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REBUTTAL TESTIMONY OF

MICHAEL J. DEWOLF, RONALD J. HOMENICK, VALERIE A. LEFLER,

DANA M. JENSEN, PHILIP W. THOR, KELLY W. KINTZ, AND BYRNE E. LOVELL

Witnesses for Bonneville Power Administration

SUBJECT: Rebuttal Testimony for the Revenue Requirement Study

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Attachments

1. Memo, dated May 26, 1999, to Regional Federal Executives
2. Data Response to CR-BPA-028
3. Data Response to CR-BPA-003
4. Data Response to NA-BPA-004
5. Data Response to BPA-PP-007
6. Data Response to BPA-PP-009

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SUBJECT: REBUTTAL TESTIMONY FOR THE REVENUE REQUIREMENT STUDY

Section 1. Introduction and Purpose of Testimony

Q. Please state your names and qualifications.

A. My name is Michael J. DeWolf. My qualifications are contained in WP-02-Q-BPA-16.

A. My name is Ronald J. Homenick. My qualifications are contained in WP-02-Q-BPA-30.

A. My name is Valerie A. Lefler. My qualifications are contained in WP-02-Q-BPA-43.

A. My name is Dana M. Jensen. My qualifications are contained in WP-02-Q-BPA-32.

A. My name is Philip W. Thor. My qualifications are contained in WP-02-Q-BPA-66.

A. My name is Kelly W. Kintz. My qualifications are contained in WP-02-Q-BPA-36.

A. My name is Byrne E. Lovell. My qualifications are contained in WP-02-Q-BPA-44.

Q. Please state the purpose of your testimony.

A. Our testimony has five purposes. First, to respond to direct testimony filed by witnesses regarding Bonneville Power Administration's (BPA) proposal to implement its policy standard for Treasury Payment Probability (TPP) in full in this rate case. Second, to address issues raised about a high expected value of ending reserves, and the Dividend Distribution Clause (DDC). Third, to respond to a variety of issues regarding the Fish and Wildlife Funding Principles (Principles) and their implementation in this rate proceeding. Fourth, to address cost controls related to a Cost Recovery Adjustment Clause (CRAC). And fifth, to address issues raised regarding functionalization of costs between generation and transmission.

Q. How is your testimony organized?

A. This testimony is organized into six sections including this introductory section. The second section deals with BPA's TPP goal. The third section discusses modifications to the DDC proposal and the expected value of ending reserves. The fourth section addresses concerns regarding the Principles. The fifth section addresses cost control issues relative to CRAC. And the last section deals with functionalization.

Section 2. Treasury Payment Probability (TPP) Standard

Q. What is the purpose of this section?

A. In the Initial Proposal, BPA implements its policy standard that risks be identified and quantified, risk mitigation tools be designed, and rates be set to achieve an 88 percent probability that payments to Treasury be recovered on time and in full over a five-year rate period. *See* DeWolf, *et al.*, WP-02-E-BPA-13, at 21-27. In response, some Parties have offered testimony recommending that a different TPP level be targeted. This section addresses the issues raised by these alternative proposals.

Q. Are you proposing any changes in the Initial Proposal's 88 percent TPP goal?

A. No. The Principles strongly urge BPA to achieve an 88 percent TPP in this rate case. Although the Principles allow for a lower goal (down to 80 percent), BPA finds no compelling reason for not implementing this standard in full. Conditions that prevented BPA from implementing this goal in the 1993 and 1996 rate filings are not present today. Reserves are building at a higher pace than expected when rates were last set, BPA's costs are below market price expectations, the rate stability pledge is being met, and demand for Subscription products is apparently strong. In the judgment of the Administrator and concerned Executive Branch agencies, implementation of Principle No. 4 could be undermined if the 88 percent TPP goal in Principle No. 3 were relaxed.

Q. Northwest Requirements Utilities' (NRU) testimony recommends lowering TPP in conjunction with replacing the DDC with a Reverse CRAC and lowering annual CRAC *thresholds and caps. Saven, WP-02-E-NI-01, at 11-17. Do you agree with NRU's recommendation?*

A. No. The risk mitigation package proposed by NRU reduces the TPP goal to about 85.5 percent by replacing the DDC with a Reverse CRAC that automatically triggers rebates to customers if reserves reach $850 million. In fact, BPA's modeling of the NRU proposal calculates only an 83.3 percent TPP. In addition, the package lowers the annual CRAC thresholds and caps, but keeps planned net revenues for risk (PNRR) at the same level as BPA proposes. The Reverse CRAC is inherently flawed because its rigid, mechanistic nature does not take into account prevailing costs, risks, and reserve requirements in deciding how much to distribute as dividends. The inflexibility of the automatically triggered Reverse CRAC could jeopardize Treasury repayment in situations where there are high costs that lie ahead. It is not sound business practice to rebate money shortly before that same money will be needed. *See* Section 3 of this testimony and WP-02-E-BPA-40 on CRAC. BPA also disagrees with NRU's proposal for reducing the CRAC thresholds and caps because it lowers TPP below the goal unless more PNRR were included in revenue requirements. As noted previously, BPA sees no compelling reason to modify its risk mitigation tools in a manner that will result in a TPP lower than 88 percent. And increasing PNRR to accommodate the changes advocated by NRU would preclude BPA from meeting its rate stability pledge, all other things being equal.

Q. Several parties conclude that the TPP should be reduced to prevent accumulation of excessive reserves. Saven, WP-02-E-NI-01, at 4; Speer, et al., WP-02-E-AL/VN/EG-02, at 10. Do you agree?

A. No. BPA disagrees with the conclusion that the build-up of reserves is excessive, and we therefore see no problem in need of correction. *See* Section 3 of this testimony. That said, reducing TPP for the purpose of reducing the build-up of reserves is something of a blunt instrument, in that the DDC that BPA proposes will accomplish the same objective without reducing TPP. *See* Section 3 below.

Q. *NRU argues that "an 85.5 percent TPP results in an acceptable level of risk, in part because it is not likely that all power will be sold under five-year contracts, and in part because there is a low probability that some of the more expensive options under the 13 alternatives for system reconfiguration will ever occur." Saven, WP-02-E-NI-01, at 6. Do you agree?*

A. No. While we agree that three-year contracts provide some protection against rising costs, they also increase the risks due to the potential for low markets and increased competition. And as discussed in Section 4 of this testimony, the Administration, including BPA believe that the "keep the options open" strategy, and treatment of the 13 Alternatives as equally likely to occur, is sound and necessary given uncertainties on future fish and wildlife (F&W) funding requirements. BPA made a commitment to implement the Principles, including treatment of the 13 Alternatives without prejudice, in this rate proposal. Maintaining that commitment remains a reasonable basis for addressing F&W costs.

Q. *The testimony of some of the direct service industrial customers (DSI) assert that BPA is expecting its highest level of starting reserves in 2002 and is increasing fish funding in spite of the absence of a fish program spending level. In light of these factors, this testimony recommends that BPA lower its TPP goal to 74 percent, which represents a midpoint between 88 percent and 60.5 percent (calculated using the 88 percent TPP minus PNRR and CRAC). Speer, et al., WP-02-E-AL/VN/EG-02, at 10. Do you agree?*

A. No. The proposal for a reduction of the TPP goal to 74 percent falls outside the allowable range of TPP in the Principles, and BPA is adamant that it will implement the Principles in full in this rate filing. This party has provided no case or evidence that it would be sound financial and public policy to sharply reduce the TPP goal and shift risk to Treasury and taxpayers.

Q. *Do you agree with the DSIs statement that increasing TPP to 88 percent from the 1996 rate case level of 80 percent is too expensive, therefore justifying decreasing the TPP goal adopted in the Initial Proposal? Schoenbeck and Bliven, WP-02-E-DS/AL/VN-03, at 10-11.*

A. No. BPA adopted the 88 percent policy standard in 1993 after extensive public discussion with customers, constituents, members of the Northwest Delegation, and the Administration at the time. The Administration, including BPA, believes that this TPP level represents sound fiscal policy, particularly in view of BPA being able to set rates below market price expectations. This policy provides real value for BPA's customers, while fulfilling environmental obligations and protecting Treasury and taxpayers.

Q. *The investor-owned utilities (IOU) argue that the 88 percent TPP results in a 12 percent probability that Power Business Line (PBL) will not be able to pay its costs in full, resulting in a transmission surcharge or a cost shift to transmission customers? Eakin, et al., WP-02-E-AC/GE/IP/MP/PL/PS-01, at 4-6. Do you agree with the validity of that assumption?*

A. No. With an 88 percent TPP, there is a 12 percent probability that BPA will not be able to meet the generation portion of its Treasury payments on time and in full over the five-year rate period. If a missed payment were imminent, BPA may have available a variety of financial options, depending on timing and magnitude. A transmission surcharge would likely be one of the options. The parameters for a transmission surcharge that are being considered by Congress and the Administration all treat cash transfers from transmission to generation as a loan to be repaid at rates of interest that keep transmission customers "whole" over time, so no "cost shift" is in prospect. Per the Initial Proposal, DeWolf, *et al.*, WP-02-E-BPA-13, at 21-27, BPA is for the first time implementing its longstanding TPP policy standard in full in this rate proposal. The proposed set of risk mitigation tools is unprecedentedly robust. Even though a transmission surcharge is an option, the TPP goal is being met with no reliance on this potential tool. Further, the DDC is designed so that "dividends" will be distributed unless some or all of the reserves over a predetermined threshold are needed to meet cost recovery requirements over the ensuing five-year period. BPA's strategy provides exceptional protection for the Treasury and taxpayers and, for that matter, for transmission ratepayers.

Q. The DSIs argue that "with regard to the limitation to TPP testimony, BPA has never before attempted to preclude testimony on TPP." Speer, et al., WP-02-E-AL/VN/EG-02, at 4, lines 23-25. Please respond.

A. BPA's policy is to achieve an 88 percent TPP when setting rates. The Principles established the TPP range of 80 percent-88 percent as acceptable. As has been discussed previously in this section, BPA sees no compelling reason to lower the TPP goal. However, BPA did not foreclose testimony on this issue, and BPA made no motion to strike testimony advocating a TPP below the range.

