RESIDENTIAL PURCHASE AND SALE AGREEMENTS WITH PACIFIC NORTHWEST INVESTOR-OWNED UTILITIES

ADMINISTRATOR'S RECORD OF DECISION

Bonneville Power Administration
U.S. Department of Energy

October 4, 2000

Record of Decision

Residential Purchase and Sale Agreements
With Pacific Northwest Investor-Owned Utilities

I. INTRODUCTION

BPA's Power Subscription Strategy (Subscription Strategy) proposes comprehensive settlements of the Residential Exchange Program (REP) with participating regional investor-owned utilities (IOUs). However, IOUs will also have the option of entering into contracts to participate in the traditional REP (also referred to as "REP" or "Program"). The Subscription Strategy also notes that public agency customers are eligible to enter contracts under the REP. To fill this need, BPA has prepared a prototype Residential Purchase and Sale Agreement (RPSA) to implement the REP for all eligible customers.

The purpose of this Record of Decision is to

1. describe BPA's proposal for RPSAs implementing the REP;

2. evaluate comments made by interested parties; and

3. explain BPA's final decisions with respect to the matters upon which comments were received.

The prototype RPSA was proposed as the basis for contracting with all eligible utilities applying for benefits under the REP. BPA requested public comment on the following:

1. which entities are eligible utilities to request benefits under section 5(c) of the Northwest Power Act;

2. BPA's proposal to implement the in lieu provisions of section 5(c)(5) of the Northwest Power Act through wholesale market purchases;

3. any exceptions to the limitations of section 5(c)(6) that preclude the restriction of exchange sales under section 5(c) below the amounts of power acquired from, or on behalf of, the utility pursuant to section 5(c); and

4. any comments on the terms and conditions of the prototype RPSA.

II. BACKGROUND

A. Section 5(c) of the Northwest Power Act

Section 5(c) of the Northwest Power Act established the REP. 16 U.S.C. 839c(c). Under the REP, a Pacific Northwest electric utility may offer to sell power to BPA at the utility's average system cost (ASC). 16 U.S.C. 839c(c)(1). BPA purchases such power and, in exchange, sells an equivalent amount of power to the utility at BPA's PF Exchange rate. *Id*. The amount of the power exchanged is based on 100% of the utility's qualifying residential and small farm load. *Id*. BPA's past practice did not require actual power sales. Instead, BPA provided monetary benefits to the utility based on the

difference between the utility's ASC and the applicable PF Exchange rate multiplied by the utility's residential and small farm load. These monetary benefits must be passed through directly to the utility's residential and small farm consumers. 16 U.S.C. 839c(c)(3).

While REP benefits have previously been monetary, the Northwest Power Act also provides for the sale of actual power to exchanging utilities in specific circumstances. Pursuant to section 5(c)(5) of the Northwest Power Act, in lieu of purchasing any amount of electric power offered by an exchanging utility, the Administrator may acquire an equivalent amount of electric power from other sources to replace power sold to the utility as part of an exchange sale. 16 U.S.C. 839c(c)(5). However, the cost of the acquisition must be less than the cost of purchasing the electric power offered by the utility. *Id*. In these circumstances, BPA acquires power from other sources and sells actual power to the exchanging utility.

At its inception, the REP was implemented through RPSAs executed in 1981. These contracts established the Program benefits only for the period through June 30, 2001. BPA's proposed RPSA would establish the mechanism for providing Program benefits beyond July 1, 2001.

Except for one exchanging utility that is in "deemer" status[1], all obligations under RPSAs held by utilities that ever received Program benefits have been settled through Residential Exchange Termination Agreements, which terminated participation in the Program for a period of time. Regional utilities are eligible to participate in the REP again beginning July 1, 2001, except for those utilities that have executed settlement agreements for terms extending beyond July 1, 2001.

B. BPA's Power Subscription Strategy

During the spring and summer of 1998, BPA conducted extensive public meetings with all interested parties regarding the development of a "Power Subscription Strategy." At the conclusion of these lengthy discussions, on September 18, 1998, BPA released a "Power Subscription Strategy Proposal" for public review. During the comment period BPA received nearly 200 responses to the proposal comprising nearly 600 pages of comments. After review and analysis of those comments, BPA published its final "Power Subscription Strategy" on December 21, 1998. *See* "Power Subscription Strategy" and "Power Subscription Strategy, Administrator's Record of Decision." At the same time, the Administrator published a National Environmental Policy Act (NEPA) ROD that contained an environmental analysis for the Power Subscription Strategy. This NEPA ROD was tiered to BPA's Business Plan ROD (August 15, 1995) for the Business Plan Environmental Impact Statement (DOE/EIS-0183, June 1995). The purpose of the Subscription Strategy is to enable the people of the Pacific Northwest to share the

[1] Deemer status is where a utility sets its ASC equal to BPA's PF Exchange rate and does not receive positive monetary benefits but accrues a negative balance that must be worked off before resuming the receipt of positive monetary benefits.

benefits of the Federal Columbia River Power System after 2001 while retaining those benefits within the region for future generations.

