reason to adjust the May Proposal forecasts of payments (as is the case in the FB CRAC and SN CRAC ANR calculations). As noted earlier, BPA does not reflect prior advanced amortization payments as fulfilling the current year obligation to pay Treasury because, as with an advance mortgage payment, BPA's banker, the Treasury, does not view it as such. For the foregoing reasons, Golden Northwest's reliance on canons of construction is inapposite. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 3-4. For the same reasons, ICNU/ALCOA's argument that BPA

inappropriately reads new language into the SN CRAC GRSPs is also misplaced. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 3.

Further, there is no requirement that BPA must use all its financial tools in lieu of a rate increase. Keep, *et al*., SN-03-E-BPA-11, at 41. BPA recognizes ENW's reduced debt service costs for what they are, an extension of bond principal, which would otherwise have been paid off at maturity. *Id*. That principal extension, on its own, is pushing a significant amount of debt into future years. *Id*. Without planning for the corresponding payment of Treasury debt, the act of extending the ENW debt would be financially imprudent. *Id*. In order to be effective and justifiable, the Debt Optimization Program is a two-part transaction extending ENW principal and paying down Treasury debt. *Id*. This is consistent with the intent of the SN CRAC. *Id*.

BPA views use of the Treasury note similar to use of the ENW debt extension proceeds. Keep, *et al*., SN-03-E-BPA-11, at 60. That is, it is a tool that is available for short-term liquidity purposes if necessary. *Id*. However, planning to use it, and lowering rates with the expectation that it will be used, is not a position BPA is willing to take, given that it exacerbates longer-term financial impacts and would be viewed negatively by rating agencies. *Id*.

As explained above, BPA's intention on a planning basis is to conform to the Debt Optimization Program. Keep, *et al*., SN-03-E-BPA-11, at 62. This entails repaying the same amount of combined Federal and non-Federal debt that was planned in the May 2000 proposal, using proceeds from extending ENW debt to repay an equivalent amount of higher-interest Federal debt. *Id*. Given this plan, BPA is not misstating its cash position. *Id*. The GRSPs do not require BPA to use all cash tools to lower rates. *Id*. Rather, the GRSPs state that, in developing BPA's initial proposal, BPA will give priority to *prudent* cost management and other options that enhance TPP while minimizing rate increases. *Id*. BPA believes that planning to use ENW proceeds or all available cash tools to lower rates is not a prudent business plan. *Id*. Rather, BPA assumes it will have some cash tools available to cover short-term liquidity needs. *Id*. In terms of using "other options" to minimize rate increases, in developing BPA's SN-03 initial proposal, BPA gave priority to prudent cost management and other options that enhance Treasury Payment Probability while minimizing changes to the FB CRAC. Keep, *et al*., SN-03-E-BPA-11, at 45. BPA's initial proposal reflected cost reductions, cash tools (including the use of borrowing for long-lived assets where appropriate), and BPA considered the potential use of ENW debt extension proceeds to minimize rate adjustments, although BPA determined this latter option was imprudent. *Id*.

While BPA's initial proposal gave priority to prudent cost management and other options, BPA is continuing to look for additional cost cuts which, given BPA's proposed variable and contingent rate design, would decrease the size of rate increases under the SN CRAC. Keep, *et al*., SN-03-E-BPA-11, at 45. Furthermore, the PBL is currently borrowing for all investment that is appropriately considered capital investment. *Id*. Also, BPA is using cash tools to minimize the level of the SN CRAC. *Id*. BPA requested and ENW implemented a process to release bond reserve funds by purchasing surety bonds. *Id*. In keeping with the spirit of parties' proposals to delay cash payments until later in the rate period, BPA has shaped the payments to Treasury for the Judgment Fund associated with the Enron settlement. *Id*. Payments will remain

within the original term of the Enron contracts, but are heavily weighted toward the end of the rate period. *Id.*

In FY 2002, ENW proposed, and BPA agreed, to start issuing debt for new capital investments. *Id.* This change reversed historical practice and reversed the accounting and revenue financing that had occurred in prior years for the Independent Spent Fuel Storage Installation at CGS. *Id.* ENW and BPA are in the process of issuing bonds for this capital project and other anticipated projects for FY 2004. *Id.* Contrary to ENW's standard of levelized debt service, the ENW board has agreed to schedule principal payments to start in 2007. *Id.*

Golden Northwest notes BPA's recognition that the GRSPs require BPA to "give priority to prudent cost management and other options that enhance TPP while minimizing rate increases" when developing BPA's initial SN CRAC proposal. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 4. Golden Northwest argues that such prudence has nothing to do with whether BPA may arbitrarily exclude certain forecasted reductions from the trigger forecasting. *Id.* Golden Northwest notes that BPA recognizes that the prudence standard applies to developing BPA's initial proposal, but not to BPA's trigger determination, yet uses prudence as a basis for not reflecting ENW cost reductions in the trigger determination. *Id.* As explained above, BPA has not excluded any forecasted reductions in its trigger calculation. Rather, both sides of the Debt Optimization Program transaction have been included – both the decrease in ENW debt service due to debt extension, and the commensurate payment of Federal debt. Furthermore, while there is an express requirement that BPA give priority to prudent cost management and other options that increase TPP for BPA's initial proposal, and there is no such express requirement for BPA's trigger determination, this does not mean that BPA's trigger determination should be financially irresponsible. Instead, BPA's trigger determination should reflect the agency's normal, financially responsible conduct of its business. This includes respecting the financial efficacy of BPA's Debt Optimization Program.

Risk of Missing FY 2003 Treasury Payment. Golden Northwest argues that, as demonstrated in the testimony of the Joint Customers' Technical Panel, Bliven, *et al.*, SN-03-E-JC-01, when BPA's 2003 costs and revenues are updated to reflect committed cost reductions, currently anticipated water conditions and market prices, and other factors, the Treasury Payment Probability for FY 2003 ranges from 97 percent to 100 percent in the four cases analyzed. Golden Northwest Brief, SN-03-B-GN-01, at 6. GPU argues that the Coalition Customers and the Joint Customers presented computer model results that show that BPA is not at risk of missing its next Treasury payment. GPU Brief, SN-03-B-GP-01, at 6, citing Faddis, *et al.*, SN-03-E-CC-01, at 5, and Bliven, *et al.*, SN-03-E-JC-01, at 17-20. NRU also argues that the Joint Customers have shown that the conditions for triggering SN CRAC are not present. NRU Brief, SN-03-B-NR-01, at 3. NRU argues that under the three scenarios analyzed by Joint Customers, Treasury repayment in 2003 is virtually certain, and the probability of a full U.S. Treasury payment in 2004 is 94 percent or greater. *Id.*, citing Bliven, *et al.*, SN-03-E-JC-01, at 18. NRU argues that the high TPP for 2004 exceeds the 50 percent threshold standard in BPA's 2002 GRSPs for triggering the SN CRAC. *Id.* These arguments are misplaced.

While these arguments are relevant to BPA's section 7(i) hearing determinations regarding whether BPA should impose an SN CRAC and, if so, at what level, they have little bearing on

the triggering of the SN CRAC process. Keep, *et al*., SN-03-E-BPA-11, at 43. The Administrator's determination to trigger the SN CRAC process necessarily occurs prior to the beginning of BPA's section 7(i) hearing to implement the SN CRAC. The Administrator's determination to trigger the SN CRAC process must be made at a specific time. *Id*. This trigger determination does not establish or require the implementation of an SN CRAC. *Id*. Instead, it simply begins a process in which BPA must determine whether to implement an SN CRAC and, if so, the extent of that SN CRAC. *Id*. The fact that costs, revenues, water or prices may change over time does not affect the trigger determination, but instead is considered in determining whether an SN CRAC should be implemented and, if so, the level of such a CRAC. *Id*. The Joint Customers' arguments regarding costs, revenues, water and prices are addressed elsewhere in this ROD. *Id*.

GPU argues that BPA actually had a relatively high probability of making its next Treasury payments (>96 percent) with the use of then-current data. GPU Brief, SN-03-B-GP-01, at 6, citing Faddis, *et al*., SN-03-E-CC-01, at 5, and Bliven, *et al*., SN-03-E-JC-01, at 17-20. This statement is incorrect. Neither of the cited testimonies establishes that BPA had a high probability of making its next Treasury payment using data available at the time of the trigger determination. The cited testimonies rely on assumptions that were not available at that time or that continue to be inappropriate assumptions. The Joint Customers' testimony used three cases to review the effects of proposed cost cuts and revenue enhancement scenarios on whether BPA should impose an SN CRAC. Bliven, *et al*., SN-03-E-JC-01, at 17-18. Case 1 assumes limited use for a repayment reserve of $100 million of the $315 million in ENW refinancing proceeds in 2003 with Treasury repayment of the $100 million in 2006. *Id*. This assumption, regarding the proposed use of ENW debt extension proceeds, is inappropriate for the many reasons explained previously.

Case 1 also assumes full realization of the $300 million in further Financial Choices cost reductions. Bliven, *et al*., SN-03-E-JC-01, at 18. This is inappropriate. As the Joint Customers' testimony noted, "[t]hese are costs imposed on BPA by other entities and thus require the action or renegotiation of contracts and agreements by these other entities." *Id*. at 13. BPA cannot assume such cost savings until the noted contracts and agreements have been executed, and there is no evidence this has occurred. BPA, however, is aggressively pursuing cost reductions both internally and with its generating partners (*i.e.*, Corps, Reclamation, and ENW). Keep, *et al*., SN-03-E-BPA-11, at 52. BPA will incorporate all cost reductions that have been identified with a high level of certainty by the time of development of the final proposal. *Id*. Additionally, BPA is considering a contingent SN CRAC design, which would allow resetting the SN CRAC parameters in August 2003, based on cost savings found in specific categories. *Id*. Specifically, to the extent relevant events occur and cost savings have been identified with some certainty for the FY 2004-2006 period, reductions in the following categories will be reflected in recalibrated SN CRAC thresholds, caps and revenue amounts: BPA Internal Operations Costs (the sum of PBL Internal Operations and Corporate Internal Services); Corps and Reclamation O&M; CGS O&M, BPA's Fish and Wildlife Integrated Program O&M; and any IOU litigation settlement. *Id*. To the extent savings are realized each year, the variable component of the proposed SN CRAC will capture those savings. *Id*. Because the foregoing savings have not occurred, they also had not occurred at the time of BPA's trigger determination. Section II.F.3.a of the GRSPs

recognizes that cost management is to be considered in preparing BPA's initial proposal, not the Administrator's trigger determination.

Case 1 also assumes revenues from ENW bearer bonds. Bliven, *et al*., SN-03-E-JC-01, at 18. This is an inappropriate assumption for the trigger determination because such revenues only became available to BPA *after* the trigger determination. SN-03-Study, SN-03-E-BPA-01, at 9; Keep, *et al*., SN-03-E-BPA-11, at 51.

Case 1 also assumes revenues from higher streamflows. Bliven, *et al*., SN-03-E-JC-01, at 18. This is an inappropriate assumption for the trigger determination because BPA used then-current streamflows for the trigger determination and could not have foreseen future changes in streamflows, whether positive or negative.

Case 1 also assumes BPA's internal cost cuts. Bliven, *et al*., SN-03-E-JC-01, at 18. This is an inappropriate assumption for the trigger determination because BPA was not aware of the issue regarding approximately $20 million of cost cuts inadvertently omitted from BPA's initial proposal until after preparation of that proposal. Keep, *et al*., SN-03-E-BPA-04, at 9.

Case 1 also assumes IOU benefit savings and removal of the litigation penalty. Bliven, *et al*., SN-03-E-JC-01, at 18. This is an inappropriate assumption for the trigger determination. BPA views an agreement over benefits paid to IOUs as an essential part of the overall effort to control potential rate increases, and is working actively with other parties to bring such an agreement about. Keep, *et al*., SN-03-E-BPA-11, at 69. Building such an agreement into the SN CRAC analysis before it actually is reached, however, would not be financially responsible. *Id*. Parties may or may not reach a settlement and, even if settlement were reached, there are currently no settlement terms to reflect. The contingent and variable rate design would allow an agreement to be reflected in rates if it occurs in a timely manner. *Id*. No litigation settlement agreement had been reached when the Administrator made the trigger determination, and no settlement agreement has been reached to date.

Case 2 is the same as Case 1, except that use of ENW proceeds is limited to $150 million and further cost cuts are assumed to achieve $40 million less savings than in Case 1. Bliven, *et al*., SN-03-E-JC-01, at 18. Case 2, therefore, is premised on the same incorrect assumptions contained in Case 1 and does not invalidate the Administrator's trigger determination. The only additional factor is that Case 2 assumes that the litigation premium continues to be paid to the IOUs through the rate period.

Case 3 uses all of the proceeds of ENW debt restructuring for 2002 through 2006 that occurred or will occur as a result of the 2001 though 2003 refinancing programs. Bliven, *et al*., SN-03-E-JC-01, at 18. This assumption is inappropriate for the trigger determination for the reasons stated previously. Case 3 also assumes the availability of funds from the ENW bearer bonds, higher streamflows in 2003 than in BPA's initial proposal, and $44 million in spending reductions for internal operations and corporate overheads. Bliven, *et al*., SN-03-E-JC-01, at 18. These assumptions were not appropriate for the trigger determination for the reasons stated previously. Case 3 also assumes ConAug amortization savings. Bliven, *et al*., SN-03-E-JC-01, at 18. BPA believes that its current policy is the prudent and correct treatment for ConAug

amortization. Lefler, *et al.*, SN-03-E-BPA-13, at 5. For regulatory assets such as conservation that can only be capitalized under Financial Accounting Standard Number 71, the useful life of the asset must be tied to the ability to demonstrate cost recovery. *Id.* BPA's policy is based on the view that for ConAug, cost recovery is best demonstrated by the duration of signed power contracts, through 2011. *Id.* Further, from a cash standpoint, there would be little effect on the SN CRAC rate from changing BPA's policy on the current ConAug amortization. *Id.* Assuming a change in BPA's amortization of ConAug in the trigger determination therefore would have been inappropriate. Case 3 assumes no further cost cuts or any further reductions to IOU benefits or removal of the litigation premium. Bliven, *et al*., SN-03-E-JC-01, at 18.

In summary, the argument that BPA actually had a relatively high probability of making its next Treasury payment with the use of then-current data is not persuasive. At the time of the trigger determination, the many factors the parties use to argue against the level and imposition of an SN CRAC were not available or were inappropriate.

Golden Northwest argues that in addition to the foregoing cases reviewed by BPA, there is an additional case that paralleled the model run used to make the trigger determination, with the only difference being the reduction in ENW costs that BPA staff acknowledges were fair to assume. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 5. This statement is incorrect. BPA staff did not acknowledge that Golden Northwest's proposed treatment of the ENW funds is "fair to assume." Indeed, BPA staff concluded just the opposite, finding that such treatment would be contrary to BPA's Debt Optimization Plan. BPA has previously explained this in detail. The additional case cited by Golden Northwest is a case where, as Golden Northwest acknowledges, it was assumed that adopting *Golden Northwest's* proposed treatment of $315 million of ENW funds would produce a 100 percent TPP for FY 2003. *Id*. at 5, citing Faddis, *et al*., SN-03-E-CC-01, at 6. Because it is inappropriate to assume the use of the $315 million in the manner advocated by Golden Northwest, BPA was correct not to make such an aberrant assumption in BPA's trigger determination.

GPU argues that BPA did not directly respond or refute GPU's or CC's testimony that specifically addressed assumptions and conclusions in BPA's trigger decision. GPU Brief, SN-03-B-GP-01, at 7. As noted previously, however, the testimony cited by GPU did not address BPA's trigger determination, but rather whether BPA should impose an SN CRAC and, if so, the size of the SN CRAC. Furthermore, BPA did address the assumptions and conclusions raised by the Joint Customers. As noted previously, BPA established that the parties' arguments, which GPU argues were related to the trigger determination, were either not available to the Administrator at the time of the determination or were inappropriate assumptions.

GPU argues that it challenged statements by staff that supported the Administrator's trigger determination because those statements were unsupported without the trigger record in the SN-03 proceeding. GPU Ex. Brief, SN-03-R-GP-01, at 15. GPU notes BPA's statements that the trigger determination had been made before the current SN-03 rate hearing based on the record at the time of that determination and BPA did not file that record in the current proceeding. GPU Ex. Brief, SN-03-R-GP-01, at 14-15. GPU then notes BPA's conclusion that the decision to trigger the SN CRAC was eminently reasonable. *Id.* GPU argues that BPA's conclusion is inappropriate because it is based on the SN-03 record, which does not contain the

separate trigger record. *Id*. First, once again, BPA's trigger determination was made *before* the SN-03 rate hearing. It was not, and could not be, decided in the formal evidentiary hearing. It is temporally impossible for BPA to make the trigger determination in BPA's evidentiary hearing because the trigger determination by definition must precede the hearing. Some parties attempted to revisit the trigger determination in the SN-03 hearing. BPA responded to every argument presented by the parties regarding BPA's trigger determination. *See* Keep, *et al.*, SN-03-E-BPA-11, at 41-46; SN-03 draft ROD, 3-1 to 3-17. These were the statements of expert witnesses that comprise evidence in the proceeding rebutting all challenges regarding BPA's trigger determination. This creates a record on revisiting the trigger determination. If GPU wanted to see additional information regarding BPA's trigger determination, GPU could have requested the information through discovery. GPU did not do so. More importantly, GPU did not need to do so because GPU already had copies or access to the information on which BPA's trigger determination was based. GPU fails to note that on February 12, 2003, BPA made the Toolkit model, inputs and other information used in the trigger determination available to all parties at: http://www.bpa.gov/power/psp/rates/RateCases/sn03/pre-proposal.shtml

This provided all parties a large amount of information regarding BPA's trigger determination. BPA provided a pro forma income statement showing net revenues for the PBL. BPA also provided a net revenue to cash adjustment worksheet, which makes the necessary adjustments to turn BPA's net revenues number into a change in revenues number. The Toolkit model and inputs take a net revenue distribution from RiskMod and then apply the net revenue to cash adjustments and compare the end-of-year cash number to BPA's threshold of reserves (working capital) for 3,000 iterations to determine BPA's TPP for FY 2003. This TPP is compared to the 50 percent TPP standard in the GRSPs.