Section 3. Concerns Regarding Average Ending Reserve Level, and Proposals to Replace Dividend Distribution Clause with a "Reverse CRAC"

Q. Please summarize the Public Power Council's (PPC) testimony regarding average ending reserves and its proposal for a "Reverse CRAC."

A. The PPC describes BPA's initial proposal as a proposal to accumulate average financial reserves of $1.26 billion for the generation function by the end of the next rate period. *See* Hansen, *et al.*, WP-02-E-PP-03, at 8, lines 6-9. The PPC contends that such a level of reserves is not necessary to keep BPA financially viable or ensure high probability of Treasury payment. *Id.*, at lines 17-18. Among other recommendations, the PPC recommends a "reverse CRAC" that would refund revenues to customers subject to the

CRAC when BPA's financial reserves exceed $850 million. The maximum amount of money that could be returned in a given year under the reverse CRAC would be capped, meaning that reserves could rise above $850 million. The stated intent is to slow the rate of accumulation of reserves above $850 million, and to ensure that the expected value of reserves at the end of the rate period would be $850 million. (*See* Hansen, *et al.*, WP-02-E-PP-03, at 10, line 5.) By the PPC's analysis, its proposal would reflect " . . . a 30 percent chance that BPA's reserves would be at or in excess of $1.2 billion at the end of the rate period." *Id.* at lines 14-16.

Q. The PPC contends that BPA's DDC has a number of design flaws. Please summarize this position on DDC design.

A. The PPC contends that there are several flaws with BPA's proposed DDC:

- a reserves threshold ($1.2 billion) for triggering distributions that is too high;
- no assurance that the mechanism will trigger even if reserves reach such a high level because the Administrator retains discretion on whether and how much to distribute; and
- BPA "does not support returning the refund to those customers who are responsible for supporting BPA's finances in bad times via the CRAC." Further, BPA is inappropriately proposing to decide on dividing and allocating dividends among stakeholders in a separate process following the rate case.

See Hansen, *et al.*, WP-02-E-PP-03, at 13, starting at line 9 to page 20, to line 17.

Q. Please summarize NRU's position on reserves and the DDC.

A. NRU describes BPA's initial proposal as a proposal to accumulate average financial reserves of $1.26 billion in the generation function by Fiscal Year (FY) 2006, with half the scenarios being higher and half being lower. NRU states that there would be a 10 percent chance that the level of reserves will be $2.43 billion or higher. NRU notes that these levels assume that the DDC is not triggered. *See* Saven, WP-02-E-NI-01, at 8, lines 1-7.

NRU does not support the accumulation of "maximum or average reserves at the high levels proposed by BPA", arguing that the proposal does not meet BPA's policies on operating in a "sound and business-like manner." *Id.*, at lines 10-12. Specifically, NRU argues that:

- Such a high level of reserves becomes an "attractive nuisance", in that businesses with large cash reserves become prime targets for takeovers (*Id.,* at 8, lines 16-18).
- Members of the Northwest Delegation have repeatedly warned BPA that reserves of over $1 billion pose a serious threat, in part due to the attractiveness of selling Power Marketing Agencies and using the proceeds for other purposes (*Id.*, at 8, lines 19-22).
- It is further ammunition for members of Congress from other areas of the country that are already attacking cost-based rates in the Northwest and want to move BPA rates from cost to market basis (*Id.*, at 8, line 22 through page 9, line 2).
- The availability of "unnecessary" reserves simply results in pressure on the agency to spend money, either for one-time or ongoing newly defined responsibilities. This is a major concern to BPA's historic full requirements customers, including NRU members, particularly at the end of the next rate period. *Id.*, at 9, lines 3-5.

Q. *What does NRU propose as an alternative?*

A. Like the PPC, NRU proposes an expected value of ending reserves of about $850 million, and notes that this level represents a 70 percent increase over the starting reserves level assumed when the Principles were adopted, and a 25 percent increase over the starting reserves in BPA's initial proposal (*Saven*, WP-02-E-NI-01, at 10, lines 1-7). NRU also urges BPA to abandon its proposal for a DDC, and instead adopt a "Reverse CRAC" similar to the PPC proposal wherein reserves in excess of $850 million would be rebated automatically to customers who are subject to the CRAC, up to an annual cap (*see* Saven, WP-02-E-NI-01, at 12, lines 14-21).

Q. *What is NRU's rationale for proposing the Reverse CRAC?*

A. NRU argues that the Reverse CRAC:

- Clarifies that BPA does not intend to accumulate funds in excess of what is required to sustain existing rates and TPP;
- "Solves the problem of potential transfer of benefits between current customers in 2002-2006 and future customers post 2006";
- Generally aligns a sharing of benefits with customers who have responsibility to pay for the system, and who are subject to CRAC; and
- Supports the principle of cost-based rates by giving BPA both a forward and a reserve mechanism to help respond to potential swings in reserve levels.

See Saven, WP-02-E-NI-01, at 14, lines 8-21.

Q. Why does NRU not support BPA's proposed DDC?

A. NRU argues that the DDC:

- Pushes BPA away from its obligation to operate in a "sound and business-like manner" by subjecting the agency to extensive political pressures, *see* Saven, WP-02-E-NI-01, at 16, lines 4-8; and
- Potentially shifts costs of the post-2006 era to current customers. *Id.*, lines 10-13.
- In addition, "this is the customers' money, which should be used for business-related activities, including returning excessive collections to the customers." Further, high reserves "lead to uncoordinated and potentially dysfunctional spending patterns, encouraging confusion and lack of accountability, and keeping the region from developing a truly integrated plan." Finally, the NRU argues that the proposed follow-on public process for deciding on the allocation of dividends among stakeholders will "diminish the region's ability to work constructively on such topics

as a Regional Transmission Organization (RTO), and Northwest Chapter, a comprehensive plan for F&W, and a review of approaches to governance." *See* Saven, WP-02-E-NI-01, at 16-17.

Q. How do you respond to the PPC and NRU criticisms and proposals for reserves and a Reverse CRAC?

A. Our response includes three components: first of all we clarify BPA's initial proposal regarding reserves and the DDC. Second, we propose a change to our initial proposal for the DDC. And third, we rebut several of the arguments raised by these parties.

Q. Please begin with the first component, clarifying BPA's initial proposal. Why did BPA's initial proposal include a DDC?

A. There is substantial "upside" uncertainty that may cause net revenues to accumulate at levels higher than our cost recovery goal of an 88 percent required TPP. If hydro, market price, and other risks do not materialize, and costs are not significantly higher or revenues significantly lower than planned, BPA's generation function may accumulate reserves in excess of its long-term needs. For this reason, BPA proposed the DDC. *See* DeWolf, *et al.*, WP-02-E-BPA-13, at 27, lines 8-12.

Q. Does BPA's initial proposal include a "reserves" target?

A. No. BPA has not proposed a reserves target or a reserve plan in this rate proceeding. Rather, BPA has modeled its risks and proposed a set of risk mitigation tools that are designed to achieve the 88 percent TPP goal. It is the five-year, 88 percent policy standard that is the goal, not a particular expected value of reserves.

Q. What does BPA mean when it refers to the "expected value of reserves"?

A. The term "expected value of reserves" refers to a statistical mean, or average, of the ending FY 2006 reserves in the 3,900 "games" in BPA's risk analysis. This set of 3,900 games represents the range of possible futures for BPA's reserves, taking into account projections of costs and revenues and the impacts of risks and risk mitigation tools. About half of the games include higher reserve results than an expected value and about half include lower reserve results.

The expected value of reserves itself is uncertain because BPA was unable to use its models to reflect the operation of the DDC. Two uncertainties were not modeled: (1) distributions under the DDC can reduce or "zero out" the accumulation of reserves above the DDC threshold; and (2) decisions on the exact amounts to be distributed will be made during the rate period, at such time as the threshold is reached. In the initial proposal, the DDC includes a threshold of $500 million in actual accumulated net revenues (equivalent to $1.2 billion in reserves) attributable to the generation function. At such time as the threshold is reached, reserves in excess of the threshold are distributed unless it is demonstrated that some or all of the excess must be retained to meet the 88 percent TPP goal for the ensuing five-year period. It is this five-year, forward looking 88 percent TPP test that BPA was unable to model in its initial proposal. This demonstration entails a financial forecast and TPP analysis that takes into account risk factors prevailing at that time. The forecast and TPP analysis would undergo the scrutiny of a public review and comment process before decisions are made to reduce amounts that otherwise would be distributed.

Q. *Did BPA's initial proposal model the probabilities of distributions being made under the DDC in calculating the expected value of reserves by FY 2006?*

A. No. The modeling we presented in the initial proposal, wherein the expected value of reserves ramped up to $1.26 billion by FY 2006, did not take into account the fact that distributions would be made under the DDC--even in the large number of games where reserves were substantially higher than the $1.2 billion threshold. This means that the $1.26 billion represents the upper bound on what the expected value would be if the DDC were factored in, because reserves above the DDC threshold will be affected by dividend distributions, and the level of distributions will not be decided now, but during the rate period based on conditions at the time the threshold is reached. Our initial proposal testimony was not as clear as it might have been that the $1.26 billion estimate was an upper bound.

Q. Let's move to the second component of your response. Please explain how BPA proposes to change its initial proposal.

A. The design of the DDC is sound given the very large financial uncertainties that we face and clear direction in the Principles and Subscription Strategy. We propose to make no change to our initial proposal that reserves in excess of the DDC threshold be distributed unless it is demonstrated that some or all of the excess is needed to meet the 88 percent TPP goal for the ensuing five-year period. We make no change to the requirement that BPA prepare a forecast and analysis of revenues, expenses, and TPP for the ensuing five-year period, and that BPA subject its forecast and analysis to public scrutiny and comment before deciding finally on a distribution amount. *See* WP-02-E-BPA-02A, Volume 1, Chapter 12, Appendix 2, and WP-02-E-BPA-07, pp. 91-92. In addition, our position is unchanged that decisions on "dividing and allocating" dividends among customers and other stakeholders should be deferred to a public process following this rate proceeding. *Id*.

