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REBUTTAL TESTIMONY OF
MARK H. EBBERTS

Witness for Bonneville Power Administration

**SUBJECT: Rebuttal Testimony for Issues Related to the 7(c)(2) Industrial Margin Study
and Floor Rate Test**

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6 **INDUSTRIAL MARGIN STUDY AND FLOOR RATE TEST**

7 **Section 1. Introduction and Purpose of Testimony**

8 *Q. Please state your name and qualifications.*

9 A. My name is Mark H. Ebberts. My qualifications are contained in WP-02-Q-BPA-18.

10 *Q. Please state the purpose of your testimony.*

11 A. This testimony addresses issues raised by parties in response to Bonneville Power
12 Administration's (BPA) Initial Proposal for calculating the 7(c)(2) floor rate and
13 industrial margin. See Ebberts, WP-02-E-BPA-23. Specifically, this testimony addresses
14 the following testimony: the direct service industrial customers (DSI), Schoenbeck,
15 *et al.*, WP-02-E-DS/AL/VN-01; the Public Power Council (PPC), Hansen, *et al.*,
16 WP-02-PP-06, at 20-29; and the investor owned utilities (IOU), Hoff, *et al.*,
17 WP-02-E-AC/GE/IP/MP/PL/PS-03, at 11-19.

18 *Q. How is your testimony organized?*

19 A. This testimony is in three sections including this introductory section. The second
20 section responds to issues raised by parties regarding the floor rate calculation. The third
21 section responds to issues raised by parties regarding the industrial margin calculation.

22 **Section 2. Responses to Floor Rate Issues**

23 *Q. The DSIs state that "[u]nder no circumstances should the floor rate test increase the*
24 *Industrial Firm Power (IP) rate if the IP rate, as calculated before the floor rate test,*
25 *already exceeds the floor rate." Schoenbeck, et al. WP-02-E-DS/AL/VN-01, at 3. Do you*
26 *agree with this conclusion?*

1 A. The testimony regarding the calculation of the floor rate reflects the same concepts and
2 methodologies that have been adhered to in all past rate cases and floor rate calculations.
3 The above comment appears to be related to the floor rate sequence issue that is being
4 addressed in testimony by Doubleday, *et al.*, WP-02-E-BPA-44.

5 *Q. The DSIs propose that BPA adjust the floor rate by removing the costs of the deficiency*
6 *associated with the surplus firm power sold short-term at market rates which recovered*
7 *less than fully allocated costs. Schoenbeck, et al. (WP-02-E-DS/AL/VN-01) at 5-6. The*
8 *rationale is that these are non-recurring costs similar to other such costs that BPA has*
9 *previously removed from the floor rate calculation. Id. Do you agree?*

10 A. No. Exclusion of the surplus deficiency would simply be an adjustment to reflect the
11 conditions projected in this particular test period. There are good reasons why the
12 surplus deficiency should not be characterized as non-recurring. BPA is making
13 long-term (five-year) purchases in advance of the close of Subscription for approximately
14 1,100 average megawatts to augment the Federal Base System. It is possible that at some
15 time during the next five-year rate period, federal loads could change, and therefore, BPA
16 could experience a firm revenue deficiency of the nature found in the Industrial Firm
17 Power (IP)-83 Standard rate. In addition, in any future rate case, the full cost of any BPA
18 firm surplus may exceed market prices for various reasons. The testimony does not offer
19 a solid justification for removal of these costs at this time and therefore, it cannot be
20 concluded that including such costs in the floor rate provides a windfall to BPA's non-
21 DSI customers.

22 *Q. The DSIs also point out that the surplus firm power revenue deficiency that BPA projects*
23 *in this rate case does not correspond to the revenue deficiency allocated to the IP-83*
24 *Standard rate and that the surplus firm power revenue deficiency in the 1983 rates was*
25 *not allocated to the DSIs in 1983. Schoenbeck, et al., WP-02-E-DS/AL/VN-01, at 10.*
26 *Does this make a difference in your response?*

1 A. No. It is true that the firm revenue deficiency in this rate case is a different firm revenue
2 deficiency than was included in the 1983 rate case. However, BPA is not basing its
3 decision not to remove such costs from the floor rate on the fact that BPA has something
4 called a firm revenue deficiency in this rate case. The decision not to remove more costs
5 from the floor rate is based on the conclusion, as stated in the previous response, that the
6 floor rate surplus revenue deficiency is not a non-recurring cost, as that term has been
7 applied to previous floor rate exclusions.