In addition to providing all interested parties with this information, BPA, pursuant to the GRSPs, conducted a workshop on February 11, 2003, to explain BPA's trigger determination. BPA also publicly posted a February 7, 2003, news release; a February 7 letter from the Administrator; a trigger letter dated February 7, including trigger documentation and a February 11, 2003, workshop agenda; and follow-up questions for February 11, 12, and 18 workshops. Thus, while BPA did not file the trigger determination record in the evidentiary hearing record, parties had previously been provided the record. Parties and BPA developed an evidentiary record on revisiting the trigger determination in the SN-03 proceeding. It was on this record that the Administrator determined the trigger determination was eminently reasonable. This hearing record need not include the previous record on which the Administrator made his trigger determination.

GPU notes BPA's statement that the trigger determination is only a procedural matter. GPU Ex. Brief, SN-03-R-GP-01, at 15-16. GPU argues this is not supported by the record. *Id*. The record, however, provides that "[t]he Administrator's determination to trigger the SN CRAC process must be made at a specific time. *This trigger determination does not establish or require the implementation of an SN CRAC. Instead, it simply begins a process in which BPA must determine whether to implement an SN CRAC and, if so, the extent of that SN CRAC*." Keep, *et al*., SN-03-E-BPA-11, at 41-42 (emphasis added). GPU is wrong. The record supports this conclusion.

GPU then argues that BPA's decision to trigger the SN CRAC, in effect, has determined that BPA will implement the SN CRAC. GPU Ex. Brief, SN-03-R-GP-01, at 15-16. GPU argues that because BPA's likelihood of Treasury payment is higher than when BPA triggered the SN-03 hearing, the trigger determination cannot be procedural because the basis for the SN-03 proceeding would be gone, yet it continues, and BPA will implement the SN CRAC regardless of having a high TPP. *Id*. GPU's abstruse argument is incorrect. First, the trigger decision only provides that BPA will conduct a section 7(i) hearing. It unequivocally does not mean that BPA will implement an SN CRAC. If the evidence presented at the hearing shows that no SN CRAC is needed, no SN CRAC is implemented. If the evidence presented at the hearing shows that an SN CRAC is needed, an SN CRAC is implemented. GPU confuses the trigger determination with the evidentiary hearing. Once the trigger determination is made, it is only in the hearing that BPA determines whether BPA will implement an SN CRAC.

Secondary Revenue Forecast. PPC/IEA and PNGC argue that the calculations of forecasted secondary revenue BPA uses in its SN CRAC analysis are based on a dated version of the AURORA model and a dated and erroneous version of the inputs to AURORA, citing Bliven, *et al*., SN-03-E-JC-01, at 28-46. PPC/IEA Brief, SN-03-B-PP-01, at 10; PNGC Brief, SN-03-B-PN-01, at 3. PPC/IEA and PNGC argue that the combined effect is a flawed forecast that should not be relied upon to initiate the SN CRAC proceeding or to impose a multi-year SN CRAC. *Id*. PNGC and PPC/IEA, however, provide only summary descriptions of BPA's secondary revenue forecast. Review of the record refutes their contentions. While PNGC and PPC/IEA argue that BPA's AURORA model was outdated, the only support provided for this statement is a citation to the testimony of Bliven, *et al*., SN-03-E-JC-01. While this testimony states that BPA is using a version of AURORA that is older than the version currently available, it also states that "[o]ur sense is that while there are differences between versions 5.6 and 6.3, they are not necessarily ones that need to be addressed in this case, especially given the short timeframe of the SN-CRAC process. Therefore, given the magnitude of the changes necessary to move from 5.6 to any of the 6.X versions, we are comfortable enough with the version of the model to accept BPA's continued use at this time." Bliven, *et al*., SN-03-E-JC-01, at 32-33. Thus, PNGC and PPC/IEA's argument that BPA's AURORA model is outdated was not pursued by the Joint Customers themselves.

PNGC and PPC/IEA also argue that BPA's AURORA model contained flaws and produced a flawed forecast of secondary energy revenues. PNGC Brief, SN-03-B-PN-01, at 2-3, and PPC/IEA Brief, SN-03-B-PP-01, at 10-11, citing Bliven, *et al*., SN-03-E-JC-01, at 28-46. This argument also lacks merit. BPA does not agree that BPA is using an out of date, default database. Oliver, *et al*., SN-03-E-BPA-14, at 3. In data response BPA-JC-004, the Joint Customers state that they did not perform an analysis comparing the database that BPA used in the initial proposal and the "dated" version of the database supplied by the vendor. *Id*., citing Attachment A. BPA, in fact, updated the resources in the default database. *Id*. BPA, however, reviewed the Joint Customers' data and adopted several legitimate changes identified by the Joint Customers that BPA now proposes to make in its AURORA database for purposes of running the final case. *Id*. There are over 100,000 inputs that feed into the AURORA model. *See* Documentation for SN-03 Study, SN-03-E-BPA-02, Vol. 2. BPA acted reasonably to keep those inputs as current as possible. Oliver, *et al*., SN-03-E-BPA-14, at 15. The Joint Customers identified only a small number (approximately 20) they believe BPA should change. Bliven,

et al., SN-03-E-JC-01, at 28-46. Although BPA proposes to update some of its resource files for the Final Proposal, the Joint Customers have not demonstrated that updating data renders BPA's forecast irrational. *Id*. BPA's forecast is reasonable. *Id*.

Recently Updated Information. NRU argues that the Joint Customers' analysis of BPA's Treasury risk was performed before the Joint Customers had knowledge of a number of other factors that work in favor of improved financial performance for BPA in 2003 and 2004. NRU Brief, SN-03-B-NR-01, at 3. NRU argues that, as discussed in the PPC/IEA's initial brief, these include the recently announced Enron settlement, a five percent higher projection of run-off than was assumed in the Joint Customer testimony and a nineteen percent higher runoff than assumed in BPA's initial proposal. *Id*. NRU argues that all of these factors contribute to a much higher probability of Treasury payment in 2003 and 2004 than in BPA's initial proposal. *Id*. at 4. NRU argues that the tariff conditions for triggering the SN CRAC adjustment have not been satisfied. *Id*. NRU argues that in light of the new evidence since the initial proposal, the Administrator should not trigger SN CRAC in FY 2004. *Id*. The IOUs similarly argue that because BPA has newer information than when BPA made the trigger determination, the SN CRAC should not have triggered. IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 10.

As noted previously, the trigger determination precedes the beginning of BPA's section 7(i) hearing. The Administrator's trigger determination was simply a determination that BPA would hold a hearing to evaluate whether or not to implement an SN CRAC. The Administrator's determination to trigger the SN CRAC process must be made at a specific time. Keep, *et al*., SN-03-E-BPA-11, at 43. The trigger determination does not establish or require the implementation of an SN CRAC. *Id*. Instead, it simply begins a process in which BPA must determine whether to implement an SN CRAC and, if so, the extent of that SN CRAC. *Id*. The fact that costs, revenues, water or prices may change over time does not affect the trigger determination, but instead is considered in determining whether an SN CRAC should be implemented and, if so, the level of such a CRAC. *Id*. The Enron settlement did not exist at the time the Administrator determined that the section 7(i) process had triggered. *Id*. at 18. By definition, recent runoff forecasts also did not exist at the time the Administrator determined that the section 7(i) process had triggered.

Decision 2

The Administrator's determination to trigger the SN CRAC process was the first phase of BPA's SN CRAC ratemaking process and preceded BPA's SN-03 evidentiary hearing. The trigger determination was not based on the record of a formal evidentiary proceeding but rather on documentation that preceded the evidentiary hearing. As discussed above, the Administrator's decision to trigger the SN CRAC process was eminently reasonable.

3.2 Rate Lock Provision

Issue 1

Whether the "rate lock" provision in Canby's contract precludes the application of the SN CRAC.

Parties' Positions

Canby contends that section 12(b) of its contract with BPA does not allow BPA to revise rates pursuant to successor GRSPs, and thus, must not impose the SN CRAC on Canby. Canby Brief, SN-03-B-CA-01, at 3; Canby Ex. Brief, SN-03-R-CA-01, at 5. BPA has now proposed amended or changed GRSPs in this proceeding. Canby Ex. Brief, SN-03-R-CA-01, at 6. BPA cannot now try to prevent Canby from responding to revisions adopted by BPA itself. *Id.* The new GRSPs contained in Appendix A of the draft ROD speak for themselves. *Id*. at 7. They are the successors to what was adopted in 2001 as part of the Supplemental ROD. *Id*.

BPA's Position

Canby raised this issue when BPA supplemented its May 2000 rate filing and is precluded by the scope of this proceeding from revisiting the appropriateness or reasonableness of BPA's decisions in the WP-02 rate hearing. Notwithstanding BPA's objection, BPA is neither revising nor promulgating successor GRSPs in this proceeding, and thus, may impose the SN CRAC on Canby as provided under Canby's contract.

Evaluation of Positions

Canby argues that section 12(b) of its power sale contract with BPA does not include the language "or successor GRSPs." Canby Brief, SN-03-B-CA-01, at 5. Canby contends that its power sales contract does not authorize BPA to impose rate changes, pursuant to successor GRSPs. Canby Ex. Brief, SN-03-R-CA-01, at 7. Canby contends that BPA, in triggering the SN CRAC, has proposed the adoption of revised or successor GRSPs. *Id*. Canby claims that this is "precisely" what BPA said it would not do in the 2001 Supplemental ROD. *Id*., citing 68 Fed. Reg 12053-54 (March 13, 2003) and GRSPs, SN-03-E-BPA-03. Canby argues "[t]he revised GRSPs contain specific formulas for calculating the SN CRAC; they are successors to those published in the 2001 proceeding. Canby therefore requests that BPA reevaluate its position. It must exempt Canby and other entities (if any) whose rates may not be adjusted pursuant to successor GRSPs." *Id*. at 6.

As BPA pointed out in its 2002 Supplemental Power Rate Proposal, Administrator's Record of Decision, WP-02-A-09, "Canby's argument is premised on the faulty assumption that by adjusting the LB CRAC or triggering the SN CRAC during the rate period, BPA is resetting rates in violation of this contract provision." *Id*. at 9-27. Canby now argues, incorrectly, that setting the SN CRAC is a revision to the existing GRSPs with successor GRSPs. BPA is not revising or replacing its 2002 wholesale power rate schedules with successor GRSPs. To the contrary, BPA is implementing the provisions in the GRSPs that pertain to the SN CRAC. As

the WP-02 Supplemental ROD stated, "[t]he CRACs allow BPA to make adjustments to the base rate levels to address specific problems. When each of the CRACs is triggered, the adjustment to base rates from the application of the CRACs will be the result of implementing the provisions in the GRSPs." *Id*. at 27-28. The SN CRAC is one of three adjustment clause provisions under the GRSPs. It is the only CRAC that must be implemented through establishment of a formula that modifies the FB CRAC parameters in a hearing held pursuant to section 7(i) of the Northwest Power Act. In contrast, a revision to the GRSPs with successor GRSPs requires sweeping changes, i.e., replacement of all existing GRSPs with new GRSPs. As BPA witnesses testified:

> As provided in Section II.F.3 of BPA's 2002 General Rate Schedule Provisions (GRSPs), the SN CRAC enables BPA to implement an upward adjustment to posted power rates that are subject to the FB CRAC by modifying the FB CRAC parameters. With this SN CRAC proposal, BPA is proposing changes to the FB CRAC parameters that, to the extent market and other risk factors allow, will achieve a high probability that the remainder of Treasury payments during the FY 2002-2006 rate period will be made in full. BPA's proposal includes, consistent with the GRSPs, changes to the Maximum Planned Recovery Amount (the amount of revenues planned to be recovered), the duration (the length of time the SN CRAC would be in place, which can be more than 1 year), and the timing of collection.

Keep, *et al*., SN-03-E-BPA-04, at 2.

Canby further argues that two years ago, BPA argued that it would not revise or change the GRSPs in subsequent years, and that it would implement the SN CRAC based on the 2002 GRSPs, "as written at the time." Canby Ex. Brief, SN-03-R-CA-01, at 5. Canby contends that it never argued that BPA was revising or amending all of the GRSPs. *Id*. at 6. Canby claims that it argued that BPA was publishing successor GRSPs that allowed it to design and then impose an SN CRAC rate surcharge. *Id*. at 6-7.

BPA is not persuaded by Canby's arguments. The plain language of the 2002 GRSPs pertaining to the SN CRAC, Section II.F.3, at page 115, demonstrates that *implementation* of the SN CRAC is not a revision to the existing 2002 GRSPs with successor GRSPs: "The SN CRAC will be an upward adjustment to posted power rates subject to the FB CRAC by *modifying* the FB CRAC parameters. BPA will propose *changes* to the FB CRAC parameters . . . ." Consistent with this language, BPA has proposed changes to the FB CRAC parameters that modify the FB CRAC vis-à-vis implementation of the SN CRAC. The language of the 2002 GRSPs states that BPA will propose changes to the FB CRAC parameters to achieve a high probability that the remainder of Treasury payments will be made in full. Such changes could include the Revenue Amount, the duration, and the timing of collection. *See* 2002 Supplemental Power Rate Proposal, Administrator's Record of Decision, WP-02-A-09, 9-27.

Decision 1

The "rate lock" provision in Canby's contract does not preclude the application of the SN CRAC to Canby.

3.3 Evidence of Financial Improvement

Issue 1

Whether BPA improperly attempted to keep evidence of its financial improvement out of the record based on the argument that the BPA panel was not prepared to be cross-examined on a particular document.

Parties' Positions

Golden Northwest contends that BPA, in its rebuttal testimony, claimed a net revenue loss of $191 million in FY 2003, but that BPA's FY 2003 Second Quarter Review showed an equivalent net revenue loss of only $87.8 million for FY 2003, a $104 million improvement. Golden Northwest Brief, SN-03-B-GN-01, at 7. Golden Northwest argues BPA "tried mightily" to keep the simple fact of this "huge discrepancy" out of the record, "based on the phony argument that the BPA panel was not prepared" to be cross-examined on a particular document. *Id*.

In its brief on exceptions, Golden Northwest contends that staff appears to propose that the Administrator overrule the Hearing Officer's decision to permit a response to the question: "And what is Bonneville's current view for what the equivalent number is going to be for FY 2003 [for the negative $191 million in FY 2003 Net revenues shown on E-BPA-11F and sponsored by the witness]?" Golden Northwest Ex. Brief, SN-03-R-GN-01, at 5-6.

BPA's Position

BPA has made no secret of financial improvements during this SN CRAC hearing and has testified throughout this proceeding to such matters. BPA is reflecting improvements in its financial health; however, it is not fair to subject a party's witnesses to cross-examination on documents received into evidence without prior notice of the introduction of such documents. The Administrator has not proposed to overrule the Hearing Officer's decision to permit a response to properly introduced exhibits in this proceeding.

Evaluation of Positions

Golden Northwest contends BPA tried "mightily" to keep a "simple" fact (an alleged $104 million improvement) based on "the phony argument" that the BPA panel was not prepared to be cross-examined on a particular document that was "referred to in passing to assist the panel in refreshing recollection—if necessary," by counsel for Golden Northwest. Golden Northwest Brief, SN-03-B-GN-01, at 7. Golden Northwest posed the following question to BPA's witnesses:

> Q: And what is Bonneville's current view of what the equivalent number is going be for FY-2003? And if it helps to refresh your recollection, I would point to the second quarter review that was introduced this morning by ICNU as E-IN-06, page 3?

Tr. at 93. Golden Northwest states the question "provoked a blizzard of objections and false accusations of collusion and sandbagging from BPA counsel." *Id*. BPA counsel objected on the grounds that the referenced document had been introduced into evidence with certain stipulations. The transcript of cross-examination shows that counsel for ICNU and counsel for BPA agreed to the introduction of six exhibits subject only to both parties agreeing to waive cross-examination of each other's witnesses. Tr. at 9. In doing so, BPA's witnesses had not been given advance notice of the Exhibit E-IN-06 being introduced—the stipulation being they would not be cross-examined on it.

Although Golden Northwest's counsel contends he was referring to the exhibit merely to refresh the witnesses' recollection, s*ee* Tr. at 93; Golden Northwest, SN-03-B-GN-01, at 7; Ex. Brief, SN-03-R-GN-01, at 6, the transcript reveals an intent by Golden Northwest's counsel to cross-examine BPA witnesses on Exhibit E-IN-06. In its brief on exceptions, Golden Northwest claims that the cross-examiner was not questioning the witness about E-IN-06, but rather, Golden Northwest contends, the question solely asked the witness for an update to Exhibit E-BPA-11F, which had been sponsored by the witness. Golden Northwest contends that staff appears to propose that the Administrator overrule the Hearing Officer's decision to permit a response to the question. *Id*.