We do, however, propose to reduce the DDC threshold level by $250 million from the initial proposal level of $500 million actual accumulated net revenues (equivalent to $1.2 billion reserves) to $250 million actual accumulated net revenues (equivalent to $950 million reserves). This reduction increases the average annual probability that the DDC threshold will be reached, from the initial proposal probability of 32 percent, to 44 percent. The threshold would continue to serve as a cap on the total amount that may be distributed in a given year.

Q. Why is BPA reducing the DDC threshold?

A. The concept of the DDC is that cash in excess of the threshold will be distributed unless some or all of the excess is needed to meet the five-year, forward looking TPP test. In other words, cash should not be retained but rebated or otherwise distributed if it is not needed to mitigate risks and recover costs. A significant percentage of the games that we have modeled in Tool Kit suggest that the TPP test may be met with a lower level of reserves than the initial proposal's $1.2 billion threshold. Accordingly, BPA is proposing to lower the DDC threshold to help ensure that cash is not retained if it is not needed for the TPP test.

Q. Why is BPA reducing the threshold by $250 million, from $1.2 billion to $950 million (reserves equivalent)?

A. The $950 million trigger level was derived judgmentally, based on consideration of three criteria: (1) it falls below the $1 billion amount identified earlier by the region's Congressional delegation, (*see* Saven, WP-02-E-NI-01, at 8, lines 19-22) as a threshold for being an "attractive nuisance" for extraregional interests who might use it to support a proposed sale of the Federal system or a major change to the way that Federal power is priced; (2) by reducing the threshold, we are forced to review our five-year projections more often, thereby giving customers a more frequent chance to review the logic behind our reserve requirements. Again, BPA's intent is not to build reserves beyond its risk and TPP requirements; and (3) the new $950 million threshold is close to the highest level of reserves BPA has attained, so a review is appropriate as we move to build reserves beyond.

Q. You mentioned that BPA did not model DDC distributions in its initial proposal. Have you modeled DDC distributions since then?

A. No, but BPA has made an approximation that takes into account the $950 million threshold that is useful to consider.

Q. How was this approximation made?

A. When BPA makes its five-year TPP test to determine the amount of a dividend distribution, if any, it will assess the current forecasts of costs and revenues. Key components will be the forecasts of market prices for electricity and forecasts of BPA's expenses for F&W. While BPA's analytical tools cannot yet take the market forecast into account, representations of the range of F&W costs are available from the 13 Alternatives in a form suitable for modeling. BPA ran the ToolKit with separate DDC thresholds for each of the 13 Alternatives (18 including the schedule variations). The thresholds for ending FY 2002 reserves (for distribution starting in FY 2003) were set to: (1) $950 million for those F&W Alternatives where the Conditional TPP (CTPP) was at least 88 percent with the DDC at that level; or (2) the lowest DDC threshold that did not reduce the CTPP for that alternative below what it was before modeling the DDC. The DDC thresholds for FY 2006 were set by adjusting the FY 2002 thresholds for change in the financial impacts of the F&W program. For each F&W Alternative, BPA calculated the amount by which the average cost for FY 2007 through FY 2011 exceeded the average cost for all alternatives for FY 2002 through FY 2006. BPA assumed for this approximation that the first $100 million of this increase would be covered by rates, and that half of the remaining increase would be covered by rates. The other half would be covered by reserves, if sufficient reserves exist. The DDC threshold for FY 2006 was then set to be equal to the FY 2002 threshold plus five times half of the amount of the increase remaining after subtracting $100 million. The thresholds for years FY 2003 through FY 2005 were set by straightline interpolation between the values for FY 2002 and FY 2006. The expected value of the ending FY 2006 reserves calculated this way is a little under $900 million.

Q. This seems very complicated. What does it really mean?

A. Since the methodology for performing a five-year TPP test in FY 2002, FY 2003, etc., has not been developed yet, and the data that will be used then does not exist now, all we can do now is to approximate how that test could work. A reasonable conclusion to draw from this approximation is that the expected value of ending FY 2006 reserves will be well below $1.0 billion. In those cases where the ending FY 2006 reserves could be above $1.0 billion, it would be because larger reserves were required to mitigate risks foreseeable at that time, such as risks of large financial impacts of F&W programs.

Q. *Let's continue with the third component of your response to testimony on reserves and the reverse CRAC. The PPC and NRU recommend that BPA discard its DDC proposal and replace it with a "Reverse CRAC." Do you agree with their proposal?*

A. No. However, BPA agrees that the threshold for considering distributions, including rebates to customers, should be substantially lower than we proposed initially.

Q. *Why doesn't BPA accept other elements of the PPC's and NRU's proposal for a Reverse CRAC?*

A. BPA uncertainties and risks are great, and PPC's and NRU's proposed "Reverse CRAC" is unduly rigid and mechanistic, therefore offering little flexibility or adaptability to changing costs and risks. BPA believes the automatic nature of the proposed Reverse CRAC creates an inflexibility that could jeopardize Treasury payments in situations where BPA knows that high costs lie ahead. It is not sound business practice to rebate money shortly before that same money will be needed. In this way, the Reverse CRAC fails to meet the requirements of Principle No. 4 (of the Principles) because it includes no consideration of prevailing TPP and no option to recalibrate the reserve amount that is rebated as risk and cost conditions change. By specifying inflexible formulaic criteria today that govern reserve levels up to seven years hence, the Reverse CRAC could shift significant risk to the U.S. Treasury, and make any potential for rate spikes and cost recovery problems worse when rates are set for the post-FY 2006 rate period.

The PPC's and NRU's testimony incorrectly concludes that a reverse CRAC triggering at $850 million would result in expected reserves of that amount

($850 million). PPC's and NRU's testimony overstates the expected amount of reserves that would be accumulated by a reverse CRAC triggering at $850 million because it does not take into account the scenarios in which reserves never reach the $850 million level. As a result, the expected reserve level might not be enough to ensure a sufficiently high TPP.

Q. The NRU argues that the DDC is inconsistent with BPA's obligation to operate in a "sound and business-like manner" by subjecting the agency to extensive political pressures. Western Public Agencies Group (WPAG) states that "BPA is not a philanthropic organization with license to disperse funds where ever it deems it politically correct to do so. BPA does not have authority to engage in income redistribution in this manner." Cross, et al., WP-02-E-WA-01, at 31-34. NRU also argues those high reserves leads to poor cost management and lack of accountability, Saven, WP-02-E-NI-01, at 16, line 22 to page 23, line 1. Do you agree?

A. No. Because BPA faces so much uncertainty, we have proposed a CRAC to increase rates and revenues temporarily if net revenues fall off significantly. By the same token, we have proposed a DDC because there is significant "upside" uncertainty that may cause BPA to collect more revenues than needed to meet its cost recovery goal. It is sound business practice to design its risk management measures and a dividend policy that adapts to changing circumstances. We understand that public processes for the DDC may be contentious because they entail issues of regional priorities and values and allocation of public benefits. However, in our judgement the Reverse CRAC's lack of flexibility and adaptability, its potential for shifting risk to Treasury and taxpayers, and its inconsistency with the Principles all pose greater political risks. Elsewhere in our rebuttal testimony, BPA is including new financial disclosure commitments to further improve public accountability, and a new safeguard to assure our customers and constituents that we will not trigger CRAC because of unsound or ineffective cost management.

Q. *The NRU argues that "accumulation of a projected average of reserves of over $1 billion would be … a kind of attractive nuisance," in that "businesses with large cash reserves become prime targets for takeovers. Members of the Northwest Delegation have repeatedly warned BPA that reserves of over $1 billion pose a serious threat, in part due to the attractiveness of selling Power Marketing Agencies and using the proceeds for other purposes. It is further ammunition for members of Congress from other areas of the country that are already attacking cost-based rates in the Northwest and want to move BPA rates to market." Saven, WP-02-E-NI-01, at 8, lines 16 - page 9, line 2. How do you respond?*

A. Reserve levels that BPA showed in its initial proposal did not include any estimate of the impact of the DDC. We have since proposed lowering the threshold for the DDC's five-year, forward looking TPP test from $1.2 billion to $950 million. We have been able to approximate the impact on the expected value of reserves with the lower DDC threshold, and the expected value of ending 2006 reserves would be below $1 billion.

Second, concerns over BPA becoming a takeover target are highly speculative. In BPA's judgement the political risk of an imprudent financial policy that places greater risk on Treasury and the taxpayer outweighs the risk of making BPA a more attractive takeover target.

Third, the scenarios in which BPA may accrue reserves above $1 billion are those in which BPA would be able to demonstrate that for sound business reasons larger reserves are needed to reduce the risk to the Treasury of a deferral. These scenarios are likely to be ones in which we face large F&W expenses. Such circumstance would significantly reduce any attractiveness as a takeover target.

Q. *NRU argues that "the availability of unnecessary reserves simply results in pressure on the Agency to spend money, either for one-time or ongoing newly defined responsibilities. This is a major concern to BPA's historic full requirements customers, including NRU members, Saven, WP-02-E-NI-01, at 9, lines 3–5. Do you agree?*

A. We agree that in would be inadvisable to accumulate "unnecessary reserves," and have proposed a powerful DDC mechanism to prevent this. BPA proposes to distribute all of the reserves above $950 million that are unnecessary for meeting a five-year 88 percent TPP test. Therefore, by definition, if BPA retains reserves it will be because they are needed for prudent operation of the business, especially for ensuring a high likelihood of being able to make payments to the Treasury on time. In addition, BPA closely follows its annual performance and makes a great deal of information about this performance available publicly. High reserve levels cannot mask annual performance problems, and BPA has a strong motivation to operate prudently no matter how high its reserves may be.

Q. *The NRU argues that "this is the customers' money, which should be used for business related activities, including returning excessive collections to the customers," Saven, WP-02-E-NI-01, at 16, lines 16-18). Do you agree?*

A. No. The increasing importance of market mechanisms in the Pacific Northwest utility industry means that many parties have to make adjustments in their businesses. The fact that customers now have the opportunity to choose from many suppliers in addition to BPA has forced BPA to make many changes in its marketing and business planning. Customers must make corresponding changes in how they think of the money they pay to BPA. Once a customer has paid money for a product, the product is the customer's, and the money is the supplier's. The money that customers have paid to BPA becomes money for use in meeting statutory and regulatory responsibilities and policy objectives.