8 *Q. Does it matter that the surplus firm power revenue deficiency in the 2002 rates, described*
9 *in the previous question and response, was not allocated to the DSIs? Id. at 10.*

10 A. No. The revenue deficiencies attributable to the exchange resource cost component were
11 allocated to the IP class. That is how those costs became a part of the IP-83 Standard rate
12 and, hence, became a component of the floor rate. Those are the costs under
13 consideration here.

14 *Q. The DSIs argue that “BPA must subtract the cost of ancillary services in addition to the*
15 *transmission costs from the IP-83 Standard rate to develop an unbundled power only*
16 *floor rate.” Id. at 6. The testimony recommends adjusting the floor rate by reducing the*
17 *generation revenue requirement allocated to the IP-83 rate by 3.5 percent, which*
18 *constitutes the percentage of the currently proposed generation revenue requirement*
19 *represented by the proposed “cost basis for the generation inputs for ancillary services*
20 *of \$438.610 million.” Id. Do you agree?*

21 A. No. It is true that the cost of generation inputs needed to supply ancillary services will be
22 recovered through ancillary service rates. However, the proposed adjustment would be
23 inconsistent with the methodology adopted by BPA for “unbundling” the floor rate into
24 power and transmission components. The testimony proposes using current projections
25 of generation input revenues as a surrogate for ancillary services in the floor rate
26 calculation. To be analytically consistent, the transmission expenses in the floor rate

1 would have to be calculated in a similar manner. That is, the transmission costs allocated
2 to the DSI customer class would need to be estimated, with that number forming the basis
3 for the transmission costs to be extracted from the floor rate.

4 Moreover, as pointed out in the initial proposal, BPA considered such an
5 approach and adopted instead the more straightforward and accurate approach of
6 removing known transmission costs from the IP-83 Standard rate. *See* Ebberts, WP-02-
7 E-BPA-22, at 11. As stated there: “The transmission costs included in the IP-83
8 Standard rate are known and removing them from the rate involved no guesswork.
9 However, transmission costs and rates that will be applicable to DSI customers in the
10 next rate period are not known, and an attempt to project those future costs would not be
11 as accurate as removing known identifiable costs.” *Id.*

12 Ancillary service rates are part of a relatively new pricing construct that attempts
13 to identify and separate all of the services associated with providing reliable transmission.
14 Ancillary services were not identified at the time the IP-83 Standard rate was developed.
15 It is not clear that correlating costs recovered through that rate with present-day ancillary
16 service cost projections is an accurate means of unbundling the floor rate. It is certainly
17 not appropriate to do so unless transmission costs are treated in a similar fashion. BPA’s
18 method of removing identifiable transmission costs in the IP-83 Standard rate creates a
19 reasonable parity between the floor rate and the unbundled IP-02 rate.

20 *Q. PPC argues that because the IP rate in effect on June 30, 1985, included both*
21 *transmission and power charges, “the floor rate test that BPA must use includes both*
22 *power and transmission charges.” Hansen, et al., WP-02-E-PP-06 at 22. Do you agree?*

23 *A. BPA’s Power Business Line is developing rates for undelivered power products. BPA*
24 *chose to separate transmission costs from the floor rate test because it would otherwise be*
25 *comparing the floor rate to a power product that does not include transmission costs.*
26

1 Q. PPC also maintains that, if BPA chooses to exclude transmission costs from the floor rate
2 in this rate case, BPA will have two alternatives: (1) do a “true-up” of the floor rate in
3 the transmission case and then “impose a higher transmission charge on the DSIs for
4 delivery of Federal power, if required,” or (2) impose a 3.81 mills/kilowatthour (kWh)
5 transmission floor rate on deliveries of Federal power. Hansen, et al., WP-02-E-PP-06,
6 at 22. Do you agree?

7 A. The proposals described in the testimony are both transmission proposals. As noted
8 previously, such proposals are beyond the scope of the power rate case and will be dealt
9 with in the transmission rate case. The parties to that case could voice a variety of
10 perspectives that won’t necessarily be limited to the options identified in PPC’s
11 testimony.