BPA did not propose in its draft decision, nor in this final decision, that the Administrator overrule the Hearing Officer's decision to permit a response to the question pertaining to attachment E-BPA-11F. Counsel for Golden Northwest asked:

> Q. With respect to the 920 million, at one of the rate case workshops a rather large document was handed out which shows PBL net revenues year by year for the period '02 through '06, and the net revenue amount shown was there was 920 million, 948. Is that the same 920 million that you were discussing with . . .?"

Tr. 92. BPA counsel raised an objection concerning service of cross-examination exhibits, stating his belief that BPA witnesses had not been properly served. *Id*. Golden Northwest's counsel responded that the document was Attachment 11-F to the BPA panel's rebuttal testimony. *Id*. BPA counsel then withdrew his objection and BPA's witness proceeded to answer the question posed by Golden Northwest's counsel. *Id*. at 93.

In its brief on exceptions, Golden Northwest contends that it is a mischaracterization on BPA's part to conclude there was some sort of "inchoate intent" to question the witness about Exhibit E-IN-06. Golden Northwest contends that its counsel made remarks to refute the false accusations of collusion and sandbagging. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 7. Golden Northwest states that such allegations of collusion and sandbagging should not be

endorsed in the final Record of Decision because there was no collusion or sandbagging, nor any basis for BPA counsel to assume that there had been. *Id.*

Golden Northwest counsel stated he was aware that the document was going to be introduced into evidence, but that he did not participate in nor was he aware of any agreements that Golden Northwest could not cross-examine on it. Tr. at 95. When asked by the Hearing Officer why he did not offer the document himself, Golden Northwest counsel stated it seemed duplicative. *Id.* Golden Northwest counsel stated, "I discussed with my colleague . . . my desire to have this particular document in the record, and [he] informed me that that would be unnecessary because [counsel for ICNU] was going to put it in the record, and therefore, in reliance on that, I didn't bother to file as a second separate question." Tr. at 98. When given the opportunity by the Hearing Officer at the outset of cross-examination to comment on the introduction of exhibits by ICNU and the agreement between BPA and ICNU to waive cross-examination of each other's witnesses, Golden Northwest counsel was silent.

BPA does not endorse allegations of sandbagging or collusion. The record of the transcript speaks for itself. This record of decision does not attempt to sort, judge or discern the parties' underlying motivations for remarks made during cross-examination, and thus, makes no endorsement of allegations made by counsel for BPA. Such allegations, whether right or wrong, simply have no substantive bearing on the issues or decisions made in this proceeding.

Golden Northwest contends that BPA staff is arguing that the Rules of Practice should be interpreted after the fact to expand the stipulation that BPA counsel expressly recognized as being between BPA and ICNU to bind all parties making up the Coalition Customers. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 8. BPA makes no such argument and reaches no such conclusion.

Golden Northwest argues that it did not agree to waive cross-examination by virtue of the fact that ICNU did so waive. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 8. Golden Northwest contends that it did so in accordance with the rule that grouping will be without derogation to the right of any party to represent a separate point of view where its position differs from that of the group in which it is participating. *Id.* Golden Northwest also claims that staff's position would discourage parties with common interests from ever making any joint presentation because they might thereby be bound by agreement to which they are not parties and of which they had no knowledge. *Id.*

BPA's Procedures encourage the grouping of parties with common interests and positions. Many parties grouped together to forge common interest-based testimony, including ICNU and Golden Northwest joining together as part of the Coalition Customers. Tr. at 98. The witnesses providing testimony on behalf of a group represents the interests of that group. BPA's Special Rules of Practice provide:

> Parties with common interests or positions in these proceedings should group themselves to make a joint presentation including oral representation, presentation of evidence, cross-examination, and briefing. Such grouping will be without

> derogation to the right of any party to represent a separate point of view where its position differs from that of the group in which it is participating.

Order, SN-03-O-01, at 1. Under this rule it was reasonable for BPA counsel to assume that the stipulation not to cross-examine BPA's witnesses on the exhibits introduced by ICNU would bind all parties making up the Coalition Customers, including Golden Northwest. ICNU counsel stated he represented ICNU yet he waived his right to cross-examine BPA's witnesses directly on the basis that the Coalition Customers' witnesses would not be cross-examined by BPA. Tr. At 8-9.

BPA notes the rule to show that it is unfair for parties to form into a group and to be represented by such group for purposes of direct and rebuttal testimony, and then dissolve one's participation in the group when it is convenient to do so. This is particularly true when parties are agreeing to give up rights to cross-examine each other's witnesses. The special rule on grouping is intended to avoid the unnecessary confusion that occurs when grouped parties decide to disengage, unless for differences in position. An example of such confusion is evident from the Hearing Officer's following comments.

> Hearing Officer: It's difficult to get a sense of the level of prejudice the witnesses are going to have with respect to the procedure. And I'd like to keep the procedures sacrosanct in order to keep them from being undercut by procedural tactical maneuvering by various parties, whether it's permissible or impermissible. I'm somewhat disturbed by the fact that you have two parties that seem to have parallel interest, where one will agree to waive, and then the other one will not. And then one party with a parallel interest will utilize the fact that he didn't, when the other party did.

Tr. at 96-97. It is not fair to subject a party's witnesses to cross-examination on documents received into evidence without prior notice of the introduction of such documents. Further, parties that group for purposes of presenting their case should remain grouped throughout the proceeding, except when a party wishes to represent a separate point of view because its position differs from that of the group in which it is participating, as prescribed in BPA's Special Rules of Practice. Confusion is created when parties disengage mid-stream during the hearing process. Other litigants are then at a loss to discern which party has authority to waive rights and agree to stipulations, including parties formerly grouped with one another. BPA does not agree with Golden Northwest's contention that parties will be discouraged from making joint presentations. To the contrary, it is reasonable to believe that parties sharing common interests will group and, if they hold some separate views, represent separate points of view as allowed under the rules.

Decision 1

BPA properly objected to questions asked of BPA witnesses on the basis that the BPA panel was not prepared to be cross-examined on a particular document and BPA did not improperly attempt to keep evidence of its financial improvement out of the record.

Issue 2

Whether BPA inappropriately sought to forbid, and the Hearing Officer erroneously foreclosed, cross-examination to identify the current state of BPA's financial position.

Parties' Positions

Golden Northwest contends that BPA inappropriately sought to forbid, and the Hearing Officer erroneously foreclosed, cross-examination to identify the current state of BPA's financial position. Golden Northwest Brief, SN-03-B-GN-01, at 9.

BPA's Position

BPA properly objected to Golden Northwest's attempt to cross-examine BPA's witnesses on matters discussed separately in settlement negotiations and which were not properly introduced into evidence.

Evaluation of Positions

Golden Northwest quotes an exchange between the Hearing Officer, Golden Northwest's counsel, and BPA's counsel relating to whether or not certain information regarding BPA's financial position should be elicited from BPA's witnesses by counsel for Golden Northwest. Golden Northwest Brief, SN-03-B-GN-01, at 9-10. Golden Northwest claims the ruling was incomprehensible and erroneous. *Id*. at 10. Golden Northwest states that the question posed by Golden Northwest's counsel did not request any description of conduct or statements made during settlement discussions. *Id*. Golden Northwest says it requested factual information regarding BPA's current view of its financial condition. *Id*. Golden Northwest contends that it was entirely appropriate to ask BPA to disclose for the record its present forecast of any net improvement. *Id*. Golden Northwest contends that BPA objected to the question: "What is the total expected improvements [i.e., for the entire rate period] as Bonneville sees it now as compared to the time at which Table F-11 was prepared?" Golden Northwest Ex. Brief, SN-03-R-GN-01, at 8, quoting Tr. 106. Golden Northwest argues that staff defends the Hearing Officer's refusal to permit a response to this question without addressing the substance of the question at all, that "[s]taff's diatribe about the magnitude of BPA's net interest income as wholly without merit."

In this case, Golden Northwest counsel learned of a number regarding BPA's financial improvement in settlement discussions between BPA and the rate case parties. Golden Northwest argues that the question posed did not request any description of conduct or statements made during settlement discussions and thus did fall under Rule 408 of the Federal Rules of Evidence. *Id*. at 10. Golden Northwest contends its question was relevant, requested discoverable data, and was not privileged. *Id*. Golden Northwest claims it was error to forbid the witness from responding and that it was unseemly for staff to seek to exclude such information from the record. *Id*.

BPA counsel raised a concern that there might have been an issue of confidentiality in the vein of Federal Rule of Evidence 408 regarding settlement discussions. Tr. at 105. This concern was raised to prevent BPA witnesses from violating any applicable confidentiality terms by discussing items raised during settlement discussions. *Id*. BPA counsel stated, "Ms. Leathley presented a number of financial scenarios, one of which may or may not be what [Golden Northwest counsel] is discussing. To the extent he is probing into this area, it's directly related to the matter we discussed yesterday [in settlement discussions]." *Id*. at 106. While Golden Northwest contends that it should have been allowed to question BPA's witness on this matter, BPA's witnesses did not introduce the number into evidence in the rate hearing. Rather, without laying any foundation to ask the witness about her knowledge of the number, Golden Northwest's counsel asked a question:

> Q. Have you estimated the positive interest effects to be as much as $100 million for the remainder of the rate period . . .

Tr. at 103. The witness' eventual answer was:

> A. I can't, right now, represent whether or not that figure is 100 million or – because it could easily be plus or minus some figure. We haven't run the final studies yet. That number can vary widely, but I would expect to the degree that we have greater revenue coming in the door relative to negative revenue of the 920, then we would have a positive benefit of interest.

Tr. at 104. Not satisfied, Golden Northwest counsel asked the same question of whether the witness herself had estimated the number to be in the range of $100 million. Tr. at 105. Again, the witness answered no. *Id*. Golden Northwest counsel then attempted to ask the witness whether any BPA staff member had given her the $100 million number. *Id*.

It is clear that BPA's witnesses did not testify or introduce the $100 million number counsel for Golden Northwest sought to explore. Rather, it was counsel for Golden Northwest who suggested the number. In its brief on exceptions, Golden Northwest contends that the $100 million figure is irrelevant to the question at issue, i.e., the total magnitude of BPA's expected negative net income for the rate period at the time the witness took the stand. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 10. Golden Northwest argues that the record now reflects only that the critical cost and revenue data offered in evidence by BPA was known by BPA to be stale and obsolete when offered and that BPA does not, in any event, intend to rely on it in crafting the SN CRAC. Golden Northwest Brief, SN-03-B-GN-01, at 10. Although BPA does not agree with Golden Northwest's characterization that BPA cost and revenue evidence was stale and obsolete, BPA will update its costs based on financial improvements when establishing the SN CRAC. *See* Chapter 2.7, *supra*. The variable nature of the design proposed in BPA's initial proposal will respond to both positive and negative events that impact revenues and costs, once they have occurred. McCoy, *et al*., SN-03-E-BPA-17, at 5.

In its brief on exceptions, Golden Northwest argues that it was error for the Hearing Officer to forbid questioning concerning changes to BPA's financial estimates, particularly after its witnesses had acknowledged the existence of such changes. Golden Northwest Ex. Brief,

SN-03-R-GN-01, at 10. Golden Northwest states, "[t]he baseless objections advanced by Staff then and now to disclosing the changes in BPA's financial position should not be endorsed in the final Record of Decision." *Id*.

Golden Northwest obfuscates the issue by more or less claiming that the question it posed was straightforward. The transcript of cross-examination demonstrates that the question was anything but straightforward. The Hearing Officer appropriately presided over the dynamic and lively exchange between counsel during the cross-examination. The numbers Golden Northwest sought to ask questions about are in the record, including the most recent numbers reflecting BPA's financial improvement, as reflected in the final studies. Golden Northwest concludes in its brief on exceptions that "BPA acknowledges substantial improvements in its own financial position. . . , Golden Northwest accepts BPA's statement that the improvement is very significant." Golden Northwest Ex. Brief, SN-03-R-GN-01, at 14.

Decision 2

BPA did not inappropriately seek to forbid, and the Hearing Officer did not erroneously foreclose, cross-examination to identify the current state of BPA's financial position.

3.4 Hearing Officer's Order Striking NEPA Testimony

Issue 1

Whether the Hearing Officer properly excluded from the evidentiary record GPU's testimony regarding BPA's ongoing SN-03 NEPA review, which is being conducted in a separate public process.

Parties' Positions

GPU argues the Hearing Officer should not have excluded GPU's testimony regarding whether BPA had complied with the National Environmental Policy Act (NEPA) from the administrative record because the Northwest Power Act requires BPA to allow any person to refute or rebut any material submitted by any other person or the Administrator, and requires that BPA include any information submitted by any person, including parties, in the administrative record. GPU Brief, SN-03-B-GP-01, at 15-17; GPU Ex. Brief, SN-03-R-GP-01, at 17.

BPA's Position

BPA develops wholesale power rates in formal evidentiary hearings conducted in accordance with section 7(i) of the Northwest Power Act. 16 U.S.C. § 839e(i). BPA, however, conducts environmental review of its ratemaking actions separately under NEPA, 42 U.S.C. § 4321-4347. BPA Motion, SN-03-M-02. BPA is currently conducting a separate public process on NEPA review of BPA's SN-03 rate proposal. *Id*. BPA's separate NEPA review will be included as part of the administrative record supporting the Administrator's SN CRAC proposal. *See* "Bonneville Power Administration's Proposed Safety-Net Cost Recovery Adjustment Clause

Adjustment to 2002 Wholesale Power Rates, BPA File No: SN-03," 68 Fed. Reg. 12048, 12052 (2003).

Evaluation of Positions

GPU submitted direct testimony responding to a statement regarding BPA's planned approach to NEPA compliance that was contained in BPA's March 2003 Federal Register Notice. Lovely, *et al.*, SN-03-E-GP-01. The Federal Register notice announced BPA's intent to proceed with a formal evidentiary hearing for the proposed SN CRAC rate adjustment. GPU's testimony argued that BPA had not conducted any NEPA analysis and that the scope of the 1995 Business Plan EIS did not encompass the level of the proposed SN CRAC rate adjustment or the potential impacts stemming from the rate proposal. *Id*. BPA moved to strike the testimony and associated exhibits from the evidentiary record of the section 7(i) rate hearing on April 23, 2003. BPA Motion, SN-03-M-02. GPU filed an Answer on April 29, 2003. GPU Response, SN-03-M-13. On May 2, 2003, the Hearing Officer granted BPA's motion to strike that portion of GPU's direct testimony concerning the issue of BPA's compliance with NEPA from the evidentiary record. Order, SN-03-M-09.

In its motion to strike, BPA noted that the cited testimony, entitled "Compliance with the National Environmental Policy Act," was outside the scope of issues to be litigated in the SN-03 proceeding. BPA Motion, SN-03-M-02, at 1. BPA develops wholesale power rates in formal evidentiary hearings conducted in accordance with section 7(i) of the Northwest Power Act. *Id.*; 16 U.S.C. § 839e(i). BPA, however, conducts environmental review of its ratemaking actions (under NEPA and implementing regulations) *separately* from but parallel to BPA's formal evidentiary hearing. 42 U.S.C. § 4321-4347; *see also* 40 C.F.R. § 1500-1508; 10 C.F.R. §1021. Indeed, for the instant proceeding, BPA initiated its separate consideration of possible appropriate NEPA compliance documentation for the rate proposal *before* the section 7(i) rate hearing process was announced in the Federal Register. BPA Motion, SN-03-M-02, at 2, citing 68 Fed. Reg. at 12052 (stating that "BPA *is in the process* of assessing the potential environmental effects of this proposed rate adjustment, consistent with the requirements of [NEPA] and its implementing regulations.") (emphasis added).

BPA also noted it is not required by the Northwest Power Act, NEPA, or the NEPA regulations to conduct NEPA reviews of proposed ratemaking actions as part of the formal evidentiary section 7(i) rate hearing. BPA Motion, SN-03-M-02, at 2, citing 16 U.S.C. § 839e(i). BPA's NEPA review process thus occurs *parallel* to BPA's rate development hearings, not within the formal hearings. BPA Motion, SN-03-M-02, at 2.

BPA also noted that inclusion of NEPA review in the formal hearing process would be contrary to the manner in which environmental review under NEPA must occur. *Id*. For example, only parties granted intervention in the formal hearing may raise substantive issues regarding BPA's rate development in that hearing. *Id*., citing "Procedures Governing Bonneville Power Administration (BPA) Rate Hearings," Section 1010.4(e), 51 Fed. Reg. 5,611 (1986). The review of NEPA issues in the formal hearing therefore would limit such review to a small number of parties. BPA Motion, SN-03-M-02, at 2. One of the primary purposes of NEPA, however, is to foster public participation in agency actions, rather than limit such participation.

Id., citing *Trout Unlimited v. Morton*, 509 F.2d 1276, 1282 (9th Cir. 1974) (stating that one of the purposes to be served by NEPA documentation is to "provide the public with information on the environmental impact of a proposed project as well as encourage public participation in the development of that information"); *see also* 40 C.F.R. § 1506.6 (requiring agencies to use appropriate measures to involve the public in its decision-making under NEPA). If NEPA review of BPA's SN-03 rate proposal were conducted through the formal section 7(i) rate hearing and its restricted public participation, BPA would run afoul of NEPA's public involvement directive. BPA Motion, SN-03-M-02, at 3. BPA thus argued that GPU's concerns about BPA's compliance with NEPA for this rate proposal are not appropriately addressed in the formal section 7(i) rate hearing, but rather are best suited for consideration in the ongoing parallel NEPA process BPA is conducting for the SN-03 rate proposal. *Id*. BPA also noted that GPU's stricken testimony would be provided to BPA's NEPA staff conducting the environmental review of BPA's SN CRAC rate proposal, thus assuring that the testimony would not be ignored. *Id*. Indeed, this testimony was provided to BPA's NEPA staff for consideration in BPA's separate but concurrent NEPA review.