The NRU appears to be advancing an argument that would be appropriate if BPA were a co-op owned by its customer utilities. BPA's structure is very different from a co-op. The Federal Government retains title to all of BPA's assets, including accumulated net revenues and cash in the BPA Fund at Treasury. BPA's customers have no equity position or ownership share in the enterprise. These issues may be addressed more appropriately in "regionalization" discussions.

Q. *The NRU claims at that creation of high reserves "leads to uncoordinated and potentially dysfunctional spending patterns, encouraging confusions, lack of accountability, and keeping the region from developing a truly integrated plan." Saven, WP-20-E-NI-01, at 16, line 22 – at 17, line 1. Do you agree?*

A. No. As explained above, BPA will not be accumulating reserves above $1 billion unless it is demonstrably prudent from a business perspective to retain those reserves. In Section 5 of this testimony, BPA is including new financial disclosure commitments to further improve public accountability and a new safeguard to assure our customers and constituents that we will not trigger CRAC because of unsound or ineffective cost management. The Administrator remains accountable--formally to the Secretary of Energy, and less formally to regional parties, the Congressional Delegation, and other parts of the Administration--for all of BPA's spending. Since one of the greatest risks causing the need for high reserves is uncertainty over future regional plans; completion of a "truly integrated plan" for the region would help reduce the size of reserves BPA needs to maintain.

Q. *Finally, NRU asserts that the proposed follow-on public process for deciding on the allocation of dividends among stakeholders will "diminish the region's ability to work constructively on such topics as a regional transmission organization, a Northwest Chapter of Federal legislation, a comprehensive plan for F&W, and a review of approaches to governance." Saven, WP-20-E-NI-01, at 17, lines 5-10. How do you respond?*

A. We understand the concern, but regional discussions on regionalization, RTO and river governance are long-term discussions that are likely to engage the region's attention well beyond the period during which BPA plans to conduct a public process on the DDC. We have no expectation that the public process on dividing and allocating distributions will be lengthy, open-ended discussion--indeed, we purposely included a deadline in the rate schedule for bringing these issues to prompt debate and closure (September 2001).

Q. The PPC asserts that BPA's proposed DDC is flawed because "the Administrator retains discretion on whether and how much to distribute." Hansen, et al., WP-02-E-PP-03, at 14, lines 1-5. How do you respond?

A. Our DDC proposal calls for an analytical test to determine whether and how much to distribute. This five-year, forward looking 88 percent TPP test (or replacement financial criterion), not the Administrator's judgement, is the basis for determining the amount of the dividend. Again, cash in excess of the threshold will be distributed unless it is determined, with the benefit (and rigors) of a public review and comment process, that some or all of the excess must be retained for cost recovery purposes.

Q. The NRU argues that BPA's DDC could shift the costs of the post-2006 era to current customers. Saven, WP-02-E-NI-01, at 16, lines 11-13. Do you agree?

A. No. BPA's rates are being set to recover costs for the FY 2002 through 2006 period. Adopting a mechanism to distribute during the FY 2002 through 2006 period some of the revenue generated by those rates if circumstances show that it is not all needed does not shift any post-2006 costs into the FY 2002 through 2006 period. Post-2006 costs are not driving this rate proposal.

Section 4. Fish and Wildlife Funding Principles and Their Implementation

Q. What is the purpose of this section?

A. This section will address a variety of issues regarding Principles and their implementation. This section begins by addressing issues related to the scope of the rate proceeding relative to the Principles, and allegations that this rate proposal does not meet some of the Principles.

Q. *In answer to its question whether parties can submit testimony and argument on revenue requirements issues, Alcoa, Vanalco, and Energy Services, (Alcoa, et al.) argue that, in its Federal Register Notice (FRN), the Administration attempted to exclude from the section 7(i) process, testimony and argument on the Principles adopted in the Subscription Record of Decision (ROD), in particular the range of F&W costs adopted in the Principles. Speer, et al., WP-02-E-AL/VN/EG-02, at 4. Please respond.*

A. First, the statement of Alcoa, *et al*., that the Principles were adopted in the Subscription ROD implies that the Principles were developed in the same process as BPA's Subscription Strategy. This is not correct. To clarify, the Principles were developed in a separate public review process that occurred during the same period of time. As BPA noted in the FRN, in June 1997 the Northwest Congressional delegation sent a letter to Vice President Gore requesting that he work with the delegation and the four Northwest Governors to develop a proposal for extending the Memorandum of Agreement addressing F&W funding through FY 2001 in order to enable BPA to proceed with a Subscription process for post-FY 2001 power sales. *See* Department of Energy, BPA, 2002 Proposed Wholesale Power Rate Adjustment, Public Hearing and Opportunities for Public Review and Comment, 64 Fed. Reg. 44318, 44321 (1999). However, in the absence of a consensus on a post-FY 2001 F&W recovery strategy by mid-1998, concerned Federal agencies and regional stakeholders focused on a strategy that would "keep the options open" for future F&W decisions in order to allow BPA to move forward with its Subscription process and power rates proceeding. *Id.* The Principles were developed in an extensive public involvement process that focused on providing guidelines for structuring BPA's approach to Subscription in order to ensure that BPA could meet its financial obligations, including those for F&W. *Id.* The Principles were published on September 16, 1998, and Vice President Gore announced the establishment of the Principles on September 21, 1998. *Id.* BPA's "Power Subscription Strategy" dated December 21, 1998, included the Principles as an appendix, and stated:

> "BPA is fully committed to meeting these principles in the subscription process and rate case. . . . The changes in the final subscription strategy enhance BPA's ability to meet the principles. However, this conclusion is subject to further testing in the rate case. If, upon further analysis in the rate case, the strategy contained here proves not to meet the fish and wildlife funding principles, then ***adjustments will be made to conform to the principles***. ***(Emphasis added.)***"

Therefore, to the extent that Alcoa, *et al*., are attempting to attack the Principles by trying to argue that the specific Principles were in some way decided in the Subscription process, they are mistaken. As indicated in the preceding quote, to the extent it was required, the Subscription Strategy would "conform" to the Principles that were already established. Issues related to decisions in the Subscription Strategy are addressed in the testimony of Burns and Elizalde, WP-02-E-BPA-37.

With respect to specific objection by Alcoa, *et al*., to the exclusion of testimony and argument related to the range of F&W costs, page 44321 of the FRN clearly articulated BPA's logic.

> "These Principles differ significantly from the MOA. BPA and the other participants are not establishing a budget for the FY 2002 through FY 2006 period. In fact, final decisions and approvals on a fish and wildlife recovery strategy and funding are not expected during this rate proceeding. Because rates are being set before decisions and approvals are made, the Principles take into account the broad range of potential costs associated with the hydrosystem configuration alternatives under consideration at the time the Principles were adopted. The Principles are intended to ensure that BPA's rate and power sales contracts yield a very high probability of meeting all post-FY 2001 financial obligations, including BPA funding obligations for the fish and wildlife recovery strategy that is eventually adopted."

Of necessity, BPA must move forward in setting rates for the post-FY 2001 rate period, in large part because it must negotiate new power sales contracts for the post-FY 2001 rate period. The Principles recognized the impossibility of accomplishing either of these tasks if uncertainties about F&W funding costs remained. For this reason, a range of alternatives and associated costs are specified in the Principles.

Q. Alcoa, et al., argue that while BPA previously used its Programs in Perspective process to explain its proposed program spending levels and to receive comment, the Principles purport to establish costs before the fish mitigation program is established. Alcoa, et al., argue that this is backwards and these costs are not program spending levels in the usual sense but simply an estimate of cost risk and, as such, an issue that is subject to the section 7(i) process. Speer, et al., WP-02-E-AL/VN/EG-02, at 4. Please respond.

A. Please *see* BPA's preceding response which discusses the development of the Principles. Alcoa, *et al.*, ignore the fact that several extensive public review processes occurred prior to this power rate proceeding. In addition to the Subscription Strategy public review process and the F&W Obligations public review process, BPA and the Northwest PPC initiated a Cost Review public review process in September 1997. The primary objective of the Cost Review was to ensure that BPA's long-term power and transmission costs would be as low as possible and would be consistent with sound business practices, so that BPA could maximize its ability to fully recover costs through power rates that are at or below market prices. As described in more detail on page 44320 of the FRN, the Cost Review process established a panel of five executives with considerable experience managing large organizations during periods of downsizing and competitive transition. A month-long public consultation process was conducted to solicit comment on draft panel recommendations before finalizing its submission to Congressional committees, the governors and the Administrator. The Cost Review specifically excluded costs associated with F&W recovery efforts because these issues were being addressed in separate forum. The recommendations and implementation plans that came out of the Cost Review were then a subject of yet another public review process--Issues '98--

conducted by BPA in the Summer of 1998. A key purpose of Issues '98 was to decide how the Cost Review recommendations would be implemented.

While BPA did not use its historic Programs in Perspective process prior to this rate proceeding, that does not imply some inadequacy in the many public review processes that did occur. In particular, Alcoa, *et al.*, assert that the Principles purport to establish costs before the fish mitigation program is established and therefore, these costs are not program levels in the usual sense, but simply an estimate of cost risk that should be subject to the 7(i) process. As explained in our preceding response, the use of a broad range of potential F&W costs was used in order to allow forward motion on BPA's Subscription process and this rate proceeding. As we stated in our direct testimony:

> "The 13 Fish and Wildlife Alternatives represent, in the Administration's judgment and based on extensive regional input, a reasonable range within which the costs of eventual decisions on system reconfiguration and related operations can be expected to fall. The 13 Fish and Wildlife Alternatives do not represent all options that currently are being considered, or will be considered, by agencies, tribes, interested parties, and Congress. By the same token, there is no assurance that all 13 of the Alternatives will continue to be considered until a final decision is made. . . (b)ut the range of costs established by these 13 Fish and Wildlife Alternatives is deemed by the Executive Branch to be sufficiently high and broad for BPA rate setting and Subscription purposes."

WP-02-E-BPA-13, at 9-10.