12 Q. PPC concludes that BPA should use, as the basis for the floor rate, the Premium IP rate
13 in effect on June 30, 1985, rather than the Standard Rate in effect on June 30, 1985.
14 Hansen, et al., WP-02-E-PP-06, at 22-24. The basis for this conclusion is that the
15 service being offered to the DSIs in this proceeding is more akin to the firm service
16 provided under the Premium IP rate than to the Standard Rate, which “melded three
17 quartiles of service to DSI loads with one quartile of nonfirm service.” Id. Do you
18 agree?

19 A. No. The IP-83 Standard rate forms the baseline for the floor rate, a standard that has been
20 used for over 20 years. The testimony identifies a difference in the quality of service
21 being provided to DSIs in this rate case. However, PPC offers no examples where BPA
22 has previously adjusted the floor rate to account for differences in service quality, in spite
23 of the fact that DSIs received 100 percent firm service in the 1996 rate case. Adopting
24 PPC’s proposal would raise a number of questions. For example, BPA’s current proposal
25 for DSI service is roughly half the current service level. This arguably raises a service
26 quality issue that should also impact the floor rate, which in turn raises the issue of how

1 to deal with any service quality distinctions for which no appropriate 1983 analogue can
2 be identified. The IP-83 Standard rate has provided a workable baseline of rate
3 protection to BPA's public agency customer for more than two decades. A change of the
4 magnitude proposed by PPC would not be reasonable under the circumstances.

5 **Section 3. Response to Industrial Margin Issues**

6 *Q. PPC states that revenue taxes should be included in the industrial margin. The testimony*
7 *notes that in 1996 BPA relied largely on the argument that the DSI rate would not be*
8 *competitive if revenue taxes were included in the margin, but the same rationale is not*
9 *compelling in today's market. Therefore, since revenue taxes are a cost of utilities doing*
10 *business in Washington which is not allocated to production, transmission, or*
11 *distribution, the cost of revenue taxes should be included in the margin, in light of the*
12 *substantial amount of DSI load located in Washington and served under the IP rate.*
13 *Hansen, et al., WP-02-E-PP-06, at 28. Do you agree with this analysis?*

14 *A. No. Competitiveness was a major concern in 1996, but BPA did not rely solely on*
15 *competitiveness as its justification for excluding revenue taxes from the margin. BPA*
16 *also concluded that revenue taxes were not "typical," as intended by the statutory*
17 *directive that requires the Administrator to base the IP rate "on BPA's applicable*
18 *wholesale rates and the typical margins 'included by [the] Administrator's public body*
19 *and cooperative customers in their retail industrial rates.'" See 1996 Final Rate Proposal,*
20 *Administrator's Record of Decision (ROD), WP-96-A-02, at 180. The typicality test*
21 *used in 1996 included two major elements: (1) the number of utilities serving industrial*
22 *load and subject to the revenue tax; and (2) the number of states within BPA's service*
23 *territory which levy such a tax on public agency customers served by BPA. Id. at*
24 *177-188. The facts relevant to that determination have not changed in a manner that*
25 *would lead to a different conclusion than was reached in 1996. According to our most*
26 *recent statistics, BPA has 83 public utility customers that have retail industrial loads.*

1 Of these, 32 are in Washington, and therefore are subject to revenue taxes and 51 are
2 located elsewhere and therefore are not subject to revenue taxes. These updated numbers
3 are only slightly different from those given in the Initial Proposal. See Ebberts,
4 WP-02-E-BPA-22. These are the most recent statistics BPA has. Moreover, no evidence
5 has been provided to the effect that any other state in BPA's service territory has a
6 revenue tax like Washington's. Thus, BPA sees no reason to change its position with
7 respect to exclusion of revenue taxes from the DSI industrial margin.