Since release of the Power Subscription Strategy, BPA has initiated a number of processes to implement the strategy. BPA requested comment on a number of issues that addressed implementation of the Power Subscription Strategy. *See* Letter dated December 2, 1999, requesting comment on four issues and letter dated November 17, 1999, requesting comment on methodology to allocate Subscription benefits to regional IOUs. BPA published an Administrator's Supplemental Record of Decision on the Power Subscription Strategy on April 26, 2000 addressing the comments and issues raised in those letters. References to the Power Subscription Strategy are to the December 1998 Power Subscription Strategy as modified by the Supplemental ROD.

The Power Subscription Strategy addresses how those who receive the benefits of the region's low-cost federal power should share a corresponding measure of the risks. The Power Subscription Strategy seeks to implement the subscription concept created by the 1996 Comprehensive Review through contracts for the sale of power and the distribution of federal power benefits in the deregulated wholesale electricity market. The success of the Subscription process is fundamental to BPA's overall business purpose to provide public benefits to the Northwest through commercially successful businesses.

The Power Subscription Strategy is premised on BPA's partnership with the people of the Pacific Northwest. BPA is dedicated to reflecting their values, to providing them benefits and to expanding and spreading the value of the Columbia River throughout the region. In this respect, the Strategy has four goals:

1. Spread the benefits of the Federal Columbia River Power System as broadly as possible, with special attention given to the residential and rural customers of the region;

2. Avoid rate increases through a creative and businesslike response to markets and additional aggressive cost reductions;

3. Allow BPA to fulfill its fish and wildlife obligations while assuring a high probability of U.S. Treasury payment; and

4. Provide market incentives for the development of conservation and renewables as part of a broader BPA leadership role in the regional effort to capture the value of these and other emerging technologies.

One element of the Power Subscription Strategy is an offer of a comprehensive settlement of the REP for each regional IOU for the post-2001 period. The Power Subscription Strategy proposes that IOUs may agree to a settlement of the REP which would enable them to receive benefits equivalent to a purchase of a specified amount of power under Subscription for their residential and small farm consumers at a rate expected to be approximately equivalent to the PF Preference rate. Under the proposed

settlement, residential and small farm loads of the IOUs would be assured access to benefits equivalent to 1,900 aMW of federal power for the FY2002-2006 period and 2,200 aMW of federal power for the FY2007-2011 period. While BPA proposed a settlement with benefits equivalent to 1800 aMW in the Power Subscription Strategy, BPA has decided to offer settlement agreements with benefits equivalent to 1900 aMW of federal power for the FY2002-2006 period based on the Administrator's Supplemental Record of Decision on the Power Subscription Strategy.

BPA will set the physical and financial components of the Subscription amount, by year, in the negotiated Subscription settlement contracts. Any cash payment will reflect the difference between the market price of power forecast in the rate case and the rate used to make such Subscription sales. The actual power deliveries for these loads will be in equal hourly amounts over the period.

The Power Subscription Strategy proposes that BPA will offer five-year and 10-year Subscription settlement contracts for the IOUs. Under both contracts, the Power Subscription Strategy (as modified by the Administrator's Supplemental Record of Decision on the Power Subscription Strategy) proposes that BPA will offer and guarantee 1,900 aMW of power and/or monetary benefits for the FY2002-2006 period. At least 1,000 aMW will be met with actual BPA power deliveries. The remainder may be provided through either a financial arrangement or additional power deliveries, depending on which approach is most cost-effective for BPA. The IOUs' settlement of rights to request REP benefits under section 5(c) of the Northwest Power Act will be in effect until the end of the contract term.