To the extent that this broad range of potential F&W costs is "simply an estimate of cost risk" as asserted by Alcoa, *et al.*, they are not precluded from addressing how BPA addresses risk in this rate proceeding. Alcoa *et al.*, are free to examine and argue all elements of BPA's risk mitigation package which takes into consideration the range of potential F&W costs and other risks that BPA faces in the FY 2002 through FY 2006 rate period.

Q. *The IOUs argue that the Administrator has precluded the Administrator and her customers from fully and fairly examining the issues that should be examined in rate* *setting, e.g., items that the Administrator states were finally decided in the Subscription Strategy Final ROD and other issues such as the Principles, thus preventing the development of a full and complete record in this section 7(i) proceeding. Eakin, et al., WP-02-E-AC/GE/IP/MP/PL/PS-01, at 10-11. Please respond.*

A. The IOUs make the broad argument that the decisions and guidelines that were developed in the Subscription Strategy public review process and the Principles public review process should be reexamined in this rate proceeding. As described in some detail in the previous two responses to Alcoa, *et al*., BPA engaged in several extensive public review processes prior to this rate proceeding. However, not all public review processes, must ultimately go through a section 7(i) rate proceeding. BPA provided broad public access and received extensive public comment in all of these public review processes. None of these public review processes included the establishment of rates nor were any final rate decisions made in these processes. It would be impractical and serve no policy purpose for BPA to resurrect and explore once again the myriad issues that have already been fully aired and addressed in these other public review processes. In fact, these kinds of public review processes serve the role of facilitating participation from the public in many issues that are not subject to a section 7(i) rate process, but the results of which serve to inform BPA in its subsequent section 7(i) rate proceedings.

The IOUs also imply that they were unable to examine any issues related to the Principles. This is not true. In fact, quite the contrary is the case. Many issues related to the Principles were identified in the FRN (*see* 64 Fed. Reg. 44318, 44322 (1999)) as F&W issues that will be addressed in the power rate proceeding.

"Fish and wildlife issues that will be addressed in this rate proceeding include: (1) how the terms of access to the FCCF are modeled in the rate proposal and their impact on TPP and rates; (2) how section 4(h)(10)(C) credits are modeled in the rate proposal and their impact on TPP and rates; (3) the calculation and treatment of operations and maintenance and capital investment in repayment studies and the revenue requirement; (4) the selection, design, terms and conditions, assumptions, treatment, and impact of planned net revenues for risk, CRAC, indexed power sales contracts, stepped rates, and targeted adjustment charge; (5) the RiskMod, NORM, and Tool Kit model design, operation, inputs and outputs, and use of results; (6) the level of TPP that is targeted, from the range of potential TPP targets established in the Principles; and (7) the design, terms and conditions, assumptions, and treatment of the Dividend Distribution Clause (DDC), including the threshold for triggering a dividend distribution, the conditions under which a dividend is distributed, and the mechanism used to distribute dividends to certain power customers."

The list of F&W issues that will be addressed in the rate proceeding are extensive and include those issues that are appropriately addressed in a section 7(i) process. The IOUs have not been foreclosed from "fully and fairly examining the issues that should be examined in rate setting." The IOUs also refer generally to BPA's decisions in the Subscription Strategy. This issue is addressed in the testimony of Burns and Elizalde, WP-02-E-BPA-37.

Q. Some of the parties have stated that it was inappropriate for BPA to update the range of F&W costs in the initial proposal. Could you summarize their position?

A. Yes. The PPC states that the Principles are a clear "instruction that BPA use $438 to $721 million as its range of F&W costs." *See* Hansen, *et al.*, WP-02-E-PP-04, at 4. Speer, *et al.*, also states that BPA should not have updated the range. Speer, *et al.*, WP-02-E-AL/VN/EG-02, at 10, lines 25–26 and at 11, lines 1-2.

Q Did the Principles commit BPA to an exact set of costs?

A No, on the contrary. The second Principle states:

- BPA will use the full range of potential fish and wildlife costs and financial impacts during the 2002-2006 rate period (currently estimated at $438 million to $721 million) for planning purposes. This range is based upon the current calculation of the 5 year average financial impact on BPA of thirteen long-term alternatives being evaluated in the Region for configuration of the Federal Columbia River Power System and an estimated range of costs for implementing the Northwest Power Planning Council's Fish and Wildlife Program to protect, mitigate, and enhance fish and wildlife on the Columbia River and its tributaries.

This means that the Principles reflected the full range of 13 long-term alternatives, and that at the time of the adoption of the Principles this range of alternatives was estimated to have a range of costs of $438 million to $721 million. BPA was aware that the component of the financial impacts due to operational constraints could change as the market forecast was updated, and as BPA's ability to model the operational impacts improved.

Q. *Was it appropriate for BPA to update the range of costs stated in the Principles of $438 to $721million to a new range of $430 to $780 million in the initial rate proposal?*

A. Yes. The update BPA made to the range of costs was isolated to the impacts on revenues and power purchases associated with system operations. We simply tried to reflect the market costs of power currently forecast for the rate period and more accurately model the interaction between the uncertainty over market prices and uncertainty over fish-related operational constraints. Purchase power for fish cannot be determined separately from purchase power for other reasons. It is impossible to tell the difference between a power purchase for marketing reasons and a purchase due to an operational requirement of fish. Consequently, BPA in its initial proposal assumed the appropriate generation effect for the each of the 13 Alternatives and updated the assumed market price of 20 mills per kilowatthour used in the Principles to a projected market price which varies month-by-month (*see* Documentation to the Risk Analysis Study, WP-02-E-BPA-03A, Section 1.18.2). This adjustment resulted in a slightly broader range of total costs, but did not alter the intent of the Principles. There is no impact on the revenue requirement with this update. It is simply a recharacterization of the portion of the revenue requirement that is attributable to implementation of the Principles.

Q. It is suggested that the 13 Alternatives in the Principles should not be equally weighted. Lothrop, WP-02-E-CR/YA-02, at 5-6, Do you agree?

A. Two points. First, as explained in the FRN, giving each of the 13 Alternatives equal weight is integral to the Principles. BPA is committed to implementing these Principles in this rate proposal. The Principles were developed in a separate public process in 1998, and the guidance they provide is not an issue to be addressed in this rate case. *See* Burns and Elizalde, WP-02-E-BPA-08, at 4, line 9 to page 5, line 9. Second, equal weighting recognizes that it is unknown what a final decision on a F&W Plan for the region will include. The Parties who make the argument against equal weighting believe that certain alternatives are the most likely to recover salmon, and should be given greater weight in this rate case. However, as noted earlier, others disagree: NRU argues at WP-02-E-NI-01, at 6, that BPA has assigned too *high* a probability for the more expensive F&W alternatives. At this point, however, there is no consensus regarding which alternative should be implemented, or even which alternative is most likely to result in better salmon recovery. There is considerable regional debate and no consensus on the economic impacts and benefits of the various alternatives, with strong opinions at both ends of the spectrum, as well. In the absence of clear science or regional consensus, BPA and the Administration consider it prudent to assume that all options identified in the Principles are equally likely to occur for purposes of setting rates and initiating Subscription.

Q. The IOUs argue that BPA should have analyzed alternatives related to F&W costs to make the best possible determination of fish costs. At 12, lines 3-5, they state "By making an arbitrary assumption that all 13 alternatives are equally likely, BPA has *prevented its customers from being able to adequately address BPA's fish and wildlife costs, and BPA's assumptions about the uncertainties surrounding these costs." Eakin, et al., WP-02-E-AC/GE/IP/MP/PL/PS-01, at 11. Do you agree?*

A. No. The Principles were developed to establish a reasonable range of fish costs to be used for rate setting purposes, given the fact that decisions will not be made as to an actual alternative until after this rate proceeding. The region is in the process of trying to develop a plan, and until a plan is developed, the Principles establish a reasonable approach that keeps the options open. The assumption that all 13 alternatives are equally likely is not an "arbitrary assumption." Indeed, the Principles are the product of extensive regional discussion and Administration direction, and the assumption is integral to the "keep the options open" strategy. *See* preceding testimony on Scope. *See* also FRN at 44320-44321.

Q. The argument is made that the costs BPA includes in the revenue requirement for BPA F&W operations and maintenance (O&M) (direct program) are too low. Lothrop, WP-02-E-CR/YA-02, at 2-3. Please respond.

A. No. The Principles call for BPA to assume that these costs "have an equal probability of falling anywhere within the current range of $100M to $179M." To implement these Principles, BPA could have used different point estimates in its revenue requirement, and included different distributions in Non-Operating Risk Model (NORM). However, the outcome would be the same. The full range is being considered by including a point estimate in the revenue requirement and a range of probabilities of deviating from it in the NORM model. If BPA included $179 million (annual average) as the point estimate in the revenue requirement, for example, the risk reflected in the NORM model would all be downward: The deviations in NORM would range from $0 change to -$79 million change. If BPA included only $100 million in the revenue requirement, then the deviations in NORM would range from $0 change to +$79 million change. The actual amount BPA used in the revenue requirement was $139.5 million (annual average), so the range of deviations in NORM was from -$39.5 million to +$39.5 million.

Q. *The argument is made that BPA should be including in its risk modeling a probability greater than 0 that the BPA F&W O&M (direct program) would be higher than $179 million. Lothrop, WP-02-E-CR/YA-02, at 2-3. Please respond.*

A. As stated in the previous response, the Principles call for BPA to assume that these costs "have an equal probability of falling anywhere within the current range of $100 million to $179M." The range established in the development of the Principles is still considered an adequate range for setting rates.

Q. *Are there reasons to believe that the range of F&W costs included in this rate case are adequate?*

A. In a memo to the Regional Federal Executives, Will Stelle, Jr., discussed the "need for substantial increases in F&W program funding after 2000." National Marine Fisheries Service believes these costs have been adequately captured in the range of alternatives under analysis in the rate case." *See* Attachment 1, Memo to Regional Federal Executives. Additionally, BPA has assumed it will pay all of the power-related costs contained in each of the alternatives.

Q. *Why is this assumption important?*

A. There are several reasons. With respect to dam breaching alternatives, BPA has included all of the power-related costs for the breach investment, plus assumed that BPA will repay the entire original cost of the dam that is still owed.