In granting BPA's motion to strike, the Hearing Officer stated:

> In the Notice, BPA states that "An initial review of this proposed rate adjustment indicates that it is consistent with these aspects of the Market-Driven Alternative. This rate proposal ... thus would not be expected to result in significantly different environmental impacts from those examined for the Market-Driven alternative in the Business Plan ... Therefore, BPA expects that this rate proposal will fall within the scope of the Market-Driven Alternative that was evaluated in the Final Business Plan EIS." It is essentially these statements that GPU sought to rebut with its testimony.
>
> BPA's assertions were, however, not made in sworn testimony to be given weight in the decision-making process associated with this proceeding, but rather as a means to provide the public with its current opinion as to how the separate proceeding would be affected by the outcome of the SN-03 CRAC.
>
> …
>
> BPA, by its Motion, asserts on the record that the NEPA review is in progress. …

Order, SN-03-M-09, at 2. GPU argues that section 7(i)(2) of the Northwest Power Act requires BPA and the Hearing Officer to allow any person to refute or rebut "any material submitted by any other person or the Administrator." GPU Brief, SN-03-B-GP-01, at 16, citing 16 U.S.C. § 839e(i)(2)(A). GPU argues Section 1010.11(a) BPA's Rules of Procedure Governing BPA Rate Hearings also provides that "[p]arties shall be provided an adequate opportunity to offer refutation or rebuttal on any material submitted by any other party or by BPA." *Id*.; GPU Ex. Brief, SN-03-R-GP-01, at 17. GPU argues the Federal Register Notice is part of the materials BPA submits to justify and support its rate proposal. GPU Brief, SN-03-B-GP-01, at 16, citing 16 U.S.C. § 839e(i)(1). GPU argues BPA also has included the Federal Register Notice in the administrative record. *Id*.

GPU misconstrues the role of the Federal Register Notice in this rate case, which gave public notice of BPA's proposed SN CRAC rate adjustment and announced that BPA would be conducting a section 7(i) rate hearing. 68 Fed. Reg. at 12048. The Notice expressly recognized that BPA initiated a separate consideration of possible appropriate NEPA compliance documentation for the rate proposal *before* the formal section 7(i) rate hearing process was announced in the Federal Register. The Notice states "BPA *is in the process* of assessing the potential environmental effects of this proposed rate adjustment, consistent with the requirements of [NEPA] and its implementing regulations." (Emphasis added). BPA Motion, SN-03-M-02, at 2, citing 68 Fed. Reg. at 12052. As the Hearing Officer correctly recognized, the portion of the Notice concerning NEPA compliance was merely "a means to provide the public with [BPA's] current opinion" as to how BPA intended to conduct its separate NEPA process for the proposed rate adjustment. Order, SN-03-M-09, at 2. Because the Notice simply and briefly notes that BPA is conducting a separate environmental review, and states the status of that review, the Notice does not constitute material submitted by BPA to justify and support its rate proposal. Furthermore, not all material is developed in the formal evidentiary proceeding. Section 7(i)(3) of the Northwest Power Act provides "[i]n addition to the opportunity to submit oral and written material at the hearings, any written views, data, questions, and arguments submitted by persons prior to, or before the close of, hearings shall be made a part of the administrative record." 16 U.S.C. § 839e(i)(3). GPU has not been deprived of an opportunity to offer refutation or rebuttal of BPA's environmental review, because GPU's testimony regarding NEPA and GPU's brief regarding NEPA were provided to BPA's staff conducting the environmental review and have been included in the administrative record.

GPU argues BPA's statements regarding NEPA compliance in the Federal Register Notice are not mere notices to the public as to how a separate proceeding would be affected by the outcome of this rate proceeding. GPU Brief, SN-03-B-GP-01, at 16. GPU argues that they are clear statements as to BPA's determination that further NEPA compliance is not necessary. *Id*. GPU's argument is incorrect. GPU omits significant information that directly rebuts its claims. GPU failed to quote the whole passage of the Federal Register Notice regarding BPA's NEPA review. The notice states:

> BPA *is in the process* of assessing the potential environmental effects of this proposed rate adjustment, consistent with the requirements of the National Environmental Policy Act (NEPA) and its implementing regulations. In its Business Plan Final Environmental Impact Statement, DOE/EIS-0183, June 1995 (Business Plan EIS), BPA evaluated the environmental impacts of a range of business structure alternatives that included, among other things, various combinations of power pricing and rate designs for BPA's power rates. In addition, the Business Plan EIS identifies various response strategies, such as raising firm power rates, that could be implemented to address revenue shortfalls. In August 1995, the BPA Administrator issued a Record of Decision (Business Plan ROD) that adopted the Market-Driven Alternative from the Business Plan EIS. This alternative was selected because, among other reasons, it is the alternative that best allows BPA to: (1) recover costs through rates; (2) achieve

> strategic business objectives; (3) competitively market BPA's products and services; and (4) continue to meet BPA's legal mandates.
>
> An *initial review* of this proposed rate adjustment indicates that it is consistent with these aspects of the Market-Driven Alternative. This rate proposal would result in rate levels similar to those resulting from the rate designs evaluated in the Business Plan EIS, and thus would not be expected to result in significantly different environmental impacts from those examined for the Market-Driven Alternative in the Business Plan EIS. Furthermore, implementation of this rate proposal would be consistent with the response strategy of raising firm power rates to generate necessary revenues that was identified for all alternatives in the Business Plan EIS and Business Plan ROD. Therefore, *BPA expects* that this rate proposal will fall within the scope of the Market-Driven Alternative that was evaluated in the Final Business Plan EIS and adopted in the Business Plan ROD, and that BPA thus may tier its decision under NEPA for the proposed rate adjustment to the Business Plan ROD.

68 Fed. Reg. at 12052. (Emphasis added.) These statements note that at the time of the March 2003 Federal Register Notice, BPA was still in the process of evaluating the proposed rate adjustment under NEPA. Contrary to GPU's arguments, a plain reading of the notice shows that it is indeed merely advising the public that a separate public proceeding is reviewing the environmental issues regarding the SN-03 rate proposal. As noted above, the Hearing Officer recognized that the notice was merely an expression of BPA's then-current thinking on its NEPA compliance strategy for the proposed rate adjustment. Order, SN-03-M-09, at 2.

GPU also argues that the notice contains clear statements as to BPA's determination that further NEPA compliance is not necessary. GPU Brief, SN-03-B-GP-01, at 16. This argument is simply wrong. The notice states that BPA's "*initial review* of this proposed rate adjustment indicates that it is consistent with these aspects of the Market-Driven Alternative." (Emphasis added.) Similarly, the notice states "BPA *expects* that this rate proposal will fall within the scope of the Market-Driven Alternative that was evaluated in the Final Business Plan EIS and adopted in the Business Plan ROD, and that BPA thus may tier its decision under NEPA for the proposed rate adjustment to the Business Plan ROD." (Emphasis added.) This language demonstrates that BPA was in the process of conducting its review and unequivocally had *not* concluded "that further NEPA compliance is not necessary." In fact, in its parallel NEPA process, BPA has been reviewing all NEPA-related materials submitted by the public (including the parties) to determine if tiering a NEPA ROD for the SN CRAC proposal to the ROD for the Business Plan Final Environmental Impact Statement, DOE/EIS-0183, June 1995 (Business Plan EIS), is an appropriate manner for achieving NEPA compliance, in light of the comments and issues raised by the public and parties.

GPU also argues that, contrary to the Hearing Officer's decision regarding the exclusion of GPU's direct testimony, section 7(i)(2) does not make a distinction between sworn testimony and other types of materials submitted by BPA. GPU Brief, SN-03-B-GP-01, at 17. This argument misses the point. The Federal Register notice stated BPA was in the process of conducting its environmental review in a separate process from the section 7(i) rate hearing. 68

Fed. Reg. at 12052; BPA Motion, SN-03-M-02. BPA did not file testimony or studies or any other substantive material regarding BPA's environmental review because it is not a subject that is determined in a formal evidentiary rate hearing. Furthermore, GPU has been provided the opportunity to submit its comments regarding BPA's environmental review to BPA, and such comments are being reviewed in the separate environmental review process.

GPU notes that section 7(i)(3) of the Northwest Power Act provides that "[i]n addition to the opportunity to submit oral and written materials at the hearings, any written views, data, questions, and arguments submitted by persons prior to, or before the close of, hearings shall be made part of the administrative record." GPU Brief, SN-03-B-GP-01, at 17, citing 16 U.S.C. § 839e(i)(3); GPU Brief, SN-03-B-GP-01, at 16. GPU argues this statutory directive requires any information submitted by any person, including the parties, to be included in the administrative record. *Id*. GPU's argument is overstated. GPU is well aware that BPA is conducting a formal evidentiary hearing to implement BPA's SN CRAC, and that parties to the formal hearing cannot simply submit materials into the formal evidentiary record, but must follow the procedures governing the admission of evidence. As noted above, however, NEPA issues and comments submitted by GPU and other parties in the briefs and testimony, as well as comments received from the public, have been provided to BPA's NEPA staff to be considered and addressed as appropriate in the separate but concurrent NEPA review being conducted for this proposed rate adjustment. Although NEPA issues raised by GPU have properly not been made part of the *evidentiary* record for the section 7(i) rate hearings, these issues are part of the *administrative* record of BPA's environmental review and the general administrative record of BPA's SN-03 rate proceeding. As noted in section 7(i)(5) of the Northwest Power Act, the Administrator will make a final decision establishing rates based on the record, which includes "such other materials and information as may have been … developed by, the Administrator." 16 U.S.C. § 839e(i)(5).

Decision 1

The Hearing Officer correctly excluded GPU's testimony regarding BPA's compliance with NEPA from the formal evidentiary record. Such compliance is being reviewed in a separate public process. GPU's testimony is properly being considered in this separate process, and will be made a part of the administrative record.

3.5 Due Process Review of Previous Proceedings

Issue 1

Whether the Administrator denied parties due process by precluding the review of decisions previously made in BPA's WP-02 rate proceeding and the Financial Choices Process.

Parties' Positions

GPU argues that the Administrator improperly limited the scope of this proceeding in the Federal Register Notice by prohibiting parties from addressing several relevant topics. GPU Brief, SN-03-B-GP-01, at 13-14. GPU notes that BPA's Federal Register Notice precluded parties

from addressing or submitting evidence on four topics: (1) the appropriateness or reasonableness of BPA's decisions in the WP-02 rate proceeding; (2) the appropriateness or reasonableness of BPA's decisions in the TR-04 rate hearing; (3) the appropriateness or reasonableness of BPA's decisions in Financial Choices on spending levels, as included in PBL's test period revenue requirements for FY 2003-2006; and (4) the policy merits or wisdom of implementation of the Biological Opinion, or the related operations, assumptions, and program spending level forecasts included in BPA's rate proposal. *Id*.

GPU claims that BPA's decision to exclude its prior decisions in the WP-02 rate case and the Financial Choices Process was based upon the doctrine of collateral estoppel. *Id*. GPU argues that collateral estoppel only applies to relitigation of the same issue and is rarely invoked in the context of ratemaking. *Id*. GPU believes the decisions in the WP-02 rate proceeding and the Financial Choices Process are critical to the current SN CRAC proposal and exclusion of such issues is contrary to the Administrative Procedure Act. *Id*.

BPA's Position

Contrary to the implications of GPU's argument, BPA has routinely limited the scope of its rate proceedings through directions from the Administrator to the Hearing Officer to exclude particular matters from evidence. In BPA's WP-02 rate proceeding, the rate case parties were afforded full due process rights to litigate all issues regarding BPA's WP-02 rate development. BPA relied on these decisions in establishing BPA's power rates, which are pending final approval at FERC. The Financial Choices Process concerned BPA's spending levels and was not a ratemaking process.

Evaluation of Positions

GPU argues that the Administrator's decision to exclude matters related to the WP-02 rate proceeding and the Financial Choices Process from discussion in the SN CRAC proceeding constitutes a denial of due process. GPU Brief, SN-03-B-GP-01, at 13-14. GPU contends that the Administrator's decision to exclude reconsideration of the decisions in these processes is based upon collateral estoppel. *Id*. GPU contends that collateral estoppel and res judicata do not apply in an administrative law context. *Id.*

Although GPU fails to identify how excluding testimony in these areas violated due process rights, a due process analysis involves two separate legal issues. The first is whether any due process rights attach to BPA's actions. The second issue involves determining whether GPU was afforded due process. Because BPA's rate cases are akin to an administrative rulemaking, there is no question that due process attaches to the proceeding. Procedural due process requires a party the opportunity to be heard "at a meaningful time and in a meaningful manner." *Armstrong v. Manzo*, 380 U.S. 545 (1965). With regard to the WP-02 rate case, GPU was afforded both notice and an opportunity for a hearing on the issues. In the WP-02 proceeding, GPU filed direct and rebuttal testimony, briefed the issues, and made oral arguments to the Administrator. Currently, BPA's WP-02 rates are under review by FERC. If FERC grants final confirmation and approval to BPA's WP-02 rates, the rates will be subject to appeal in the United States Court of Appeals for the Ninth Circuit, where GPU will have another opportunity

to challenge decisions in the WP-02 proceeding. Due process provides a party notice and the opportunity to be heard. Contrary to the implications of GPU's argument, due process does not guarantee parties the right to relitigate matters.

The suggestion that parties should be able to relitigate matters decided in a previous rate proceeding makes little sense in the instant case. In the WP-02 proceeding, BPA established its base rates and also established three CRACs, including the SN CRAC. As noted above, these rates and adjustment clauses are currently pending final approval before FERC. The purpose of the SN CRAC proceeding is only to adjust the parameters of the FB CRAC. The purpose of the SN CRAC proceeding is *not* to establish new base rates. Therefore, there is no reason to revisit decisions made in the prior proceeding. By definition, BPA has used more current information in the development of its SN CRAC proposal than the earlier WP-02 proposal. This information has been subject to thorough review in the SN CRAC process.

Despite having a full and fair opportunity to comment on the WP-02 rate proposal, GPU maintains that foreclosing debate of the issues decided in WP-02 proceeding is a violation of its due process rights. It is difficult to gauge how GPU's rights were violated because GPU fails to identify any substantive evidence or issues it was prohibited from presenting by the Administrator's decision to limit the scope of this proceeding. GPU merely states "[m]any events and conditions have changed since the close of the WP-02 and Financial Choices processes. Additionally, the Administrator's current SN CRAC proposal demonstrates significant departures from policy decisions in those prior processes." GPU Brief, SN-03-B-GP-01, at 15. GPU provides no indication of what events or conditions have changed or what the significant departures from prior policy decisions were. Absent some understanding of how due process rights were violated, it is difficult to respond substantively.

GPU's own evidence in this proceeding, however, demonstrates that BPA did not preclude the introduction of evidence on changes in events and conditions. BPA merely prohibited parties from raising the same issues in the SN CRAC proceeding that had already been litigated and decided in the WP-02 proceeding. 68 Fed. Reg. 12048, at 12051. The bar on relitigating matters from the WP-02 proceeding related to the specific issues addressed in that proceeding. *Id.* For example, one issue discussed in the WP-02 proceeding involved the appropriate assumptions regarding the level of BPA's secondary revenues. GPU presented evidence in the SN-03 proceeding related to changed circumstances between the close of the WP-02 proceeding and the SN-03 Initial Proposal, arguing that BPA should recognize "higher revenues from surplus power sales resulting from the increase in stream flows that have occurred and are forecast to occur for the remainder of this fiscal year." Lovely, *et al.*, SN-03-E-BPA-01, at 4. BPA agreed with GPU on this issue. GPU's own evidence therefore shows that changed circumstances were part of the evidence in this SN-03 proceeding.

GPU maintains that BPA excluded testimony and evidence related to issues decided in the WP-02 proceeding based upon the doctrine collateral estoppel, which bars relitigation of matters previously decided. GPU cites *Borough of Lansdale, Pa. v. FPC*, 494 F2d.1104, 1115 n.45 (D.C. Cir. 1974) for the proposition that collateral estoppel does not apply generally in ratemaking proceedings. Collateral estoppel is now frequently referred to as "issue preclusion", which means a final decision of an administrative agency or court on an issue actually litigated

and determined is conclusive of that issue in any subsequent litigation involving a party from the first case, even on a different cause of action. *See Matter of Ellis*, 674 F.2d 1238, 1250 (9th Cir. 1982). GPU's conclusion regarding the application of collateral estoppel is misplaced. In the absence of statutory direction to the contrary, courts will apply *res judicata* and collateral estoppel to agency decisions. *United States v. Utah Construction & Mining Co.*, 387 U.S. 394, 422 (1966). In addition, *Borough of Lansdale* addressed the fairly narrow question of whether a rate schedule summarily rejected by the FPC should preclude refiling and reconsideration of the schedule in a subsequent proceeding. Reasoning that things change over time, the court found that the utility was not barred by *res judicata* from refiling the schedule because there may no longer be an identity of issues. *Borough of Lansdale,* at 1115.

The decision to preclude revisiting the decisions in the Financial Choices Process presents some distinct issues. Unlike the WP-02 proceeding, the Financial Choices Process was a public discussion of policy decisions related to cost cutting within BPA. *See United States v. Florida East Coast Railway Co.*, 410 US 224 (1973) (where no due process right to notice and opportunity to be heard necessary for across the board rate increase). The Financial Choices Process was not an administrative hearing like the WP-02 proceeding. In addition, the outcome of the process did not deprive anyone of a property or liberty interest protected under the Fourth Amendment. As a consequence, the Financial Choices Process did not raise any due process requirements for BPA.