Under the 10-year contract, in addition to the benefits provided during the first five years, BPA proposes to offer and guarantee 2,200 aMW of power or financial benefits for the FY2007-2011 period. BPA intends for this 2,200 aMW to be comprised solely of physical power deliveries and believes that the expiration of existing long term surplus sales should make such deliveries possible. The IOUs' settlement of rights to request REP benefits under section 5(c) will be in effect until the end of the 10-year term of the contract. In the event of reduction of federal system capability or increased public preference customer load obligations during the term of the 10-year contracts, BPA will determine whether to provide monetary compensation or purchase power to guarantee power deliveries during the FY2007-2011 period.

In summary, residential and small farm loads of the IOUs may receive benefits from the federal system in either of two ways. An IOU may participate in the established REP by signing an RPSA or it may participate in a settlement of the REP through Subscription. If an IOU chooses to request REP benefits under section 5(c), then the total IOU Subscription settlement amount would be reduced by the amount originally allocated to the exchanging utility, with the settlement amounts allocated to other utilities remaining unchanged.

Issues related to rates for power sales under the proposed settlements, as well as the forecast market price of power, were decided in BPA's 2002 wholesale power rate case,

BPA Docket No. WP-02. BPA issued a 2002 Final Power Rate Proposal, Administrator's ROD, for the rate case on May 15, 2000.

On August 1, 2000, BPA sent a letter to its customers and interested parties identifying significant potential cost recovery problems with the 5-year rates included in the BPA Wholesale Rate Case Final ROD. BPA initiated a public process to identify options for addressing this issue. On August 30, 2000, BPA announced a supplemental section 7(i) process to address cost recovery concerns.

III. RESIDENTIAL PURCHASE AND SALE AGREEMENT

BPA has developed a prototype contract for implementing the REP. The prototype reflected modifications of certain provisions of the 1981 RPSA to reflect current market conditions and to reflect BPA's experience under the initial RPSA. The draft prototype RPSA reflects substantive discussions with regional IOUs and some discussions with other regional utilities. These discussions were based on the following principles, which were modified as a result of the discussions.

1. REP benefits are available to residential and small farm consumers through all entities serving residential loads under State law or through order of State regulatory authorities.

2. The RPSA should be a standard contract applying to all eligible entities.

3. All REP benefits should continue to be passed through in full to residential and small farm loads.

4. Recovery of administrative costs for implementing the REP from State ratepayers is a matter between the entities and the appropriate State regulatory authorities.

5. Average system costs (ASCs) for all entities will be established under an approved ASC Methodology, as required by statute.

6. Entities will establish ASCs by jurisdiction consisting of the service territory of distribution utilities regulated by State commissions as defined in the ASC Methodology.

7. Entities using projected amounts of purchased power to meet load shall base their ASCs on forecasts of purchased power costs for such amounts as well as the costs of their other resources, if any, used to serve their forecasted contract system loads by jurisdiction.

8. BPA's right to acquire power in lieu of purchasing power at an entity's ASC will be implemented based on the entity's forecast of its loads, procedures established under BPA's In Lieu Power Policy identifying the sources and cost of in lieu power, and the

cost of delivering In Lieu PF Power to the transmission system connected to the distribution system serving the residential and small farm loads in a jurisdiction.

9. BPA will provide monetary benefits under the RPSA for invoiced amounts of residential and small farm load that exceed amounts of In Lieu PF Power provided under an in lieu notice.

10. BPA will allow agency agreements where one entity may act as an agent for another entity in invoicing residential and small farm loads for a jurisdiction under the RPSA. BPA's approval for such agreements will be based on whether the secondary exchanging utility had the same cost basis for ASC purposes as the primary exchanging utility acting as its agent. Examples of such arrangements may include distribution utilities purchasing from the primary exchanging utility on a wholesale requirements basis or licensed electric suppliers without resources using only purchased power to meet loads on the same basis as a default supplier without resources using only purchased power to serve loads.

11. BPA may require REP benefits to be placed in escrow accounts for entities that do not meet BPA's credit tests until such benefits are distributed to residential and small farm consumers.

12. BPA shall have the right to review all RPSA transactions (e.g., exchange of eligible residential loads) and adjust benefit payments based on the results of such periodic reviews.

13. All obligations of an entity to pay BPA under the RPSA shall be placed in a payment balancing account and used to reduce future benefit payments from BPA under the REP. Amounts entered in the payment balancing account will not accrue interest for a period of one year.

These principles guided BPA in its evaluation of the comments received and in the development of the final proposal reflected in this Record of Decision.

IV. ALLOCATION OF FCRPS BENEFITS

Issue

Whether the RPSA represents an appropriate alternative for exchanging utilities deciding whether to continue participation in the RSPA or accept the settlement option.