Following breach, power production may no longer be a project purpose for the breached dams. Should Congress authorize dam breaching, it will necessarily look at who should pay both the dam's original investment costs, plus the costs for breaching. With no power generation purpose, it is uncertain whether BPA will remain responsible for the same scope of project costs. *See* DeWolf, *et al.*, WP-02-E-BPA-13, at 20-21.

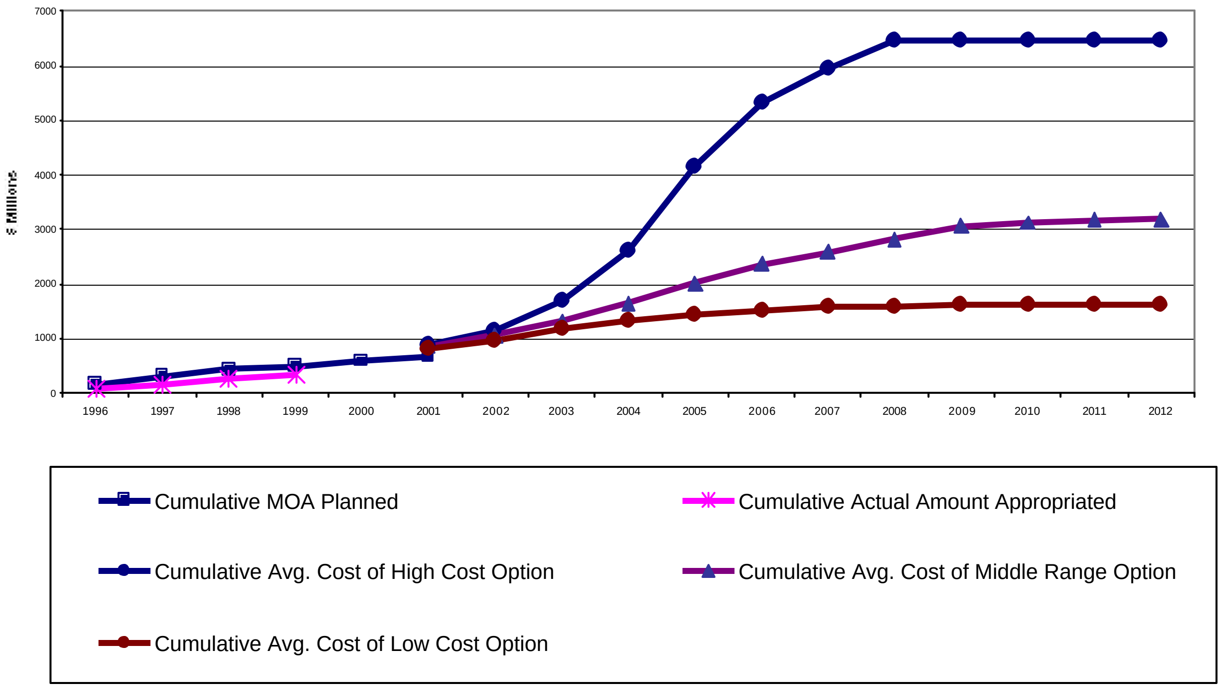
Q. *Is it correct to assume that BPA will be responsible for all other costs contained in the 13 Alternatives?*

A. Not necessarily. Currently the Region is working to develop a Unified Regional Plan for F&W. An element of this plan will include determining what BPA will be responsible for, as well as the responsibilities for the other Federal Agencies, states, and local governmental bodies. It is premature to assume BPA will necessarily be charged for 100 percent of the costs because the plan has not been completed or approved, and Congressional action has not been taken.

Q. *Is the range of F&W costs in the Principles robust? If so, why?*

A. Yes the range is robust, in several ways. Five of the 13 Alternatives include high-cost drawdown, even though it is unlikely that Congressional authorization and appropriations would occur in sufficient time for these costs to hit FY 2002-2006. Also, in implementing the Principles, BPA has assumed that Congress will appropriate capital funds consistent with the amounts and timing of investments projected in the 13 Alternatives. The level of appropriations required is nearly double the amount Congress has recently appropriated for Columbia River Fish Mitigation. Additionally, in developing the range no test of scientific appropriateness has been applied to the activities included, and such a test might eliminate some of the activities.

The Total Capital Appropriations for the Alternative System Configurations range from over $1 billion to about $6 billion through FY 2010



Q. *It was suggested that BPA should not use the range of $428 to $721 million for fish costs since there is no relation between this range and what BPA's actual costs will be. Speer, et al., WP-02-E-AL/VN/EG-02, at 12, lines 10-13.*

A. While it is impossible to predict precisely BPA's F&W costs during the upcoming rate period, the range of costs represented by the 13 F&W Alternatives represents a reasonable range of costs given the variety of possible future alternatives for program implementation and operational impacts. (The range of costs associated with that set of Alternatives was estimated at the time of the adoption of the Principles to be $438 to $721 million; more up-to-date and sophisticated modeling has modified the estimated costs of the operational impacts, and the current range of costs is $430 to $780 million.)

We have attempted to design our rates so that we can "keep the options open." A decision on a strategy for ensuring F&W survival and recovery has not been made. In addition, Speer *et al.*, suggest no alternate recommendation for F&W costs that we should use.

Q. The Columbia River Inter-Tribal Fish Commission (CRITFC) and the Yakama Indian Nation (Yakama) say that BPA may not meet Principle No. 1, because it is assuming "a low probability for F&W alternatives that are most likely to meet treaty and trust obligations and the responsibilities under the Endangered Species Act (ESA) and the Clean Water Act." They also state "Bonneville may not be able to meet both principles No. 1 and No. 3 for scenarios that address treaty and trust responsibilities." Lothrop, WP-02-E-CR/YA-02, at 6 to 8. Do you agree?

A. No. We contend that the Rate Proposal meets both Principles Nos. 1 and 3. As a Federal agency, BPA shares the government's general trust responsibility to tribes. BPA fulfills its share of this general trust responsibility by complying with all statutes applicable to BPA, including the Northwest Power Act, ESA, and National Environmental Policy Act. For purposes of this rate proposal, BPA is implementing Principle No. 1 by:

- ensuring that rates and risk mitigation measures are sufficient to recover the costs of future decisions on system reconfiguration and associated standards. This is done by ensuring that revenue requirements, the repayment schedule, and risk analysis take into account the full range of potential fish costs by identifying and modeling all significant risks;
- adopting a very high standard for recovering costs on time and in full; and
- designing risk mitigation measures that meet the standard.

S*ee* DeWolf, *et al.*, WP-02-E-BPA-13, at 11, lines 4-15 and Volume 1, Documentation to the Revenue Requirement Study, WP-02-E-BPA-02A, Chapter 13. *See* also

Attachment 2: data response to CR-BPA:028, for further explanation of BPA's approach to meeting Principle No. 1.

Q. CRITFC and Yakama and the Shoshone-Bannock Tribes, argue that the Principles were not developed "in consultation" with the Columbia Basin Tribes as they define the terms "in consultation." Lothrop, WP-02-E-CR/YA-02, at 7, lines 10-15; and Kutchins, WP-02-E-SH-01, at 5. Do you agree?

A. No, at least not in the informal sense of the word "consultation." As explained in our response to data request CR-BPA-003, we did not intend to use the strict definition of "consultation" as that term is defined in BPA's Tribal Policy, but rather a more general definition, since we were seeking input from many parties in addition to the tribes. We regret any confusion our use of the word may have caused. *See* Attachment 3: data response to CR-BPA:003.

Q. CRITFC and Yakama and the Northwest Energy Coalition (NWEC) expressed concern that BPA's proposal is not meeting Principle No. 4 of the Principles. Sheets, WP-02-E-CR/YA-01, at 3-4, NA-01, at 7-14. Do you agree?

A. No. Principle No. 4 states "Given the range of potential F&W costs, BPA will design rates and contracts which will position BPA to achieve similarly high Treasury payment probability for the post-2006 period by building financial reserve levels and through other mechanisms." We interpret Principle No. 4 to mean that BPA must position itself reasonably well for, or position itself to have a reasonable expectation of, achieving a similarly high TPP. We assert that the rate proposal positions BPA's power function reasonably well to be able to obtain a "similarly high" TPP for the post-2006 period through such mechanisms as potential rate increases, a planned build-up of reserves, potential rate adjustment mechanisms, and other actions that can be taken between now and 2007.

There are several features of BPA's rate proposal that contribute to BPA's confidence that it is positioning itself reasonably well to achieve a high TPP in the post-2006 years. They include the facts that BPA can set rates again in 2007, and can raise the rates substantially if necessary, as it has in the past; that any Slice customers will be taking on many risks that BPA has previously borne, and would be committing themselves to 10-year contracts; that BPA is offering three-year contracts, as well as five-year contracts, giving BPA the opportunity to adjust rates in 2005, if necessary. The expected values of BPA's annual financial reserves are projected in the 2002 rate case to increase quite substantially, though there is very large uncertainty in these projections. This planned increase is on top of a healthy level of starting reserves; BPA is proposing a CRAC that could raise hundreds of millions of dollars of additional revenue if needed. *See* data response to NA-BPA: 004 (attachment 4) for a more complete list. *See* also DeWolf, *et al.*, WP-02-E-BPA-13, Section 4, and Volume 1, Documentation to the Revenue Requirement Study, WP-02-E-BPA-02A, Chapter 13.

Q. CRITFC and Yakama and NWEC state that "BPA has asserted that it has met Principle No. 4 without any analysis." Sheets, CR/YA-01, at 3-4, NA-01, at 8, Lines 14-25, and page 9. NWEC states it is "derelict of BPA to not even attempt to run its model past 2006 given that many of the inputs are readily available." Weiss, WP-02-E-NA-01, at 8, lines 17-19. How do you respond?