Even assuming *arguendo* that there were some due process protections associated with the Financial Choices Process, BPA provided ample opportunity of notice and the ability to be heard. BPA initiated the process with a letter to the region and held a number of related workshops to weigh the alternatives involved in the decisions to cut, eliminate or defer particular expenses. Keep, *et al*., SN-03-E-BPA-04, at 8. BPA also solicited public comment from interested parties after the workshops and issued a close-out letter. *Id.* Therefore, to the extent that any due process right existed, BPA provided GPU and others notice and ample opportunity to participate and comment.

Finally, BPA has consistently precluded the establishment of program levels in BPA's section 7(i) ratemaking hearings. The establishment of BPA's program levels occurs in separate forums. For all program level issues raised in this proceeding, BPA hereby incorporates by reference BPA's discussion of this issue in its previous ratemaking proceedings. *See* 1993 Administrator's ROD, WP-93-A-02, at 319-329; BPA Motion, WP-93-M-12.

Decision 1

The Administrator did not deny parties due process by precluding parties from revisiting decisions made in BPA's WP-02 rate proceeding and the Financial Choices Process.

3.6 Hearing Officer's Order Striking Biological Opinion Testimony

Issue 1

Whether the Hearing Officer properly struck CRITFC's testimony regarding the funding and operational changes required to meet BPA's obligations under the Biological Opinion.

Parties' Positions

CRITFC contends the Hearing Officer improperly struck testimony related to the funding necessary to meet the obligations of the Biological Opinion. CRITFC Brief, SN-03-B-CR/YA-01, at 11. CRITFC testimony provided estimates of the likely costs of implementing the Biological Opinion and the Council's Fish and Wildlife Program. *Id*. CRITFC also contends the Hearing Officer erred when he struck testimony about operational assumptions related to the Biological Opinion. *Id.* at 22.

CRITFC maintains that BPA's Federal Register Notice and the Hearing Officer's decision are at odds with the statutory requirements of the Northwest Power Act. *Id.* at 13. CRITFC contends that section 7(i) of the Act requires the *any* material submitted by BPA or a party be made part of the record and that BPA cannot ignore testimony that is reasonably related to issues related to BPA's ability to cover its total system costs. *Id*. at 14.

BPA's Position

The Hearing Officer properly struck material from CRITFC's testimony because it was outside the scope of this proceeding.[1] The Federal Register Notice established the scope of this proceeding. "Proposed Safety-Net Cost Recovery Adjustment Clause Adjustment to 2002 Wholesale Power Rates," 68 Fed. Reg. 12048 (2003). The Administrator directed "the Hearing Officer to exclude from the record any material attempted to be submitted or arguments attempted to be made in the hearing which seek in any way to revisit the policy merits or wisdom of implementation of the Biological Opinion, or the related operations, assumptions, and program spending level forecasts included in BPA's rate proposal, as discussed above. *Id*. at 12051. The Implementation Plan and any subsequent modifications were and are developed through extensive public involvement and comment processes, and have been and will be adopted as policy pursuant to those separate procedures." *Id.*

The Administrator has the discretion to limit the scope of this proceeding and was well within his authority to exclude debate in the SN CRAC rate case over the appropriate cost levels to assume for compliance with the Biological Opinion.

[1] The three CRITFC motions for reconsideration are found at CRITC Brief, SN-03-B-CR/YA-01, at 11, 21, and 25. Because the Hearing Officer's decision to exclude the testimony in question involves the limitation on the scope of this proceeding by the Administrator related to fish and wildlife matters, to avoid repeating the same discussion three times, these three arguments are all dealt with in this issue.

Evaluation of Positions

CRITFC makes three separate but related requests for reconsideration of the Hearing Officer's decision to strike portions of its testimony. The requests raise two separate questions. The first question is whether the Administrator improperly limited the scope of this proceeding when he excluded from this proceeding material related to appropriate funding levels for compliance with the Biological Opinion. Second, if the Administrator was within his authority to limit the scope of this proceeding in this fashion, whether the Hearing Officer erred in striking the CRITFC testimony.

CRITFC contends the Administrator improperly limited the scope of this proceeding by excluding from the record testimony and exhibits related to the costs of implementing the Biological Opinion. CRITFC Brief, SN-03-B-CR/YA-01, at 14. CRITFC argues that absent vetting and debating these matters within the confines of a section 7(i) proceeding, BPA will ignore matters relevant to issues that affect its total system costs. *Id*. Implied by this argument is the notion that absent raising and debating these matters in a rate case, no debate will occur and, in CRITFC's opinion, BPA will underestimate the costs and operational limitations associated with the Biological Opinion. CRITFC also contends that it should be allowed to debate the wisdom of the operational assumptions made in light of the limitations of the Biological Opinion. *Id*. at 22.

The Administrator has traditionally set limits on the scope of BPA's section 7(i) rate hearings. In the WP-02 proceeding, similar to this case, the appropriateness or reasonableness of spending levels for fish and wildlife was excluded because, to the extent BPA would re-examine those assumptions, it would occur outside of the rate case. Similarly, in this proceeding it is not appropriate to debate assumptions regarding the funding and river operations necessary for compliance with the Biological Opinion. It is not necessary, practical or desirable to vet and debate every issue that has some impact on BPA's rates within the structured format of a rate case. BPA, the Council and other interested parties should be allowed a full and open debate about these matters unconstrained by the rigid legal formalities of the rate case. To the extent decisions are made in these separate forums, BPA imports those decisions into BPA's rate case assumptions. Questions related to the appropriate funding and operations for compliance with the Biological Opinion are debated before the Council and in other forums. Therefore, contrary to CRITFC's contention, BPA is not "categorically dismissing" these matters but rather is merely allowing the debate on these matters to occur with CRITFC and others outside the confines of the rate case, as they have always been.

Given that it is appropriate for the Administrator to limit the scope of this proceeding in the manner described, the issue arises whether the Hearing Officer properly struck CRITFC's testimony. CRITFC acknowledges that the stricken testimony involved "the funding required to meet the biological opinion." CRITFC Brief, SN-03-B-CR/YA-01, at 11. It further notes that "[t]he stricken testimony CRITFC and Yakama would have provided detailed estimates of the likely costs of implementing the Biological Opinions and Council Fish and Wildlife Program . . .." *Id.* Given CRITFC's admission that the purpose of its testimony addressed the matters specifically excluded in the Federal Register Notice, the Hearing Officer correctly struck the material.

CRITFC contends that section 7(i) of the Northwest Power Act requires that any material submitted by BPA or a party be made part of the record and that BPA cannot ignore testimony that is reasonably related to issues related to BPA's ability to cover its total system costs. CRITFC Brief, SN-03-B-CR/YA-01, at 14. CRITFC's argument is overstated. CRITFC is well aware that BPA is conducting a formal evidentiary hearing to implement BPA's SN CRAC, and that parties to the formal hearing cannot simply submit materials into the formal evidentiary record, but must follow the procedures governing the admission of evidence. *See* 16 U.S.C. § 839e(i); Procedures Governing Bonneville Power Administration Rate Hearings, 51 Fed. Reg. 5,611 (1986).

Decision 1

The Administrator properly limited the scope of this proceeding by excluding debate of "the policy merits or wisdom of implementation of the Biological Opinion, or the related operations, assumptions, and program spending level forecasts included in BPA's rate proposal." The Hearing Officer also did not err in striking CRITFC's testimony regarding the funding and operational assumptions required to meet BPA's obligations under the Biological Opinion.

3.7 Hearing Officer's Order Striking Political Risk Testimony

Issue 1

Whether the Hearing Officer properly struck CRITFC's testimony regarding BPA's political risks.

Parties' Positions

CRITFC argues it provided evidence that the GAO is conducting a study of BPA that will address, among other things, BPA's use of borrowing authority and the risk associated with missing a Treasury payment. CRITFC Brief, SN-03-B-CR/YA-01, at 38. They contend the Hearing Officer improperly struck this evidence from the record. *Id*. CRITFC further argues it introduced this evidence to rebut BPA's assertion that its proposed TPP level is acceptable. *Id.* CRITFC ask the Administrator to reverse the Hearing Officer's decision to strike the testimony and exhibits. *Id.*

BPA's Position

The Federal Register Notice established the scope of this proceeding. In the Notice, the Administrator directed "the Hearing Officer to exclude from the record any material attempted to be submitted or arguments attempted to be made in the hearing which seek in any way to revisit the policy merits or wisdom of implementation of the Biological Opinion, or the related operations, assumptions, and program spending level forecasts included in BPA's rate proposal, as discussed above. 68 Fed. Reg. 12048, at 12051. The Implementation Plan and any subsequent modifications were and are developed through extensive public involvement and

comment processes, and have been and will be adopted as policy pursuant to those separate procedures."

Pursuant to Rule 1010.11(d) of BPA's Rules of Procedure Governing Rate Hearings, BPA moved the Hearing Officer for an order striking certain portions of CRITFC's testimony and exhibits. BPA argued the material submitted by CRITFC violates the rules governing this proceeding because it addresses matters that are clearly outside the scope of this proceeding as established in Federal Register Notice or address matters that are not relevant to the section 7(i) process. The Hearing Officer properly granted BPA's motion.

Evaluation of Positions

CRITFC argues that the Hearing Officer improperly struck part of its rebuttal testimony regarding the political risks faced by BPA. CRITFC points to a GAO study to support its argument for reversing the Hearing Officer's order. In footnote 7 of CRITFC's brief, it argues that page 5, line 21, to page 6, line 8, of Sheets, *et al*., SN-03-E-CR/YA-02, should be restored. While the testimony touches on political consequences of missing a Treasury payment, the testimony in question more directly relates to the elimination of spill and flow measures in 2001 in response to a declaration of an emergency under the Biological Opinion. CRITFC Brief, SN-03-B-CR/YA-01, at 40. In response to tribal concerns regarding the declaration of the emergency, the Administrator noted in a letter to tribal leaders that there would be political fallout if BPA failed to make its Treasury payment. *Id.* CRITFC points to a GAO audit underway to evaluate BPA's borrowing authority and the risk associated with missing a Treasury payment. *Id*. at 39. BPA argued that these matters were outside the scope of this proceeding. The Hearing Officer found that the question regarding the spill and flow measures in 2001 related to the declaration of an emergency under the Biological Opinion, which fell within the precluded "policy merits or wisdom of implementation of the Biological Opinion …"

The Hearing Officer's decision should be sustained. BPA and others moved to strike CRITFC's testimony because the rebuttal testimony in question involved the implementation of the Biological Opinion and reargued matters that were previously stricken from CRITFC's direct testimony. In a prior order, the Hearing Officer struck a lengthy discussion of BPA's declaration of an emergency and BPA's modifications of spill and flow measures. *See* Order, SN-03-O-11, striking Sheets, *et al*., SN-03-E-CR/YA-01, at 10, line 17, through 12, line 12. CRITFC's rebuttal testimony merely repeats the same argument regarding implementation of the Biological Opinion, but this time adds the Administrator's statements about the need to make Treasury payments. For purposes of addressing issues in this proceeding, the only relevance the referenced material CRITFC's rebuttal testimony has relates to implementation of the Biological Opinion. The statement related to BPA's treasury payment primarily related to an explanation of why BPA declared the "emergency" under the Biological Opinion. As a result, the Hearing Officer's decision to strike the testimony was proper and should be sustained.

Decision 1

The Hearing Officer properly struck CRITFC's rebuttal testimony.

3.8 Due Process Regarding Draft ROD Documentation

Issue 1

Whether BPA should have provided the parties with technical documentation in support of its draft ROD.

Parties' Positions

Golden Northwest, PNGC, ICNU/ALCOA, CUB, GPU, SUB and NRU argue that BPA should have provided the parties with technical documentation supporting BPA's decisions in the draft ROD, and provided parties an opportunity to respond to such documentation. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 12; PNGC Ex. Brief, SN-03-R-PN-01, at 3-4; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 5-6; CUB Ex. Brief, SN-03-R-CA-01, at 3-4; GPU Ex. Brief, SN-03-R-GP-01, at 18; SUB Ex. Brief, SN-03-R-SP-01, at 21; NRU Ex. Brief, SN-03-R-NR-01, at 12. The IOUs argue that BPA should explicitly describe the projected rate effect on each BPA customer group due to the SN CRAC itself. IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 7.

BPA's Position

BPA is not required to provide, and has never previously provided, parties with technical documentation in support of a draft ROD. Parties have had a complete opportunity to address every issue in the rate hearing. The fact that BPA performs an analysis of its draft rate proposal to estimate the general level of BPA's overall rate increase does not require the filing of new evidence or create a new round of evidence, discovery, rebuttal, cross-examination and briefing. BPA has provided the parties due process and has complied with section 7(i) of the Northwest Power Act.

Evaluation of Positions

Golden Northwest and PNGC argue that BPA's draft ROD noted an average expected value for FY 2004-2006 rates of about 5 percent above the total rate level for 2003, and noted ending reserves of $354 million, but BPA did not disclose the evidence upon which such calculations were based. Golden Northwest Ex. Brief, SN-03-R-GN-01, at 12; PNGC Ex. Brief, SN-03-R-PN-01, at 3-4. Golden Northwest, PNGC, and ICNU/ALCOA argue that BPA is required to put the documentation BPA used to determine these figures into the evidentiary record where parties may have an opportunity to respond to them, otherwise parties cannot conduct a technical analysis to verify the SN CRAC increase, end of period reserves, and whether BPA's data and assumptions are appropriate. *Id.*; ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 5-6. ICNU/ALCOA argue that parties' due process rights and section 7(i) are violated if BPA does not make available data used in making policy decisions in the draft ROD. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 6. Canby argues that in order for parties to evaluate the proposed rates, BPA should publish a draft ROD that contains the size of the SN CRAC in each year, the effect of the SN CRAC on rates after considering the other CRACs, TPP under a variety of different scenarios, and cash reserve levels at the end of each year. CUB Ex. Brief, SN-03-R-CA-01, at 3-4. GPU argues that BPA has failed to base its

decisions on substantial evidence because the draft ROD does not support the Administrator's decisions to adopt an 80 percent TPP standard, flatten rates over the rate period, and that rates will be 5 percent over 2003 rates. GPU Ex. Brief, SN-03-R-GP-01, at 18. GPU argues that BPA has not provided the model runs on which these numbers are developed, which violates the parties' due process rights by precluding them from reviewing the information on which the Administrator's decisions have been made and by not providing them adequate notice of the basis of the decision. *Id*.

In response to these arguments, BPA has never published BPA's proposed rates in a draft ROD, and has not done so in the SN-03 rate proceeding. The draft ROD provides draft decisions for each issue raised in BPA's SN-03 rate proceeding. Parties have had a full and complete opportunity to present evidence on, and to respond to other litigants' evidence regarding, every substantive and procedural issue in this proceeding. BPA's statement that BPA estimates the overall proposed rate increase to be about 5 percent was provided as a courtesy to the parties to provide them a general estimate of the magnitude of BPA's draft proposed rate increase until the release of the Final ROD and Study shortly thereafter. Under the parties' arguments, BPA should not tell parties of the approximate level of a draft proposed rate increase, thereby avoiding any requirement to provide documentation for its draft ROD decisions. This does not make sense. BPA's final decisions on issues, final proposed rates, final studies, documentation for the studies, and other information are provided in BPA's final rate proposal, not BPA's draft ROD.

Parties refer to the Administrator's draft decision adopting an 80 percent TPP standard, discussed in greater detail elsewhere in this ROD. This draft decision was based on evidence in the record. Parties have had a full and complete opportunity to respond to BPA's proposed financial standards, including the TPP standard, and to respond to other parties' proposals on TPP (such as CRITFC/Yakama and SOWS/NWEC, who advocated an 80–88 percent TPP standard). Any arguments regarding whether BPA should retain the draft proposed TPP standard in the Final ROD could be raised, and were raised, by the parties in their Briefs on Exceptions. These arguments, like BPA's draft decision, similarly must be based on the record. Parties have not been precluded in any way from making arguments regarding this draft decision in their Briefs on Exceptions. The fact that the Administrator's draft decision was different from BPA's Initial Proposal does not constitute a new rate proposal for which BPA must provide documentation. Parties do not dispute other draft decisions made by the Administrator that differ from the Initial Proposal. *See, e.g.*, GPU Ex. Brief, SN-03-R-GP-01, at 3-4. Furthermore, the use of this draft TPP decision in calculating draft estimated rates or reserves also does not constitute a new rate proposal for which BPA must provide documentation. This principle is well established. In *Central Lincoln Peoples' Util. Dist. v. Johnson*, 735 F.2d 1101 (9th Cir. 1984), the Court held that BPA's revision of its repayment study, after the original notice and comment, required no new notice and comment:

> PGP argues that section 7(i)(2)(A), which provides parties a right to rebut materials "submitted" to or by BPA, compelled BPA to allow parties the opportunity to rebut the revised repayment study. Section 7(i)(2)(A) ensures that BPA creates a complete administrative record, allowing interested parties to participate in a meaningful way. *This does not mean, however, that each time*

> *BPA adjusts the conclusions to be drawn from the record, new notice and comment must begin. Our holding is further supported by the language of section 7(i)(5), which provides no right of rebuttal for materials "developed" by the Administrator, presumably in response to received commentary.* The parties have not indicated the kind of rebuttal they would have made, nor suggested that the revisions were in fact based on any material not already contained in the record. No purpose would be served by requiring yet another round of notice and comment.