Parties' Positions

The IOUs have argued that the RPSA is flawed because it does not provide sufficient benefits to give exchanging utilities a meaningful choice between settlement and continued participation in the traditional REP.

BPA's Position

The sale under the RPSA will be based upon a lawfully developed rate and according to contractual terms that reasonably implement the relevant statutory provisions.

Evaluation of Positions

Puget argues that the benefit levels proposed under both the RPSA or the settlement proposal are inadequate. PSE, IOURESEXC:018. Puget also fears that proposed level of residential exchange benefits in both the settlement package and the RPSA will undermine the regional consensus that is essential to retain the benefits of the Federal Columbia River Power System in the region. *Id.* The result would be to jeopardize regional preference. *Id*.

Puget also cites the Northwest investor-owned utilities' joint briefs in the WP-02 proceeding for the proposition that BPA's subscription plan (intended to be implemented through the Settlement Agreement offer) treats IOU residential and small farm consumer as "second class" citizens. *Id.* Unless changed, Puget argues, the proposal will result in an allocation of less than 23 percent of the Federal power benefits to the 60 percent of the region's citizens served by Northwest investor-owned utilities. *Id*. Puget insists that such a result contravenes the purpose and requirements of the Northwest Power Act of providing an equitable share of the benefits of the Federal Columbia River Power System to all the region's residential and small farm customers. *Id*.

Puget concludes that BPA's proposal is unlawful because it reflects a decrease in benefits for investor-owned utility residential customers while proposing an increase in benefits for preference customers. *Id*. This result, Puget claims, is unfair and discriminatory, harming the IOU residential customers who constitute a majority of regional families and small farms. *Id*. PGE, PacifiCorp, Avista, and the Commissions expressed support for Puget's perspective. PGE, IOURESEXC:021; PacifiCorp, IOURESEXC:011, Avista, IOURESEXC:001; OPUC, IOURESEXC:014; WTUC IOURESEXC:016; MPUC, IOURESEXC:005; and IPUC, IOURESEXC:015.

BPA believes that Puget's conclusions are based, in part, on an unwillingness to recognize the impact that mandatory legal requirements have on implementation of the residential exchange. It misses the point to conclude that BPA's proposal is flawed simply because only 23 percent of the benefits of the FCRPS go to the residential and small farm consumers who comprise 60 percent of such customers in the region. Benefit levels cannot be viewed in a vacuum but must be considered in the context of the statutory framework that provides benefits to all of BPA's customers.

The primary law establishing these obligations is the Northwest Power Act. Implementation of the directives of the Northwest Power Act results in benefits of the Federal power system that flow to BPA's customers and, where applicable, to retail consumers of those customers. One of the most fundamental requirements of the Northwest Power Act is that public bodies and cooperatives have preference and priority

to the purchase of Federal power to meet their net requirements. 16 U.S.C. §832(a); 16 U.S.C. §839c(a). This power is used to serve all requirements loads of such preference customers, including residential, commercial, and industrial loads.

Preference customers pay the PF Preference rate for their power purchases. BPA's rate directives establish the manner in which BPA must allocate costs in establishing the PF rate, which applies to BPA's preference customers and utilities participating in the REP. 16 U.S.C. §839e(b)(1). Due to the cost allocation directives of section 7 of the Northwest Power Act, and the fact that FBS power can be priced well below other sources of power, the PF Preference rate is currently BPA's lowest rate for firm power requirements service. Therefore, under the law, BPA's preference customers receive substantial benefits from the Federal power system by being able to purchase their net requirements at the PF Preference rate.

IOUs also benefit in a number of ways from the Northwest Power Act. First, like BPA's preference customers, IOUs may place their net requirements load on BPA. 16 U.S.C. §839c(b)(1). The rate directives for IOUs' requirements power, unlike those for BPA's preference customers, are contained in section 7(f) of the Northwest Power Act, which generally results in NR rates that are higher than the PF Preference rate. Due to the level of the NR rate, BPA has forecasted few requirements sales under the NR rate to IOUs for the rate period.