A. While BPA said that it is not relying primarily on quantitative demonstrations of the satisfaction of Principle No. 4, it has provided two analyses of this issue. *See* Attachment 4: data response to NA-BPA:004. The technical problems associated with modeling and quantitative analysis of BPA's power business post 2006 are greater than implied by the Parties. A non-exhaustive list of such challenges is given here. The simplest of these difficulties have to do with the data:

1. The risk distributions from Risk Analysis Model (RiskMod) that represent operating risks are not available for the post-2006 period. The operational constraints for the 13 F&W Alternatives have not been analyzed, and are not available for use by RiskMod. The forecasts of gas and electricity prices that far in the future are far more uncertain than the forecasts for the FY 2002 – FY 2006 period.
2. BPA's F&W costs themselves for that period are far less certain. By FY 2007, it is possible that uncertainty over these costs will have been resolved; for example, by adoption of a regional plan or by Congressional action, or by spontaneous recovery of the fish stocks due to changes in ocean conditions. The range of future F&W costs may also have increased by FY 2007. Agreements about funding plans quite different from those under discussion today may have been reached. But at *this* time (December 1999), the post-FY 2006 F&W costs would have to be considered to be highly uncertain, more uncertain than the FY 2002 through FY 2006 F&W costs are today.
3. BPA program costs have not been projected out that far with the rigor of those for the FY 2002 through FY 2006 period. The projections are developed consistently among the programs and are sufficient for the 7(b)2 rate test purposes, where the significance is the cost categories that are excluded from the program case to produce the 7(b)2 case.

Other uncertainties are yet more complex. Some of the major structural uncertainties are:

1. National and state electricity industry restructuring plans--what will have happened by then?
2. Technological change--will generating supplies and loads be substantially the same, or will major changes have taken place on one or both sides of the supply and demand equation?

3. Congressional and Federal Energy Regulatory Commission (FERC) directions for BPA--what changes in BPA's responsibilities might be made by then?
4. How will financial markets have changed the ways that financial risks can be managed?

The final set of challenges to be mentioned here is that of creating an intellectual framework for making sense of whatever analytical results can be obtained. Principle No. 4 does not say that BPA will take actions now that result in an 88 percent TPP for the post-FY 2006 period calculated as of today or calculated as of FY 2006, but rather that BPA will *position* itself (now) to be able to achieve *similarly high* TPPs post-FY 2006 period. The question is whether BPA is positioning itself appropriately now so that it will be able to take actions in the future resulting in similarly high TPPs after FY 2006. In the face of the massive uncertainty facing BPA over the next seven years (12 years if we assume a five-year rate period starting in FY 2007) to define "well-positioned" so accurately as to permit meaningful statistical assessments would be impossible. This uncertainty ensures that any analysis will contain so many assumptions as to be an essentially judgmental analysis. BPA's judgmental analysis is that the rate proposal positions BPA well enough for Principle No. 4.

Q. NWEC makes the argument that BPA has failed to follow sound business principles--or satisfied Principle No. 4--by failing to take into account adequately the risk to the Treasury of a possible low level of ending reserves in 2006. Weiss, WP-02-E-NA-01, at 2, lines 19-21. Do you agree?

A. No. BPA's business environment includes significant uncertainty. The foundation of BPA's long-term financial planning is its TPP standard, a standard that is ambitious enough that it has been criticized by customers in this rate case for being overly ambitious. The significance of the uncertainty is reflected in the name and substance of that standard--it concerns the probability of making Treasury payments. With the uncertainty in BPA's environment, a financial plan that could secure a 100 percent probability of making all future Treasury payments would require rates well above market. This scenario is impossible--with rates well above market, BPA would not sell its power, and as a result would not have a 100 percent TPP. Therefore, BPA must accept a TPP less than 100 percent, which implies that the probability of a Treasury deferral is above 0 percent. As we just demonstrated, this is unavoidable. As desirable as it may be to target a minimum level of reserves for the beginning of the next rate period (FY 2007), this would be impossible to achieve, since even the minimum amount required to avoid a deferral cannot be guaranteed. In conclusion, BPA is aware of the possibility that it will not have adequate reserves as the FY 2007 rate period begins; this risk can be mitigated but not be eliminated.

Q. Oregon Public Utility Commission states, that BPA should "adopt final rates, including a risk mitigation package, that collect revenues sufficient to demonstrate a 90 percent probability of having about $500 million in ending reserves in 2006." WP-02-E-OP-01, at 5, lines 8-10. Do you agree?

A. No. BPA's proposal implies a 70 to 80 percent chance of having at least $500 million in reserves at the end of 2006. Increasing this probability would require: (1) abandoning the 88 percent TPP standard; and (2) either: (a) making the CRAC significantly more powerful, which would increase the frequency of CRAC triggering and the magnitude of the CRAC revenue increases; or (b) raising rates significantly. Whither of these would reduced rate stability. Rate stability is a key BPA goal in this rate case.

Q. CRITFC and Yakama (WP-02-E-CR/YA-01, at 3 ff.) state that using a different model, "Strandsim," they've determined that BPA could be competitive in 2007-2011 with $1.6 billion starting reserves. Has or could BPA modeled this? They say BPA has all the inputs it needs.

A. As explained above, it is impossible for BPA to guarantee any minimum level of starting FY 2007 reserves. BPA has not performed Strandsim analyses of this issue. As CRITFC and Yakama's testimony admits (page 4, line 8 ff.), Strandsim is not one of the models used by BPA in its rate case. There are many differences in data, scope, and analytical assumptions. This makes the results very difficult to compare meaningfully, especially in light of the enormous uncertainty, described above, both between now and FY 2006 and during the post-FY 2006 period.

Section 5. Cost Deferrals and Cost Recovery Adjustment Clause

Q. What is the purpose of this section of your testimony?

A. The purpose of this testimony is to respond to the direct testimony of the PPC, Hansen, *et al.*, WP-02-E-PP-02, regarding cost deferrals and the CRAC.

Q. The PPC advocates that BPA implement its financial policies <u>in to</u>, i.e., assume "with 100 percent certainty that cost reductions will be achieved . . ." Id., at 5, lines 2-3. What financial policies do you understand that the PPC refers to in this regard?

A. The PPC in response to a BPA data request (BPA-PP-007, at attachment 5) refers to BPA's 1993 10-year Financial Plan. The relevant language from the Financial Plan states:

> " . . If BPA's financial reserves fall below a specified level in the first year of a [2-year] rate period, the [Interim Rate Adjustment] (IRA) would be implemented in the second year. Before the IRA would be put into effect, BPA would implement cost deferrals of $25 million, with no more than $10 million occurring in the expensed program areas. The remainder of the reductions would occur in capital programs."

Q. Is it BPA's view that this Financial Plan requires that BPA "assume with 100 percent certainty that cost reductions will be achieved . . ."?

A. No. The Financial Plan calls for "cost deferrals," words that were purposely chosen so as not to require "cuts," as that term generally is used. The context for requiring deferrals is to obviate or reduce the need for the IRA to trigger in a particular year. And while this provision does specify minimum deferral amounts, it does not require that BPA to assume that there is no uncertainty in its budgets, or that its cost management plans must be implemented without deviation.

Q. *Are there other aspects of the Financial Plan that the PPC cites that are relevant here?*

A. Yes. The Financial Plan excerpt goes on to say that "rates will be set to include recovery of any inherent downward bias in BPA's expected cash flow distribution, taking into account normal operating risks . . . This combination of risk mitigation policies and tools is aimed at helping BPA meet the ordinary operating risks its faces." This and other portions of the Financial Plan make it clear that BPA should model its risks and design its risk mitigation package to meet its TPP standard. As discussed and documented in the Cost Review and Issues '98 processes (*see* Revenue Requirement Study, WP-02-E-BPA-02, Chapter 2 and Appendix A), and in testimony (*see* DeWolf, *et al.*, WP-02-E-BPA-13), the targeted savings in revenue requirements are "stretch" targets, with significant uncertainty and risk associated with BPA's ability to realize them.

Q. *Does the PPC contend that BPA should assume that the targeted Cost Review savings would be achieved in full?*

A. Yes. In response to a BPA data request (BPA-PP-009, at attachment 6), the PPC clarified its position that uncertainties and risks associated with achieving the targeted average annual savings of $113 million resulting from the Cost Review should not be included in BPA's risk analysis. PPC indicated that "BPA should be able to, at a minimum, secure the stated level of cost reductions for the upcoming rate period." No substantiation for this assertion was offered in the PPC data response, however.

Q. *Does the PPC take exception to specific risk and uncertainty distributions in NORM; in particular, the distributions related to implementation of the Cost Review recommendations?*

A. No. Again, PPC asserts that BPA should be able to achieve the savings, but it does not substantiate its assertion.

Q. *Given uncertainties and risks associated with the Cost Review recommendations, what would be the impact if BPA were to assume "100 percent certainty" of achieving the Cost Review savings?*

A. The effect would be to shift risk to Treasury, meaning that the TPP result in this rate proceeding would be overstated, if everything else remained the same: the corresponding probability of a Treasury deferral would be understated (*i.e.*, it would be more than the 12 percent implied by the *apparent* meeting of the 88 percent TPP standard). Such an approach would be inconsistent with the objectives of the very Financial Plan that the PPC cites in support of its position.

Q. The PPC advocates that "BPA commit itself to further cost reductions before implementing the CRAC." Hansen, et al., WP-02-E-PP-02, at 3, lines 4 and 5. Please respond.

A. While additional cost management actions may be appropriate to avert or mitigate triggering a CRAC, a mechanism that assumes or automatically requires a cost reduction before triggering would be potentially counterproductive for this rate period.

Q. What is your rationale for this statement?

A. BPA recently has gone through an unprecedented cost reduction effort, including lengthy and extensive public consultation processes. The culmination of these processes was a BPA commitment made in Issues '98 to meet in aggregate the savings identified in the Cost Review recommendations, as updated and corrected in DeWolf, *et al.*, WP-02-E-BPA-13, at 2-7. In addition, by adopting the cost reduction targets from the Cost Review, BPA established "stretch" targets for its business units due to the difficult nature of the recommendations. There is risk and uncertainty that BPA may not be able to achieve this level of cost reductions. (*See* the Revenue Requirement Study, WP–02-E-BPA-02, Appendix A, and Lovell, *et al.*, WP-02-E-BPA-14.) Therefore, additional reductions beyond the levels established in Issues' 98 could significantly affect BPA's ability to perform mission critical work and/or shift risk to Treasury if the added savings are assumed but BPA is unable to realize them.