Central Lincoln, 735 F.2d at 1118-19 (emphasis added). Parties' claims that BPA must place documentation of BPA's general estimate of the level of a draft rate increase into the evidentiary record, where parties may respond to it, is not persuasive. BPA's final rate proposal will be based on the Administrator's decisions on the issues identified in the SN-03 proceeding, not on a preliminary estimate of general rate levels. Providing a general estimate of a rate increase does not preclude parties from addressing any of the issues in the case. Parties argue that absent documentation they cannot conduct a technical analysis to verify the SN CRAC increase. But BPA has not yet identified its proposed rates, because such rates cannot be determined until after evaluating parties' Briefs on Exceptions. There is no need to attempt to verify BPA's general estimate of a rate increase. Similarly, a preliminary estimate of end of period reserves based on an 80 percent TPP standard does not preclude parties from arguing, and parties have argued, that BPA's reserves should be a larger amount, a smaller amount, or any specific level they believe is proper. These arguments are not dependent on knowing what reserve levels resulted from BPA's draft rate increase estimate. The Administrator considers these arguments in developing final proposed rates. Also, the data and assumptions used by BPA in estimating BPA's draft rate increase are based on the draft decisions in the draft ROD, which are based on the record. Parties may argue that BPA should use whatever data and assumptions they believe are appropriate in developing BPA's final proposed rates. These arguments are not dependent on knowing what data and assumptions were used in developing BPA's draft estimate. The Administrator considers these arguments in developing final proposed rates.

Some parties argue that parties' due process rights and section 7(i) are violated if parties are precluded from reviewing the information on which the Administrator's decisions have been made and by not providing them adequate notice of the basis of the decision. First, the Administrator did not make any final decisions in the draft ROD. These decisions are made in the Final ROD, not the draft ROD. Furthermore, parties have been provided the opportunity to address every issue in the rate case. Also, the Administrator's draft decisions, as shown in the draft ROD, are based on the rate case record. The Administrator could not rely on any new, extra-record evidence. Parties have therefore already reviewed all the evidence the Administrator considered. There has been no violation of parties' due process rights. The argument that BPA has not provided parties adequate notice of the basis of BPA's draft decisions in the draft ROD is puzzling. Parties have been on notice of BPA's rate hearing since BPA published its Federal Register Notice. Parties have been on notice of the SN-03 rate case schedule, the filing of BPA's initial proposal, discovery, parties' direct cases, litigants' rebuttal cases, cross-examination, oral argument, briefing, and the draft ROD. BPA can adopt a position different from BPA's initial proposal based on record evidence, which may have been provided by any party. As the Court noted in *Central Lincoln*:

> This court has stated that the APA "does not require an agency to publish in advance every precise proposal which it may ultimately adopt as a rule." *California Citizens Band Association v. United States*, 375 F.2d 43, 48 (9th Cir.), *cert denied*, 389 U.S. 844 . . . (1967). The main concern is to ensure that the final rule is sufficiently related to the proposed rule that the challenging party had notice of the agency's contemplated action. [citations omitted].

Central Lincoln, 735 F.2d at 1118. All parties have had notice of all studies, documentation and testimony filed in this proceeding. Adequate notice of BPA's decisions in the draft ROD has not been an issue.

Also, section 7(i) of the Northwest Power Act does not require BPA to make documentation of the Administrator's general draft estimate of an overall rate increase available to parties. Section 7(i) requires that "any person shall be provided an adequate opportunity by the hearing officer to offer refutation or rebuttal of any material submitted by any other person or the Administrator." 16 U.S.C. § 839e(i)(2)(A). BPA's draft ROD does not constitute material presented as evidence before the Hearing Officer. The draft ROD is a draft decision document, not a piece of testimony. Furthermore, the parties have had a full and complete opportunity to refute or rebut any and all material presented by BPA in the evidentiary hearing, and have taken advantage of that opportunity. The draft ROD documents the record evidence upon which the draft decisions are based. Parties also have had the opportunity to respond to the Administrator's draft decisions in their Briefs on Exceptions.

Section 7(i) also provides that "the Administrator shall make a final decision establishing a rate or rates based on the record . . .." 16 U.S.C. § 839e(i)(5). The Administrator has not yet made a final decision, but the Administrator's final decision will be based on the record. Finally, it is argued that BPA cannot rely upon factual material not admitted into evidence in setting rates because rates must be "supported by substantial evidence in the rulemaking record required by section 839e(i) of this title considered as a whole." 16 U.S.C. § 839f(e)(2). This argument is overstated because, as noted below, the ratemaking administrative record is not limited to the evidentiary record of the formal hearing. In any event, BPA is not relying on factual material not admitted into evidence. BPA's draft ROD only relies on record evidence. The parties have not identified any instance in which a draft decision in the draft ROD is not supported by record evidence.

Section 7(i) also provides that "[i]n addition to the opportunity to submit oral and written materials at the hearings, any written views, data, questions, and arguments submitted by persons prior to, or before the close of, hearings shall be made a part of the administrative record." 16 U.S.C. § 839e(i)(3). This provision refers to what are called "participant" comments in BPA's rate cases. It provides that in addition to the evidentiary record developed in BPA's formal hearing, any material submitted by persons outside the formal hearing, but before the hearing has ended, will be included in the general administrative record. To BPA's knowledge, all such persons' comments will be included in the administrative record. This has little apparent relevance to BPA's draft ROD.

It is also argued that BPA has failed to base its decisions on substantial evidence because the draft ROD does not support the Administrator's decisions to adopt an 80 percent TPP standard, flatten rates over the rate period, or that rates will be five percent over 2003 rates. This argument is incorrect. First, the substantial evidence test is a test conducted in judicial review of BPA's final ratemaking determinations, that is, BPA's final rates as confirmed and approved by FERC on a final basis, not BPA's draft decisions. 16 U.S.C. § 839f(e)(2). As discussed in Section 2.7 of this ROD, the Administrator's draft decision to adopt an 80 percent TPP standard is supported by BPA's and parties' testimony in the rate case. This is substantial evidence. Section 2.7 also demonstrates that the Administrator's draft decision to "flatten" rates over the rate period is supported by BPA's testimony in the rate case. This is substantial evidence. While BPA has not yet have final rate determinations, which are the only rate determinations subject to the substantial evidence standard, 16 U.S.C. § 839f(e)(2), BPA's draft general estimate of the level of BPA's overall rate increase is based on the draft decisions in the draft ROD, which are based on record evidence. In summary, BPA's draft ROD is consistent with section 7(i) of the Northwest Power Act.

PNGC argues that unlike past rate cases, BPA has materially altered data and studies for FERC's consumption and that BPA has failed to provide parties a supplemental proposal setting forth materially changed facts and analysis. PNGC Ex. Brief, SN-03-R-PN-01, at 3-4. This argument is incorrect. BPA has conducted the SN-03 rate proceeding just as it has conducted previous rate proceedings. BPA has not developed a supplemental rate proposal in the SN-03 proceeding because there is no need for such a proposal. There is no evidence that BPA has altered data for FERC's consumption. Notably, PNGC fails to identify any "materially altered data or studies". This is because, first, BPA has not filed any studies with the draft ROD. BPA's final studies always have been provided only with BPA's Final ROD. Second, the only data on which BPA relies in the draft ROD is data that was already on the record, except for updated information BPA stated in testimony would be used in developing rates, and to which no party objected. Such updated data generally reduces the level of BPA's proposed rate increase. If PNGC does not wish BPA to use updated information, BPA could increase its SN CRAC rate proposal. Furthermore, the draft ROD, virtually by definition, will contain draft decisions that will differ from BPA's Initial Proposal. This does not mean BPA is required to prepare a supplemental rate proposal. If this were the case, BPA's rate proceedings would be interminable.

ICNU/ALCOA argue that BPA has abandoned its past practice of making the input data into the final studies available at the hearing. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 5-6. ICNU/ALCOA provide no documentation of this claim. Indeed, this argument is inconsistent with BPA's past practices. In 22 years of rate proceedings under the Northwest Power Act, BPA has been unable to identify even one instance when BPA provided parties the input data supporting BPA's final studies until the final studies themselves were released. BPA's draft RODs address, in narrative form, the Administrator's decisions on issues pending in the case. To BPA's knowledge, input data for final studies have never been provided with a draft ROD.

NRU argues that BPA should make available to parties BPA's Toolkit runs and provide parties an opportunity to submit comments prior to a Final ROD. NRU Ex. Brief, SN-03-R-NR-01, at 12. PNGC argues that BPA should include the rate adjustment chart in the administrative record; make available the underlying assumptions, data and computer models that produce what

is shown in the chart; allow parties to test this information; and modify the rate case schedule to allow parties to respond. PNGC Ex. Brief, SN-03-R-PN-01, at 4. The IOUs argue that BPA should explicitly describe the projected rate effect on each BPA customer group due to the SN CRAC itself. IOU Ex. Brief, SN-03-R-PL/PS/GE/AC-01, at 7. As discussed above, BPA is not required to provide parties with BPA's draft Toolkit runs. Therefore, BPA is not required to include any such draft runs in the administrative record. Furthermore, BPA is not required to conduct a new rate hearing. Issues regarding the admission of the above-noted chart are addressed in Section 3.1. BPA's documentation of its rate proposal occurs with publication of BPA's Final ROD and Final studies, not with BPA's draft ROD. BPA's draft RODs have never contained BPA's proposed rates. BPA's final rate proposal provides BPA's proposed rates. Upon issuing the Final ROD, BPA will describe the projected rate effect on each BPA customer group due to the SN CRAC.

Decision 1

BPA is not required to provide parties with technical documentation in support of its draft ROD.

3.9 Due Process Regarding GRSPs

Issue 1

Whether BPA's failure to provide(1) GRSPs reflecting BPA's draft decisions until the draft ROD and (2)Toolkit computer model runs supporting the decision to adopt an 80 percent TPP standard violated parties' procedural due process rights.

Parties' Positions

In its brief on exceptions, NRU argues that it is unable to understand the financial implications of the decisions in the draft ROD because of the decision not to release the GRSPs and Toolkit models necessary to fully understand and refute the decision to adopt an 80 percent TPP only standard. NRU Ex. Brief, SN-03-R-NR-01, at 12. NRU believe BPA should halt the proceedings and conduct additional hearings to provide the parties an opportunity to comment prior to publication of the Final ROD. *Id*.

NRU further contends that the "GRSPs are voluminous, complicated and require a thorough (sic) analysis and review by BPA and its customers." *Id*. at 13. They contend they found areas of confusion and error with the GRSPs and that the limited time between release of the draft ROD and the Briefs on Exception did not give them sufficient time fully study them. *Id*.

GNA argues that the time between the issuance of the draft ROD and the time reply briefs are due was far too short to evaluate the GRSPs to determine whether they "in fact do what they are intended to do." GNA Ex. Brief, SN-03-R-GN-01, at 13. GNA supports having a workshop with customers before the Final ROD to assure the GRSPs work as intended. *Id*.

SUB argues that it lacks the model and supporting analysis used to develop the new 80 percent TPP. SUB Ex. Brief, SN-03-R-SU-01, at 10-11. SUB also believes the GRSPs differ

significantly from those presented in testimony and that a separate public meeting is necessary to discuss these with the customers. *Id*. at 22.

PPC/IEA contend that without an updated Toolkit model and associated source files, the parties cannot ascertain the level of ending reserves from the proposed rate increase. PPC/IEA Ex. Brief, SN-03-R-PP-01, at 4. They also contend that there was not sufficient opportunity for parties to review the GRSPs which precludes meaningful assessment and is an abuse of discretion. *Id*. at 8

ICNU/ALCOA contend parties have not been afforded the opportunity to evaluate the basis for the new financial standard of 80 percent TPP adopted in the draft ROD. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 6. The 7(i) process is violated when the Administrator uses data in making decisions in the draft ROD that have not been disclosed to the parties. *Id*. The GRSPs have been provided for the first time in the draft ROD. *Id.* There has been no opportunity for clarification, discovery or cross-examination on these complex provisions. *Id*.

CRITFC argues that BPA must release the Toolkit analysis associated with the decisions in the draft ROD because it disadvantages parties in the preparation of their arguments. CRITFC Ex. Brief, SN-03-R-CR/YA-01, at 18.

PNGC argues that BPA should make available the underlying assumptions, data and computer model runs that produce the conclusions reflected in the draft ROD. PNGC Ex. Brief, SN-03-R-PN-01, at 5. The Administrator should delay the schedule to allow parties a reasonable opportunity to test the assumptions, data and model runs that produce the conclusions reflected in the draft ROD. *Id.*

GPU argues that decisions in the draft ROD must be based upon the evidence in the record. GPU Ex. Brief, SN-03-R-GP-01, at 18. GPU claims that the Administrator has failed to provide the parties with the information and data necessary to support the decisions, particularly with regard to the adoption of an 80 percent TPP standard and flat rates. *Id.*

BPA's Position

Procedural due process affords parties notice and the opportunity to be heard. *Armstrong v. Manzo*, 380 U.S. 545, 14 L.Ed.2d 62, 85 S.Ct. 1187 (1965). BPA fulfilled all procedural due process requirements. BPA published the GRSPs with the draft ROD and made the Toolkit model available to parties early on in this proceeding to allow parties to do their own analyses. Parties were given the opportunity to comment on the draft GRSPs in their Briefs on Exceptions. Parties had the ability to conduct their own Toolkit analyses. Procedural due process does not impose any duty on BPA to conduct analysis on behalf of the parties when the tools for doing so were provided.

Evaluation of Positions

NRU and PNGC contend that BPA should suspend these proceedings to allow for additional hearings on the financial implications of the decisions in the draft ROD. NRU Ex. Brief,

SN-03-R-NR-01, at 12; PNGC Ex. Brief, SN-03-R-PN-01, at 5. NRU believes that the failure to publish the draft GRSPs that implement the decisions in the draft ROD amount to a violation of its procedural due process rights. *Id.* In addition, NRU contends that the failure to provide the Toolkit computer model runs have also precluded NRU from effectively refuting the decisions reflected in the draft ROD. *Id*. PNGC believes the Administrator should delay the schedule to allow parties a reasonable opportunity to test the assumptions, data and model runs that produce the conclusions reflected in the draft ROD. PNGC Ex. Brief, SN-03-R-PN-01, at 5.

The concern raised by the parties addressed the Toolkit computer model or other analyses allegedly used by the Administrator to make decisions about the financial standard for the SN CRAC or for other decisions in the Draft and Final ROD. The contention is that this analysis is outside of the record and as a consequence parties' procedural due process rights have been violated because they were not afforded the opportunity to test the accuracy of this analysis.

There are two aspects of the Toolkit analysis generally. There are inputs to the model and the computer model itself. BPA provided all parties copies of the Toolkit model, with the appropriate modifications to the program, during the discovery phase of this rate case. As a result all parties had access to the computer model used to analyze the financial impacts of proposed rate designs. Through the course of this proceeding, particular parties have become proficient with the Toolkit model and have challenged some of the modifications to the model. These parties have presented alternative rate designs that they have modeled, including financial impacts in Toolkit. *See* Chapter 2.7, Rate Design, and Bliven, *et al*., SN-03-E-JC-01.

As noted, the inputs to the model are the second aspect to any Toolkit analysis. The parties generally have complained that they did not have access to these updated inputs and thus cannot test the validity of these inputs. This concern is surprising in light of the testimony in this proceeding. As part of rate cases generally, BPA updates the forecasts used to set rate levels to the most current information. This rate case was no different. BPA's initial testimony, studies and documentation described in detail the methodology used to develop the forecasts used in the rate case. This included all of the various inputs used to run the Toolkit model. These inputs were made available to the parties to use in their analyses.

BPA also informed parties in its initial testimony that it would be updating the forecast as part of preparing the final studies for establishing the SN CRAC. In this proceeding, updating the forecasts, with regard to secondary revenues, particular cost categories and in several other areas became particularly important because of the dramatic improvements in these areas between the time BPA filed the initial proposal and the final ROD. Parties pressed BPA during cross-examination and in testimony to test BPA staff witnesses about how these improvements in BPA's finances were being implemented in the determination of the SN CRAC rate level. While the parties did not have access to the numbers used to develop BPA's general estimate of its overall rate increase, the parties knew the methodology used to develop the numbers, and understood that the numbers would be updated and used to set the SN CRAC level.

The question then becomes whether the Administrator denied parties their procedural due process rights because he evaluated various rate designs proposed by the parties using the Toolkit model. The answer to this question is no. Procedural due process affords parties notice

and the opportunity to be heard. *Armstrong v. Manzo*, 380 U.S. 545 (1965). The parties were on notice and in fact strongly supported BPA's intent to update of the forecasts as well as the various rate proposals advocated by BPA staff, customers and public interest constituents. The stated and implied position of many parties is that an 80 percent TPP-only financial standard was not on the record. While it is true BPA staff advocated a different standard, CRITFC and SOS/NWEC in particular argued strongly that BPA should have between an 80 and 88 percent TPP financial standard for the SN CRAC.

Given that parties had notice and opportunity to challenge the underlying assumptions that led to the decisions in the draft and final RODs, no procedural due process violation occurred. There remains an issue as to whether it is proper for the Administrator to use such analysis in weighing various proposals. The answer to this must be yes so long as the Administrator is not resorting to using materials or information that are outside the record. Here, using Toolkit to weigh various rate proposals proffered by parties is not only in keeping with the record evidence, but it is a practice that should be encouraged, rather than discouraged as the parties' arguments suggest. Evaluating the rate impacts of the various proposals in light of recent developments with BPA's finances allowed the Administrator to judge how they meet the goals of ensuring BPA's financial health, mitigating the impact on the region along with assuring BPA met its other statutory obligations. In light of all of the above, parties were not denied their procedural due process rights of notice and comment when the Administrator used the Toolkit model to evaluate the various rate proposals.