8 *Q. The PPC argues that, because 71 percent of DSI load served by BPA is located in*
9 *Washington, the Washington revenue tax should be included in the industrial margin*
10 *because doing otherwise would allow that portion of DSI load to forego "state revenue*
11 *taxes which would be paid absent access to Federal power . . ." Hansen, et al.,*
12 *WP-02-E-PP-06, at 28. The IOUs make a similar point, arguing that even if only*
13 *Washington utilities paid revenue taxes, their inclusion in the margin would still be*
14 *appropriate since more than half of all industrial load, and most of the DSI load, in the*
15 *Northwest is located in Washington State. Hoff, et al., WP-02-E-AC/GE/IP/MP/PL/PS-03,*
16 *at 18. Do you agree that the identified factors should be included in the determination of*
17 *what costs are included in the margin calculation?*

18 *A. No. BPA's margin calculation is applied on a regional basis, and the focus is*
19 *appropriately on the margins of BPA's utility customers throughout the region who serve*
20 *industrial load.*

21 *Q. The IOUs argue that revenue taxes should be included in the calculation of the industrial*
22 *margin. Hoff, et al., WP-02-E-AC/GE/IP/MP/PL/PS-03, at 13-19. One of the reasons*
23 *offered for this conclusion is that, based on BPA's direct testimony, WP-02-E-BPA-22,*
24 *at 2-4, BPA's own analysis shows "a majority of public bodies and cooperatives with*
25 *industrial customers pay revenue taxes and thus the taxes should be included in the*
26 *industrial margin." Is this statement accurate?*

1 A. No. The testimony is referring to the sample used to derive the values for the various
2 cost components of the margin. This sample is not used in the determination of whether
3 a particular cost category is “typical” in the sense that it should be included in the margin
4 calculation to begin with. There are really two separate and unrelated determinations.
5 First, BPA must determine which cost categories are appropriately included in the
6 margin. This determination is made independently of the sample. The sample is then
7 used to calculate the level of costs, in mills/kWh for each cost category that has been
8 included in the margin as a result of the first step. This approach is consistent with the
9 methodology used in previous margin calculations.

10 Q. *The IOUs state that BPA’s exclusion of revenue taxes from the margin is incorrect*
11 *because “Washington State is not the only state in which utilities, including public bodies*
12 *and cooperatives, pay revenue taxes or make payments in lieu of taxes.” Hoff, et al.,*
13 *WP-02-E-AC/GE/IP/MP/PL/PS-03, at 16-19. Do you agree?*

14 A. No. BPA’s direct testimony stated that “[I]t is our understanding that only utilities in
15 Washington State are subject to a state revenue tax.” *See Ebberts,*
16 *WP-02-E-BPA-22, at 8, lines 4-5. That statement is consistent with the 1996 rate case.*
17 *See 1996 Final Rate Case Proposal, ROD, WP-96-A-02, at 177 ff. No evidence has been*
18 *offered to refute that conclusion in this rate case. In Hoff, et al.,*
19 *WP-02-E-AC/GE/IP/MP/PL/PS-03, at 16 ff., the testimony refers vaguely to “payments*
20 *in lieu of taxes” without documenting which states require such payments of BPA’s*
21 *utility customers, how they correspond to the Washington revenue tax, or why such*
22 *payments would necessarily be functionalized and allocated in a manner that would*
23 *support their inclusion in the margin. The IOU testimony also states: “With a few*
24 *telephone calls, we identified several jurisdictions in Oregon that levy revenue taxes on*
25 *public utilities and cooperatives.” See Hoff, et al., WP-02-E-AC/GE/IP/MP/PL/PS-03, at*
26

1 19, lines 1-2, Again, this level of information is an insufficient basis for the conclusion
2 reached in the testimony.

3 *Q. The IOUs argue that the relevant consideration is not whether a majority of BPA's public*
4 *body and cooperative customers that sell power to industrial loads in Oregon, Idaho,*
5 *Nevada, and Montana pay revenue taxes (or make in-lieu payments), but whether*
6 *inclusion of revenue taxes in the margin results in a DSI rate that is equitable in relation*
7 *to certain specified retail industrial rates in the region, and that such equity is*
8 *achieved where a DSI pays a margin that is similar to the typical margin paid by large*
9 *industrial customers with similar costs of service. Hoff, et al.,*
10 *WP-02-E-AC/GE/IP/MP/PL/PS-03, at 16-17. Do you agree?*

11 *A. We agree that the goal is to achieve an equitable rate in compliance with BPA's statutory*
12 *ratemaking directives. BPA's methodology is equitable, as we understand that term.*

13 *Q. The DSIs state that in prior cases BPA has not included in the calculation of the margin*
14 *any utility that did not supply information from which the parties could calculate a*
15 *margin. Schoenbeck, et al., WP-02-E-DS/AL/VN-01, at 14. Is such a statement correct?*