Q. The PPC indicates that, in its 1993 10-Year Financial Plan, BPA committed to institute an Interim Rate Adjustment (IRA) in combination with a cost deferral mechanism in subsequent rate cases. Hansen, et al., WP-02-E-PP-02, at 4, lines 13-28. Please respond.

A. BPA is not implementing the specific IRA adopted in the 1993 rate case, which had many formulaic and mechanistic aspects. Our reasons are many.

One characteristic of the IRA in the 1993 rate case was that it distinguished costs between controllable and non-controllable, and required that the trigger threshold be lowered to the extent that "controllable" costs exceeded the rate case plan. The IRA did not include provisions for segregating power and transmission costs, revenues, and cash. The IRA also treated F&W costs as controllable, whereas in this rate case, BPA is implementing the Principles that require that BPA not presume a particular level of F&W costs. This means that such costs no longer can be considered controllable consistent with the definition used in 1993.

Another difference between 1993 and today is that rates in this proceeding cover a five-year, not two-year, period of time, and they are being set well in advance of the beginning of the rate period. It would be very difficult to develop a cost control mechanism with sufficient adaptability to remain relevant and reasonable over the next seven years. This means any rigid formulaic approach to cost control could have serious consequences because of its inability to consider changing conditions. This rigidity could ultimately disadvantage customers since BPA may not be able to rapidly respond to customer requests.

In addition, it would be difficult to capture revenue enhancements in any mechanism that only looked at cost controls, as did the 1993 IRA. An example showing the importance of revenue enhancements can be seen in the Cost Review recommendations concerning Energy Northwest, the U.S. Army Corps of Engineers and the Bureau of Reclamation. Such revenue enhancements are an important part of cost management and contribute equally to financial reserves.

Further, some increases in expenditures are the result of projects that require upfront costs in order to obtain long-term savings. Examples include an Federal Columbia River Power System hydrosystem investment plan to restore system reliability and output, and BPA's investment in new business systems and information technology similar to what many utilities are currently implementing. Eliminating or deferring these types of expenditures could result in greater costs over time.

A final complication this time involves the annual cost patterns of expense reductions arising from the Cost Review. The Cost Review focused on five-year averages, not on specific amounts by year. There is no firm annual benchmark to use in calculating the base for each year to which a mechanistic cost control mechanism of the type developed in 1993 could be applied.

Q. *What would be the effect on the U.S. Treasury if BPA adopted the mechanistic IRA from the 1993 rate case?*

A. Such an approach could shift additional risk to the U.S. Treasury because if BPA were not able to realize additional cost reductions this would lower reserves.

Q. *What effect would such a mechanistic CRAC have on customers BPA?*

A. It could cause BPA to trigger a rate adjustment when it could have been averted, or to reduce costs in areas that may lead to greater costs over time.

Q. *Please summarize your response.*

A. There are three key points. First, BPA has been and will continue to manage its internally controllable costs as aggressively as possible. Second, given the significant cost reductions recommended by the Cost Review, there is no compelling reason or ability for BPA to commit to further cost cuts. Third, BPA's earlier commitment to implement an IRA together with a cost deferral mechanism did not anticipate the extensive Cost Review/Issues '98 process that resulted in BPA commitment to implement a large range of cost reductions. In other words, the cost management objectives contemplated by the 1993 IRA have already been achieved through the Cost Review/Issues '98 process.

Q. How does BPA propose to assure its customers and constituents that reasonable actions will be taken before a CRAC triggers?

A. When actual accumulated net revenues are within $150 million of the next year's CRAC threshold, BPA will go public with an analysis of the causes of BPA's relative financial decline compared to the rate case plan, and propose a prioritized list of potential actions to avert or mitigate the need for a CRAC. These actions presumably would include, but not necessarily be limited to, cost management actions. BPA will seek public comments and advice over a two-month period on these actions to avert or reduce a rate adjustment.

Q. Will BPA make any changes in the CRAC design?

A. No.

Q. Will BPA make information available as to the actual financial performance of the PBL?

A. Yes. On a quarterly basis, BPA will post on its web site the aggregate financial results for the generation function, including Audited Accumulated Net Revenues (AANR). Year-end information will be based on the audited actual financial results. BPA will also provide preliminary, unaudited year-to-date aggregate financial results for generation quarterly on its web site. In addition, as stated in the Revenue Requirement Study

Documents, Volume 1, WP-02-E-BPA-02A, at 295, BPA will be also be providing a forecast of AANR no later than August 31 of each year.

Q. What are the benefits associated with BPA's proposal?

A. Adopting this proposal will provide BPA customers and constituents with reasonable cost management safeguards against either unnecessary triggering of the CRAC or inappropriate cost cutting to avoid triggering. It will provide an added incentive for BPA to manage its costs to the lowest reasonable level. It will avoid shifting risk to the Treasury. Finally, it will provide BPA with greater flexibility than a rigid mechanism to manage its business and deliver public benefits.

Section 6. Functionalization of Costs

Q. Please address Industrial Customers of Northwest Utilities' (ICNU) concerns, Wolverton, WP-02-E-IN-01, at 15-16, whether BPA will be unable to demonstrate that its power rates are sufficient to recover costs, and its proposal that BPA establish separate revenues and revenue requirements for its generation and transmission functions.

A. While we agree with ICNU's concept of "ratemaking separation," we do not think a separate process, as proposed by ICNU, is necessary. Beginning with its 1985 power and transmission rate filings, BPA has complied with FERC orders (particularly 26 FERC ¶61,096 [1984]) to prepare separate repayment studies and revenue requirements for generation and transmission. While a transmission component has been bundled in power rates, transmission and generation revenues have been functionalized and cost recovery demonstrated separately by function both in the rate period and over the ensuing repayment period. That practice has continued in each succeeding rate case. In the separate filings for the post-FY 2001 rate period, the unbundling of rates required by FERC's open access provisions has further enhanced that separation and allow the power and transmission rate filings to stand on their own.

Q. *The Northwest IOUs propose that the functionalization policy that FERC applies to jurisdictional utilities should be applied to BPA's functionalization of costs. Eakin, et al., WP-02-E-AC/GE/MP/PL/PS-01, at 3-5, 14-15. Does BPA's method of functionalizing costs differ from FERC's methodology applicable to jurisdictional utilities?*

A. No. In previous rate cases, BPA developed procedures and methodologies that it believed to be consistent with the standards for functionalization required of jurisdictional utilities. Overall, that approach and its associated methodologies have been carried forward into BPA's initial proposal.

Q. *WPAG states that "BPA has functionalized the entire cost of its energy conservation programs to the PBL." In addition, "BPA has assigned the entire cost of the renewable resources program to the power function." Cross, et al., WP-02-E-WA-01, at 21-22. Is this accurate?*

A. Yes, it is.

Q. *WPAG argues that "both the transmission and generation systems benefit from [energy conservation] programs" and that "they should both bear a share of the costs of these programs." Id. at 22. Do you agree?*

A. No, BPA does not agree that the transmission function should bear a portion of energy conservation costs. This issue was raised by WPAG in the 1993 rate case and was dealt with there (*see* WP-93-A-02, at 38-40). It was decided that section 7(g) of the Northwest Power Act requires conservation costs to be assigned to power rates and, while that did not preclude the costs from being functionalized to transmission, the transmission component would still need to be assigned to power rates. The fact that Subscription products are primarily undelivered power further reduces the possibility of assigning conservation costs to transmission. In addition, since transmission rates under open access no longer create separate rates for wheeling and transmission of Federal power, there is less ability to functionalize conservation costs to transmission.

Q. *WPAG also argues that the costs of both conservation and renewable resource programs should be functionalized to transmission based on the "percentage that the Transmission Business Line (TBL) revenue requirement constitutes of BPA's total revenue requirement." Id. at 23. Please respond.*

A. As stated above, BPA has not changed its position from the 1993 rate case on conservation. Renewable resources are clearly power-generating resources and, for ratemaking purposes, their costs should be included in the generation, not transmission, revenue requirements consistent with the ratemaking provisions of the Northwest Power Act.

Q. *The Northwest IOUs argue that BPA's investment in fiber optics "is not an investment in transmission facilities" and that its real purpose and function "is to benefit BPA preference power customers and BPA's PBL." Eakin, et al., WP-02-E-AC/GE/IP/MP/PL/PS-01, at 6-7. Therefore, the Northwest IOUs argue that "[i]f these costs must be functionalized to power or transmission, we believe they should be equitably allocated to power rates." Id. Hornley, et al., WP-02-E-AC/GE/IP/MP/PL/PS/EN-06 and Hogan, et al., WP-02-E-AC/GE/IP/MP/PL/PS/EN-07.) Do you agree?*

A. No. BPA's communications equipment, including fiber optic cable, is used in the operation of the Federal Columbia River Transmission System. In previous rate cases, BPA functionalized between generation and transmission the investment in the Dittmer Control Center and supporting communications equipment needed to perform the resource dispatch and control operations. The portion needed for dispatch and control of the Federal resources were assigned to power. Now that transmission entities are required to provide ancillary services, which include dispatch and control, and the power function is required to take these services at the same rates charged to others, what previously had been the generation portion of these investments is now appropriately assigned entirely to the transmission function. In BPA's transmission rate case, these costs will be allocated to transmission or ancillary services. Should it be determined that the PBL is responsible for costs associated with any incidental uses of communications plant other than for transmission or ancillary services, those costs will be represented by a user charge from the TBL to the PBL. An assumption concerning such a charge is reflected in the interbusiness line expenses in the generation revenue requirements. In the subsequent transmission rate case, we expect that incidental uses will be appropriately accounted for in the transmission revenue requirement.

Q. *The Northwest IOUs and Enron also argue that "any marketing advantage resulting from BPA's leasing of fiber optic cable will inure to the PBL, not the TBL" and, therefore, "it should functionalize all of its fiber optic cable investment to the PBL." Hornby, et al., WP-02-E-AC/GE/IP/MP/PL/PS/EN-06, at 8. Do you agree?*

A. No. Functionalization should be based on use and cost causation. The overall investments have been and are being made ultimately for transmission system usage.

Q. *Does this conclude your testimony?*

A. Yes.