The parties contend the schedule did not provide sufficient time to review and comment on the GRSPs in the draft ROD. Because there was limited time between the issuance of the draft ROD and the due date for the Briefs on Exceptions, some parties felt there was an inadequate opportunity to comment on the proposed changes to the language in the GRSPs.

While some parties felt there was not adequate time to review and comment on the GRSPs, WPAG, nevertheless, was able to accomplish this task within the time frame provided. WPAG provided a very detailed review of the GRSPs and included both a redlined and clean version of the document as part of its brief on exceptions. Given that WPAG was able to provide this analysis during the time frame provided, it is difficult to understand how NRU, GNA, PPC/IEA, PNGC and GPU, who were all part of the Joint Customer coalition, could not pool their resources again to provide comments. None of the complaining parties identified any issue outside of the time constraints that prohibited them from reviewing the materials.

Also, this proceeding is an expedited rate proceeding, as compared with a general rate proceeding. *See* BPA's Procedures, Section1010.10. The schedule in this proceeding is considerably shorter than a general rate case. However, the complaining parties all agreed to the schedule when this proceeding was initiated. At that time no party raised any issue with regard to the time line between the draft ROD and this final ROD.

Parties specifically requested in their initial briefs that BPA put the draft GRSPs in the draft ROD so that they would have an opportunity to comment on them. The Administrator did this, so it came as no surprise to parties that the draft ROD contained the GRSPs. ICNU/ALCOA contend there has no been an opportunity for clarification, discovery or cross-examination on

these provisions. ICNU/ALCOA Ex. Brief, SN-03-R-IN/AL-01, at 6. Neither procedural due process nor BPA's rate setting procedures guarantees a party the right to clarify, conduct discovery on or cross-examine BPA on the GRSPs in the draft ROD. The GRSPs in question reflect the decisions in the draft ROD, and parties also were afforded the opportunity to provide written comments. To argue as ICNU/ALCOA that there is some due process right of clarification, discovery or cross-examination at this point of the proceeding is beyond any rational concept of due process. If a party truly felt that additional time was necessary, they could have petitioned for additional time prior to filing Briefs on Exceptions. No party took this opportunity to request additional time.

Decision 1

BPA did not violate the due process rights of parties to this proceeding by (1) providing GRSPs in the draft ROD, and (2) not providing Toolkit computer model runs reflecting the decision to adopt an 80 percent TPP standard.

3.10 Admission of Estimated Rate Adjustment Chart

Issue 1

Whether the Administrator should admit into the record a chart estimating the rate adjustments anticipated as a result of the decisions in the draft ROD.

Parties' Positions

PNGC asks that the Administrator admit into the record a chart distributed by BPA to its customers estimating the rate adjustments anticipated to result from the decisions in the draft ROD. PNGC Ex. Brief, SN-03-R-PN-01, at 5.

BPA's Position

The chart has limited or no evidentiary value to this proceeding. While informative, the chart does not reflect actual rate levels for any particular customer. It was developed at the Administrator's direction to generally illustrate staff's best estimate as to what the level of the LB, FB, and SN CRACs might be given the Administrator's decisions in the draft ROD. The chart was developed without the benefit of the numbers in the final studies and only reflects the impact on average PF rates. It should be noted that the actual SN CRAC adjustments to rates would not be known even if the final studies were completed. The final ROD adopts a formula adjustment that will be calculated each August based upon ANR levels. As explained in more detail in Chapter 2.7, the contingent adjustment in August 2003 will also adjust the Caps and Thresholds used to calculate the percentage increase. In addition, the impact of a settlement of the IOU benefits litigation will have a significant impact on levels of the various CRACs, depending upon the specific terms of the settlement.

Evaluation of Positions

PNGC has requested that the Administrator admit into the record a chart distributed by BPA account executives to customers that reflect the potential rate impacts of the decisions in the draft ROD. PNGC Ex. Brief, SN-03-R-PN-01, at 5. PNGC does not state the evidentiary purpose of admitting this document to the record. As noted, the chart was developed at the direction of the Administrator to give customers and other interested parties a general understanding of the rate impact of the decisions in the draft ROD. Because final studies have not been completed, and given the August contingent adjustment and determination of ANR, it is impossible to calculate the precise SN CRAC rate adjustment. The chart was not part of the evidence reviewed by the Administrator in making any of the decisions reflected in either the draft ROD or Final ROD.

Given the fact that the chart had no role in the Administrator's decision-making process and has little or no evidentiary value, it is difficult to understand what is gained by its admission at this late date. It is possible parties would dispute its admission into the record and procedurally there is no opportunity for them to object absent halting the proceedings and reopening the record to admit the document into evidence. *See* BPA's Rules of Procedure Governing Rate Hearings Section 1010. 11(a) (providing parties an adequate opportunity to offer refutation or rebuttal to evidence submitted). Because there appears to be little value of the document to the issues in this proceeding, on balance there does not appear to be sufficient cause to halt the proceeding for the purpose of admitting a document into the record. Therefore, the chart will not be admitted into the record, however, the actual rate impacts of the decisions in this Final ROD are reflected in the final studies.

Decision 1

The Administrator will not admit into the record a chart estimating the possible rate adjustments that were estimated to result from the draft ROD.

4.0 PARTICIPANT COMMENTS

4.1 Introduction

This section summarizes and evaluates the comments of participants received by BPA after the publication of the Federal Register Notice on March 13, 2003, for a proposed SN CRAC. Participants are persons and organizations who comment on BPA's rate proposal by attending BPA's field hearing, or through correspondence or phone calls, but do not take part in the formal rate case hearing. Comments of participants are part of the official record of the rate proceeding and are considered when the Administrator makes his decisions as set forth in this ROD.

The participants' portion of the official record consists of a transcript of BPA's field hearing, held April 16, 2003, in Portland, Oregon, and additional materials. At the field hearing, 19 individuals presented comments. BPA also received about 1,150 pieces of correspondence (including e-mails) and documented telephone calls related to the rate filing during the public comment period, which officially ended on May 1, 2003. In addition, BPA received 2,565 form letters and postcards commenting on the SN-CRAC proposal. Some additional pieces of correspondence were received after the conclusion of the official public comment period. Comments received after the deadline are not reflected in the tallies below.

BPA reviewed the participants' comments and identified the concerns expressed by the participants. Participants' comments on technical areas addressed by the parties are evaluated in the ROD chapters that address those topics.

Following is a tally and summary of the testimony provided at the field hearing and the letters, e-mails and phone calls BPA received during the comment period, along with BPA's responses to those concerns. Copies of the letters of participants, and letters received after the comment period, will be available for review in BPA's Public Information Center.

4.2 Evaluation of Participant Comments

The following summary indicates the total comments for each issue. Many letters (including e-mails) contained more than one comment. A total of 2,686 comments from letters and 81 comments from the field hearing were analyzed. In addition, 2,565 form letters and postcards were received.

SN CRAC Proposal	Letter Comments	Public Meeting Comments
a. Don't raise rates; postpone until economy improves, or an internal review is done.	829	12
b. For suggested rate increase.	3	
c. Raise rates a lower amount than proposed.	4	1
d. Reduce rates, the region needs affordable rates.	53	3
e. Borrow from the future instead of raising rates now.	3	

SN CRAC Proposal	Letter Comments	Public Meeting Comments
f. Develop tools to avoid the rate increase.	1	
g. The rate increase will affect people with low incomes, seniors, disabled people, single parents, and schools.	357	4
h. The rate increase will hurt families.	2	
i. Against the change from existing structure to a market-based rate structure.	3	
j. We won't ask BPA to do what PUD wouldn't do, we have more faith in BPA to resolve issues.	1	
k. BPA has failed to meet the legal and technical requirements necessary to trigger the SN-CRAC; BPA needs to justify it is needed; the rate increase will impact BPA's relationship with its customers.	3	
l. Keep the CRAC only one year.	2	
m. Take out the bad debt for aluminum companies and the California Independent system operator.	1	
n. CRAC is a good approach.		1
o. CRAC is not a good approach.		1
p. The government needs to bail out BPA.	1	
q. Use a temporary surcharge instead.	1	
r. There needs to be a financial cushion in the SN-CRAC.	1	
s. Postcard/form letter against the rate increase.	2,565	

Discussion

Many participants commented that they do not want BPA to raise rates, that affordable rates for electricity are important to the economic vitality of the region, and that a rate increase will affect low-income people, seniors, and schools. BPA understands these concerns. BPA is doing everything in its power to minimize the size of this rate increase, including the identification of an additional $80 million in expense reductions beyond the initial $350 million in expense savings, expense deferrals, and other actions for the FY 2003-2006 period. *See* ROD chapter 2.7. In addition, BPA has been given assurances by its partners (Energy Northwest, the Corps of Engineers and the Bureau of Reclamation) that each will rigorously manage its expenses to established levels. Beyond this, BPA is continuing to pursue additional savings, but will not reflect them in the SN CRAC proposal unless there is a high degree of certainty that they will be achieved. BPA has also reached a settlement with Enron securing about $90 million in net savings over the rate period. Another area that could produce a substantial level of savings and reduce rates is the possible settlement of issues between BPA, the public agency customers, and the IOUs regarding the IOU Residential Exchange Program settlement contracts agreements. Finally, BPA proposes that the SN CRAC be a variable adjustment because this rate design feature allows for a lower rate while still ensuring a sufficiently high probability of payment to Treasury.

Some comments stated that BPA failed to meet the legal and technical requirements necessary to trigger the SN CRAC, and that BPA needs to justify that it is needed. Arguments on whether the Administrator's decision to trigger the SN CRAC rate case was reasonable are discussed in detail in chapter 3 of this ROD.

A few comments favor a rate increase. These comments likely recognize BPA's statutory obligation to establish rates sufficient to recover BPA's total costs. Setting BPA's rates, however, is a difficult task. BPA believes its SN CRAC power rate proposal successfully balances the participants' concerns with BPA's statutory obligations. *See* ROD chapter 2.1.

Northwest Economy	**Letter Comments**	**Public Meeting Comments**
a. Protect the aluminum industry and other manufacturing and other businesses in the Northwest; businesses will leave the region if there is a rate increase; save jobs in the region; consider the impacts of a rate increase to businesses.	139	8
b. A rate increase will push the economy into a recession; businesses will not be able to compete globally; analyze the impacts of a rate increase to the economy.	425	13
c. BPA must help workers impacted and displaced by a rate increase.	3	1
d. Offer incentives to businesses instead to bring jobs and build a tax base.	1	
e. Postcard/form letter stating the economy cannot afford a rate increase.	2,565	

Discussion

Many comments stated concerns about protecting the aluminum industry and other businesses in the Northwest, and that businesses will leave the region if there is a rate increase. In addition, numerous comments expressed concern that a rate increase will push the economy into a recession. Others stated that regional businesses will not be able to compete globally. BPA realizes the importance of keeping jobs in the region and using the relatively inexpensive output of the FCRPS to benefit the regional economy. BPA is also aware that the cost of electricity can be a large component of some manufacturing and farming expenses. As documented in chapter 2 of this ROD, BPA is continuing to do all it can to limit the size of the SN CRAC rate increase. Indeed, as reflected in this ROD, BPA has used cost reductions, revised information regarding hydro levels and secondary energy revenues, and additional information to dramatically reduce the size of the proposed rate increase. A rate increase could be further reduced, or eliminated, if BPA's public agency and investor-owned utility (IOU) customers can settle outstanding litigation challenging the IOUs' Residential Exchange Program settlement agreements.

BPA Management	Letter Comments	Public Meeting Comments
a. Layoff people at BPA; reduce salaries.	23	3
b. What has been done or planned to reduce the rate increase?	1	
c. Control costs internally; cut costs.	425	10
d. Don't push costs out into the future.	1	
e. The rate increase was created by BPA mismanagement; situation caused by illegal contracts, illegal practices; it is BPA's mistake; don't make the region pay for the mistakes of others; uphold laws of the country.	136	3
f. Reduce payments to third parties such as the $200 million lawsuit bonus.	15	
g. Cut non-purchased power costs and payments to related agencies back to 2001 levels.	11	
h. Return BPA to its original function of providing hydropower, flood control and irrigation.	1	
i. The Administrator should resign; should be removed.	2	1

Discussion

Many comments state that BPA should control costs internally, cut costs, lay off employees and/or reduce salaries. Some comments suggest reducing payments to third parties such as the "$200 million lawsuit bonus." Others suggested cutting non-purchased power costs and payments to related agencies back to 2001 levels. BPA understands these concerns. BPA has been reducing staff for several years and streamlining its processes as much as possible so as to become more business-like, efficient, and competitive. Prior to initiating the SN CRAC rate proceeding, BPA secured $350 million in expense savings, expense deferrals, and other actions for the FY 2003-2006 period. Since then BPA has secured an additional $80 million in expense reductions. More than $35 million of this additional savings was due to reductions in internal operations expenses bringing internal operations expenses to within one percent of FY 2001 actual levels. Additionally, BPA has also reached a settlement with Enron securing about $90 million in net savings over the rate period. BPA is continuing to pursue additional cost savings, which could be reflected in either the contingent or variable design of the rates. Furthermore, as a part of its overall management plan, the PBL has established informal monthly meetings with customers, customer representatives, and constituents to review current year actual and forecast expense levels for both program and internal operations expense levels including reductions taken to date. Keep, *et al.*, SN-03-E-BPA-11, at 37. While not a part of this rate proceeding, BPA has also committed to provide an ongoing intensive process of cost disclosure by BPA and opportunities for customers and other stakeholders to review costs and provide input to BPA. This underscores our commitment to manage costs and to explore all opportunities for prudent cost reductions. Issues regarding BPA's costs are addressed in chapter 2.1 of this ROD.

Some comments address an alleged "$200 million lawsuit bonus" or suggest BPA's financial situation is caused by "illegal contracts." These comments likely reference BPA's Residential Exchange Program settlement agreements between BPA and its IOU customers. BPA believes these are lawful agreements, as explained in the RODs BPA issued for those agreements. *See* "Financial Settlement Agreement and Amendment to Residential Exchange Program Settlement Agreement with PacifiCorp, Record of Decision," May 23, 2001, and Amended Residential Exchange Program Settlement Agreement with Puget Sound Energy, Record of Decision," June 6, 2001. While these contracts are not at issue in BPA's rate case, a rate increase could be further reduced, or eliminated, if BPA's public agency and investor-owned utility (IOU) customers can settle outstanding litigation challenging the IOUs' Residential Exchange Program settlement agreements. This is addressed in greater detail in chapter 2.1 of this ROD.

Department of Energy Involvement	**Letter Comments**	**Public Meeting Comments**
a. DOE must look at BPA's practices; BPA needs DOE oversight.	44	

Discussion

A number of comments stated that the Department of Energy (DOE) should review BPA practices and BPA needs more DOE oversight. Many BPA functions and practices already receive extensive oversight by the DOE. The BPA Administrator reports directly to the DOE Deputy Secretary and any significant issues are always brought to the attention of DOE management. The DOE reviews BPA's federal budget submissions and provides comments on BPA's funding plans prior to their transmittal to OMB and inclusion in the President's budget. For example, the DOE reviewed BPA's request for new borrowing authority and BPA's estimates of new transmission construction projects in detail. In addition, according to the Executive agency agreement between BPA, DOE, and OMB, DOE reviews all fish costs that relate to both annual 4(h)(10)(C) credits and FCCF (Fish Cost Contingency Fund) access. Based on those reviews, DOE signs a written representation that such costs were incurred and the credits earned under federal law. BPA also provides financial briefings for the DOE Chief Financial Officer on a monthly basis. BPA's annual financial statements are reviewed by DOE auditors and included as part of the DOE consolidated financial statements.

Meeting Energy Needs/Energy Resources	**Letter Comments**	**Public Meeting Comments**
a. Meet energy needs through new generation and conservation; through tax credits.	13	
b. Meet needs through blackouts.	1	
c. Base rates on use and income.	1	
d. Do not continue subsidizing wind generation.	1	
e. Quit funding conservation.	2	
f. Delay capital projects.	7	

Meeting Energy Needs/Energy Resources	Letter Comments	Public Meeting Comments
g. Oppose unnecessary cuts to conservation, renewables; fund low-income weatherization.	2	2

Discussion

A number of comments state that BPA should meet energy needs through new generation and conservation, and that tax credits should be used to stimulate increased supply and/or reduce demand. Others state that BPA should delay capital projects, or BPA should stop funding conservation. In contrast, four comments state that unnecessary cuts to conservation and renewables should be avoided, and that funding for low-income weatherization should be increased.

In response to a motion to strike filed by BPA during the formal evidentiary hearing, the Hearing Officer ordered that the portion of parties' direct testimony concerning conservation and renewable energy be stricken from the administrative record because they are outside the scope of the rate hearing. Because these issues are not within the scope of BPA's SN CRAC rate adjustment process, BPA will not respond to participants' comments on these issues. Participants are encouraged to pursue their interests in these areas in the proper forums.

Treasury Payment	Letter Comments	Public Meeting Comments
a. Defer the Treasury payment; delay the accelerated repayment schedule; seek credit for prepayments.	8	2
b. Make the Treasury payment.	2	
c. A rate increase will make future treasury payments impossible.	1	

Discussion

Several comments state that BPA should defer payment to the Treasury, delay the accelerated repayment schedule, and seek credit for prepayments to the Treasury. Deferring BPA's payment to Treasury would likely cause serious repercussions for BPA. The Northwest Congressional delegation has made it clear, including in letters to BPA, that they strongly encourage BPA to make its scheduled payments to Treasury. BPA has used several cash tools to reduce the need for an SN CRAC rate increase while still making its Treasury payment.