16 *A. No. This statement is wrong. Parties need only go back as far as the 1996 rate case to*
17 *find utility-provided data giving the amount of margin used in the margin analysis.*
18 *Furthermore, broad scale reliance on special contracts and provision of service under*
19 *market-based or other non-traditional tariff service are relatively new aspects of the*
20 *electric industry resulting from the shift to a more competitive power market. Recently,*
21 *there has been a large increase in the amount of industrial load being served under these*
22 *types of contracts. See, for example, Legislative Electricity Study 6560, January 1999.*
23 *Such contracts do not have charges based strictly on a full cost of service analysis, and*
24 *they will generally be of a business-sensitive, proprietary nature. Consequently, it is*
25 *reasonable to use margin information provided by utilities and verified by PPC for such*
26

1 contracts, on a case-by-case basis, particularly in the absence of any indication or
2 evidence of impropriety.

3 *Q. The DSIs propose that utility No. 5 from the sample be excluded from the margin*
4 *calculation. This utility did not provide a Cost of Service Analysis (COSA), or any other*
5 *supporting information comparing total costs to total revenues, with the result that there*
6 *is no way to know what portion, if any, of administrative costs are paid by that utility's*
7 *two industrial customer as part of a margin. Schoenbeck, et al., WP-02-E-DS/AL/VN-01,*
8 *at 14. Why was utility No. 5 included in the sample?*

9 *A. Utility No. 5 involved a special contract and so the utility did not have a COSA. In the*
10 *initial request for data for the margin calculation, it was recognized that some utilities*
11 *would probably have special contracts, as described in the previous response. We*
12 *requested that PPC verify that the margin number provided represented the cost of*
13 *servicing the two industrial customers over and above the cost of power, transmission, and*
14 *distribution. In other words, it is the same number that would have been calculated from*
15 *a COSA had a COSA been provided. BPA would have accepted the utility's*
16 *functionalization and allocation method and excluded from the margin calculation costs*
17 *related to production, transmission, and distribution. The information is sufficiently*
18 *reliable to be included when balanced against working with a smaller sample if the*
19 *information were excluded.*

20 *Q. The DSIs recommend the exclusion of utility No. 14 from the sample, because it did not*
21 *provide any means to ascertain what costs may be included in the margin it provided to*
22 *PPC. Schoenbeck, et al., WP-02-E-DS/AL/VN-01, at 15. Why was utility No. 14*
23 *included in the sample?*

24 *A. Utility No. 14 also indicated that it did not have a COSA for its single industrial*
25 *customer, which was receiving service under a special contract. The utility confirmed*
26 *that it was servicing the customer at a cost that would have been entirely assigned to either*

1 production, transmission, or distribution had a COSA been available. In other words,
2 there would have been no costs assigned to any other category, with the result that a
3 margin of 0 mills/kWh was applied to this utility.

4 In the case of both utility No. 5 and No. 14, no COSA was available. In both
5 cases, the utility verified that, had there been a COSA, costs would have been allocated
6 and functionalized in a manner that would have resulted in the same margin calculations.
7 This consistent treatment of the submitted data is reasonable since there is no reason to
8 have less confidence in it than the other information provided by the utilities participating
9 in the sample.

10 *Q. The DSIs state that BPA treated the cost/revenue difference for utility No. 9 inconsistently*
11 *with its treatment of cost/revenue difference of utility No. 3. Schoenbeck, et al.,*
12 *WP-02-E-DS/AL/VN-01, at 15. Do you agree?*

13 *A. No. In the case of utility No. 3, the COSA indicated that there was a revenue source of*
14 *\$40,000 needed to balance expected costs with expected revenues. These types of*
15 *revenue credits, where they were not already functionalized by the utility, have been*
16 *apportioned among the production, transmission, distribution, and other cost categories*
17 *based on relative shares of revenue requirement. See WP-02-E-BPA-22, at 6,*
18 *lines 17-18. This was done for utility No. 9, as well as other utilities with similar revenue*
19 *credits. By contrast, utility No. 31 identified a margin for its large industrial class that*
20 *constituted an additional cost assigned to that customer class over and above the basic*
21 *costs associated with electrical service. Assigning this identified cost entirely to the*
22 *margin category is in no way similar to, or inconsistent with, the treatment of utility*
23 *No. 9.*

24 *Q. Does this conclude your testimony?*

25 *A. Yes.*

26