Several comments recommend that BPA reduce any SN CRAC rate increase by seeking credit for "prepayments" to Treasury. BPA has made advanced amortization payments to the Treasury, related to the ENW Debt Optimization Program, and has proposed to Treasury that such payments be used to offset future payment obligations, and intends to continue such discussions. However, to date Treasury has made it clear that it does not view payments in prior years as

available to satisfy current year obligations. Therefore there is no basis on which to assume that BPA would obtain Treasury concurrence. BPA cannot prudently assume such recognition in the final proposal, given the current lack of acceptance from Treasury. BPA believes that if we were to claim such treatment, Treasury and others in the Administration would view this as a BPA deferral of Treasury payment, and that serious repercussions could result.

Some suggest BPA should defer its advance amortization payment. BPA will have $315 million from extending ENW principal due this year into the 2013–2018 period. BPA intends to make payments on higher-interest Treasury debt with these funds, consistent with BPA's Debt Optimization Program. BPA recognizes ENW's reduced debt service costs for what they are, an extension of bond principal, which would otherwise have been paid off at maturity. That principal extension, on its own, is pushing a significant amount of debt into future years. Without planning for the corresponding payment of Treasury debt, the act of extending the ENW debt would be financially imprudent. In order to be effective and justifiable, the debt optimization program is a two-part transaction extending ENW principal and paying down Treasury debt. This is consistent with the intent of the SN CRAC. BPA acknowledges that these funds could be applied in other ways. As the Administrator stated, "extraordinary cash tools, such as use of ENW refinancing proceeds or the Treasury note, are BPA's last line of financial defense." However, using these proceeds to decrease rates (or avoid increasing them) means they are unavailable for other purposes. BPA recognizes that these funds may be necessary for short-term liquidity purposes, such as making the scheduled year-end Treasury payment, or for cash flow in October or November. Because of this, and because other actions and factors are acting to decrease the proposed expected rate increase, BPA does not plan to use these tools in rate setting. *See* chapter 2.1.

BPA also is very concerned about moving costs into the next rate period. Using the ENW debt extension proceeds as a reserve fund in FY 2004 or FY 2005 would require a larger SN CRAC in FY 2006 or a higher rate in post-2006 period. While it could be preferable for short-term impacts to move these repayment costs beyond the current rate period, such actions will be difficult to defend to the financial community and with ENW and may have a material adverse impact on BPA's Debt Optimization Program. BPA's Debt Optimization Program and the rating agencies' perception of BPA's creditworthiness both provide value to BPA's customers and the region.

BPA's Business Model	**Letter Comments**	**Public Meeting Comments**
a. Change the business model; address behaviors so that this won't happen again.	4	
b. Act a purchasing agent for businesses.	1	
c. Extend the planning cycle.	1	
d. Alter business strategies, practices.	6	
e. Against deregulation.	5	
f. Make BPA one agency again, not separate Power and Transmission agencies.	1	

BPA's Business Model	Letter Comments	Public Meeting Comments
g. Advocate for changes in hydro operations now, including the Biological Opinion; protect the hydro system.	1	2

Discussion

A few comments suggest BPA should change its business model, and address behaviors so that BPA's financial challenges will not happen in the future. BPA's business model is outside the scope of this SN CRAC rate proceeding. However, with respect to addressing behaviors concerning cost control, BPA is taking several actions to actively manage its costs to spending levels described in the final proposal. As BPA notes in its initial proposal, BPA realizes that the practice of assuming significant cost cuts without a complete plan on how to achieve those cost cuts has contributed to BPA's current financial condition. As explained in chapter 2.1 of this ROD, BPA has established financial controls to limit new financial commitments, both capital and expense.

The following actions describe BPA's effort at changing behaviors associated with controlling costs charged to power rates. First, BPA has established internal cost controls and internal cost management plans to ensure that internal expense levels will be managed to levels established as a result of the General Managers' meetings on cost control. Second, BPA is actively working with its generating partners to ensure that their spending levels reflected in the rate case are appropriate and will not be exceeded; BPA has been given assurances by ENW, the Corps of Engineers and the Bureau of Reclamation that each will rigorously manage its expenses to established levels. Third, BPA has established workgroups with customers and constituents to get input on, evaluate, track, and report spending levels. Fourth, BPA is engaging in a Regional Dialogue effort to position BPA's power rates and contracts to be as attractive as possible for the post-2006 period given stakeholder and mission requirements. Finally, BPA will propose limiting the recovery of spending levels in the SN CRAC design for certain categories (s*ee* chapter 2.1 of this ROD).

Six comments state that BPA should change/alter its business strategies. BPA's business strategies are outside the scope of this SN CRAC rate proceeding. However, BPA is engaging in a Regional Dialogue effort to position BPA's power rates and contracts to be as attractive as possible for the post-2006 period given stakeholder and mission requirements *(see* chapter 2.1 of this ROD). This public process will enable BPA, working with its customers and other stakeholders, to clearly define its business strategies for the future.

Five comments indicate that they are against deregulation. Deregulation is outside the scope of this SN CRAC rate proceeding.

Augmentation	Letter Comments	Public Meeting Comments
a. Lower augmentation costs.	1	
b. Relate to load reduction expenses.	2	

Discussion

A few comments state that BPA should reduce its augmentation costs. In addition to actions taken prior to the initial proposal, BPA continues to look for ways to reduce augmentation costs. BPA has been in settlement discussions with several companies regarding augmentation purchase power or load reduction contracts. For example, augmentation costs were reduced by about $395 million for the April 2003 through September 2006 period when BPA reached a settlement agreement with Enron in April 2003, resulting in a net savings of $90 million to BPA's rates. Also, BPA is actively pursuing a settlement with BPA's public agency customers and BPA's IOU customers that could eliminate $200 million from BPA's load reduction payments to PacifiCorp and Puget Sound Energy. This settlement could remove the $200 million expense from augmentation costs, and could reduce or defer additional costs.

Equity and Fairness	Letter Comments	Public Meeting Comments
a. Benefits have shifted toward IOUs; power sold to IOUs instead of to public power; honor contracts with community-owned utilities.	43	
b. Wean IOU's from public trough; collect their taxes through BPA.	1	
c. Prosecute companies like Kaiser who don't honor their contracts.	2	
d. Renegotiate the residential exchange.		2

Discussion

Many comments expressed concern about the level of benefits that go to the IOUs. Several stated that benefits have shifted toward the IOUs in the region, and that power is being sold to the IOUs instead of to public utilities. Two comments stated that the Residential Exchange Program should be renegotiated. The total BPA benefits enjoyed by the residential and small farm customers of the region's IOUs are large compared to those same types of benefits in the recent past. However, BPA is not selling power to the IOUs instead of to public power. BPA's public power customers are receiving all of the BPA power they have requested. The benefits that BPA provides to the region's IOUs are not being given to the stockholders of the IOUs. These benefits are passed directly through to the residential and small farm customers of the IOUs. BPA is currently involved in discussions regarding the level of benefits provided to the residential and small farm customers of IOUs in the FY 2004-2006. These discussions could produce a substantial level of savings and reduce rates if there is a settlement between BPA, the

public agency customers and the IOUs regarding the IOU Residential Exchange Program settlement contracts agreements. BPA's utility customers, however, are not currently participating in the Residential Exchange Program. This program cannot be simply renegotiated, although BPA can revisit the Average System Cost Methodology that implements the program. Any such change would be addressed in a separate public process.

Two comments state that BPA should prosecute customers that do not live up to the terms of the contracts they signed with BPA. BPA understands frustration about customers not living up to the terms of their contracts. BPA, however, is doing everything in its power to ensure that its contracts are honored.

Process	**Letter Comments**	**Public Meeting Comments**
a. Big guys make decisions, do not listen to the little guy.	7	
b. Government agencies ignore the desires of the people.	3	
c. Need more information; there is a lack of information.	2	1
d. Thanks for working with aluminum companies before.	1	
e. BPA person rude at public meeting, Administrator was not there.	1	
f. This is just targeting the aluminum industry.		3
g. We need more discussion about issues around cost cutting.		1
h. We all need to work together in region.		1
i. BPA should be having meetings with the tribes.		1
j. The SN-CRAC must be analyzed under NEPA.	1	

Discussion

Several comments state that BPA does not listen to the little guy. Others express concern that government agencies ignore the desires of the people. Three comments state that there is a lack of information. Three state that the SN CRAC is just targeting the aluminum industry.

BPA has processes in place to ensure that anyone who desires can provide input into BPA's rate setting process. Once BPA knows it needs to adjust its rates, BPA develops its rate proposal in a multiphase process. Pre-rate case workshops and workshops on BPA's financial situation were held in late summer of 2002 and into early 2003. These workshops generally are highly technical. Notice is posted on BPA's Internet site and mailed to interested persons. BPA staff and others revise computer models, conduct analyses, and develop alternative solutions and share them in the workshops. For the rate case itself, BPA follows the procedures outlined in section 7(i) of the Northwest Power Act. BPA has added steps to those procedures to make the rate case even more informative. Rate cases include many chances for participants and parties to read and ask questions about BPA's case and to provide comments and criticisms to BPA. Rate case "parties" are involved in the formal steps of the section 7(i) hearing process. In addition, participants can provide input. One of these opportunities occurred on April 16, 2003, when

BPA held a field hearing in Portland, Oregon; the field hearing included a presentation by BPA and time for public input, questions, and answers. Rate cases also include a public comment period, during which BPA accepts comments submitted by post, electronic mail, or telephone. Other than officially recognized parties, any person or organization may comment and thus become a participant. BPA received over two thousand participant comments on its SN CRAC proposal, and each was catalogued, read, and considered before the Administrator made his decisions summarized in this ROD.

Regarding comments that there is insufficient information, BPA understands the frustration that can occur when dealing with a large entity such as BPA. BPA has tried to make information complete, accurate, and available through various sources, such as the Internet (www.bpa.gov), mailing lists of interested persons, advertisements in local newspapers, and a toll-free line to BPA's public information and document request center (1-800-622-4520). BPA also publishes a comprehensive monthly newsletter called the Journal to which anyone may subscribe free by calling BPA's toll-free line (1-800-622-4519). BPA will mail information to those who request it, free of charge. Although it is time consuming and expensive to be a party to BPA's rate case, and such a responsibility requires time and expertise, the Hearing Officer admits to party status any group that can fulfill its responsibilities and does not represent an interest already represented by another party. However, anyone not representing an official party can become a participant and have his or her comments included in the official record of the rate proceeding.

Financial Reserves	**Letter Comments**	**Public Meeting Comments**
a. Do not build up financial reserves.	14	2
b. Use refinancing as a reserve.	15	
c. Appreciate BPA taking advantage of refinancing.	1	

Discussion

Many participants commented on the topic of financial reserves, stating they do not want BPA to build up financial reserves, and that BPA should look to refinancing as a source of financial reserves. As discussed elsewhere in this ROD, BPA's risk management tools, including financial reserves, balance the many needs BPA faces. BPA must consider its obligation to repay the U.S. Treasury for the Federal investment in the FCRPS; BPA's competitive position in the market; BPA's rate setting and other requirements as set forth in its governing statutes; and future possibilities for contingencies and uses of funds. For detailed discussions of revenue recovery and risk issues, *see* ROD chapters 2.1 and 2.6.

Existing Contracts	**Letter Comments**	**Public Meeting Comments**
a. Renegotiate buy-back contracts with IOUs.	2	
b. Renegotiate supplier and labor contracts.	1	

Discussion

Two comments state that BPA should renegotiate buy-back contracts with IOUs. BPA has encouraged its public utility customers and the IOUs to discuss a possible settlement that would address the benefits provided BPA to its IOU customers. If these discussions are successful, any cost savings would be reflected in BPA's rates.

Another comment suggests that BPA renegotiate its labor contracts and contracts with suppliers. BPA continuously examines its labor and supply contracts for efficiency savings. Reductions in many of these contracts have already occurred.

Fish and Wildlife	**Letter Comments**	**Public Meeting Comments**
a. Eliminate recommendations from the Biological Opinion that have not had economic or NEPA analysis; eliminate general fish and wildlife programs (salmon recovery); other projects; reevaluate cost/benefits.	19	1
b. Oppose unnecessary cuts to fish programs.	6	2
c. Do not blame anadromous fish for financial problems; disconnect fish and wildlife from the Power Business Line.	2	
d. The initial proposal does not accurately portray the origin of the expense portion of the Fish and Wildlife Program cost.	2	
e. The initial proposal could impede the use of BPA's borrowing authority for fish and wildlife.	2	

Discussion

Many comments state that BPA should eliminate recommendations from the NMFS 2000 Biological Opinion that have not been subjected to economic analysis or NEPA analysis, and that BPA should eliminate salmon recovery programs. Several comments state that they oppose cuts to fish programs. Because these fish and wildlife issues were already developed through extensive public involvement and comment processes prior to this rate proceeding, BPA directed the Hearing Officer to exclude any material regarding them from the record. 68 Fed. Reg. 12052. These issues are thus beyond the scope of this SN CRAC rate proceeding.

Two comments asked BPA not to blame anadromous fish for its financial problems. BPA has not done so. In fact, in letters and public statements, BPA has emphasized that fish and wildlife funding was not a source of BPA's cost overruns.

Two comments also propose disconnecting the fish and wildlife program area from the PBL. BPA's Fish and Wildlife Division is in Corporate, not the PBL. The impacts BPA is mitigating under the Integrated Program arise from FCRPS operations—*i.e.*, hydropower management decisions made by PBL and the FCRPS operators, the Army Corps of Engineers and the Bureau

of Reclamation. Because there are daily hydro system operational decisions that affect both fish and power marketing, PBL must be able to coordinate closely with the Corporate service providers who help ensure that PBL's actions fully meet BPA's obligations and commitments to fish and wildlife.

Some participants believe BPA's initial proposal did not accurately portray the origin of the expense portion of the Fish and Wildlife Program. BPA believes that such information was and is accurate. Nevertheless, it was provided as background and relates to program level policy decisions that are not being decided in this SN CRAC rate proceeding. If participants desire additional information or clarification on this issue, they should examine the rebuttal testimony of BPA witnesses McNary and Lamb, SN-03-E-BPA-18.

Comments express a concern that BPA's initial proposal could impede BPA's ability to capitalize fish and wildlife projects. These participants wish to ensure the possibility that BPA would increase the class of assets that it may capitalize when implementing the Integrated Program. BPA included capitalization language in the initial proposal as part of a commitment to the region to preserve the option of capitalizing fish and wildlife habitat acquisitions. When BPA made that commitment, it understood the request was in terms of land only, not water rights, because the need under the program was land for wildlife habitat. Moreover, BPA indicated it needed a means to credit acquisitions against a known obligation in order to capitalize habitat. Because there is neither a crediting mechanism nor established obligation to guide capitalization of water rights, BPA makes the policy decision, outside this rate making process, to exercise its option to capitalize land for fish and wildlife habitat.

Other Miscellaneous	**Letter Comments**	**Public Meeting Comments**
a. Against the RTO	4	
b. Go after Enron, etc.	3	
c. Keep regulating Centralia Power	1	
d. Other miscellaneous	1	

Discussion

A few comments oppose the establishment of an RTO in the region. The policy issues concerning matters such as RTO development in the region are at preliminary stages and are not at issue in the SN CRAC rate proceeding.

Three comments suggest BPA should "go after" Enron and others who may have engaged in illegal practices in securing contracts with BPA. BPA and Enron have reached a settlement of power purchase augmentation contracts resulting in $90 million in net savings. The settlement with Enron will be paid from the U.S. Treasury Judgment Fund. BPA will repay the Judgment Fund. The details of its treatment will be an issue for BPA's LB CRAC workshops.

One comment argues for BPA to continue regulation of Centralia Power. BPA does not regulate Centralia Power.

5.0 CONCLUSION

As required by law, the SN CRAC rate adjustment established and adopted in this ROD, in conjunction with BPA's base rates and other CRACs, has been set to recover the costs associated with the acquisition, conservation, and marketing of electric power, including the amortization of the Federal investment in the FCRPS (including irrigation costs required to be repaid out of power revenues) over a reasonable period of years and all other power-related costs and expenses incurred by the Administrator in carrying out the requirements of the Northwest Power Act and other provisions of law. In addition, this adjustment, in conjunction with BPA's base rates and other CRACs, has been designed to be as low as possible consistent with sound business principles, to encourage the widest possible use of BPA's power, and to satisfy BPA's other ratemaking obligations, including those contained in the Energy Policy Act of 1992. The Hearing Officer has assured that all interested parties and participants were afforded the opportunity for a full and fair evidentiary hearing, as required by law.

BPA has evaluated its proposed rate provisions in a section 7(i) proceeding pursuant to the Northwest Power Act. In addition, BPA has considered the potential environmental effects of the proposed rate provisions, consistent with the National Environmental Policy Act. In this instance, I have reviewed the Business Plan Final EIS and ROD and determined that the proposed rate provisions are within the scope of this EIS and consistent with the Market-Driven Alternative adopted in the Business Plan ROD.

Based upon the record compiled in this proceeding, the decisions expressed herein, and all requirements of law, I hereby adopt the attached SN CRAC rate adjustment as final. In accordance with Federal Energy Regulatory Commission requirements, 18 C.F.R. section 300.10(g), the Administrator hereby certifies that the SN CRAC adjustment adopted herein, in conjunction with BPA's base rates and other CRACs, is consistent with applicable laws and provides the lowest possible rates consistent with sound business principles.

Issued at Portland, Oregon, this 30 day of June, 2003.

Administrator and Chief Executive Officer