A second way in which IOUs benefit from the Northwest Power Act is the REP. 16 U.S.C. §839c(c). Under the REP, BPA "purchases" power from each participating utility at that utility's ASC. Boling and Doubleday, WP-02-E-BPA-30, at 2. The Administrator then offers, in exchange, to "sell" an equivalent amount of electric power to the utility at BPA's PF Exchange power rate. *Id.* The amount of power purchased and sold is the qualifying residential and small farm load of each utility participating in the REP. *Id.* The Northwest Power Act requires that the net benefits of the REP be passed through directly to the residential and small farm customers of the participating utilities. *Id.* Under the normal implementation of the REP, no actual power is transferred either to or from BPA. *Id.* The "exchange" has been referred to as a "paper" transaction, where BPA provides the participating utility cash payments that represent the difference between the power "purchased" by BPA and the less expensive power "sold" to the participating utility. *Id.*

However, the PF rate for utilities participating in the REP is subject to adjustment pursuant to 7(b)(2) of the Northwest Power Act, 16 U.S.C. §839e(b)(2). See, WP-02 ROD at chapter 13. Due to this feature of the Act, this PF Exchange rate is not always the same level as the PF Preference rate. The Northwest Power Act established what is called the 7(b)(2) rate test. 16 U.S.C. §839e(b)(2). This test is designed to protect preference customers from certain costs incurred under the Northwest Power Act, including Residential Exchange costs. If the 7(b)(2) rate test does not trigger, the PF Preference rate and the PF Exchange rate are equal. If the 7(b)(2) rate test triggers, however, the PF Exchange rate is subject to a surcharge and is higher than the PF Preference rate. The lower the PF Exchange rate, the higher the exchange benefits. The

higher the PF Exchange rate, the lower the exchange benefits. This is the manner in which rates must be established by BPA under the Northwest Power Act. Where, as in the current rate case, the 7(b)(2) rate test triggers, it is not at all surprising that consumers of preference customers would receive greater "benefits" than the IOUs' residential consumers. In years when the 7(b)(2) rate test did not trigger, as has occurred periodically over the last 15 years, the IOUs receive greater benefits. In years when the 7(b)(2) rate test triggers, the IOUs receive lesser benefits.

In other words, different customer classes may receive greater or lesser benefits of the Federal system in any particular rate period. This is simply the result of the implementation of the directives of the Northwest Power Act. This outcome is consistent with the intent of Congress. The Northwest Power Act itself nowhere specifies that the IOU benefits provided under the REP would be equal to the benefits provided to BPA's preference customers. Furthermore, there is no limitation on 7(b)(2) that would suggest that section 7(b)(2) would not completely eliminate exchange benefits for utilities whose ASC rate was less than BPA's PF Exchange rate. Instead, the Acts legislative history contains general statements that the Northwest Power Act would provide "a share in the economic benefits of the lower-cost Federal system for the residential consumers of the non-preference customers," and would "extend the benefits of low-cost federal power to consumers served by investor-owned utilities." IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 10-12. Such statements provide no basis for concluding that a particular level of benefits is required or that benefits should be distributed on a per capita basis.

BPA's approach to spreading FCRPS benefits provides the IOUs with two options: (1) they may agree to a settlement of the REP and purchase some Federal power at a rate approximately equivalent to the PF Preference rate; or (2) they can continue to participate in the Residential Exchange. *Id*. at 10. BPA's Subscription ROD proposed the equivalent of 1,900 aMW of Federal power for the fiscal year (FY) 2002-2006 period, delivered flat annually, assuming the IOUs settle participation in the Residential Exchange. *Id*. at 11. Of the 1,900 aMW, delivered flat, at least 1,000 aMW will be met with actual power deliveries. The remainder may be provided through either a financial arrangement or additional power deliveries, depending on which approach is most cost-effective for BPA. *Id*.

Under the second option, financial benefits will be calculated as the difference between the exchanging utility's average system cost and the PF-Exchange rate, as required by law. This arrangement will be governed by a new Residential Purchase and Sale Agreement (RPSA). It is true that certain features of this new RPSA are not the same as the previous RPSA, e.g., the in-lieu provisions. However, these changes simply reflect different market conditions and provide a more workable framework for implementation of the relevant statutory provisions.

The IOUs perceive this as a loss of benefits and complain that these changes and the forecasted level of benefits under the new RPSA deprive them of a meaningful choice between settlement and the RPSA. However, as noted above, there is no requirement that

BPA provide an alternative other than the present RPSA. BPA has no ability to simply make the RPSA more attractive just for the purpose of providing IOUs with what they perceive as better alternatives. Instead, as envisioned by the Northwest Power Act, the PF-Exchange rate must set the price of Federal power for the RPSA transaction, and those transactions must be governed by contractual terms that reasonably implement the other statutory provisions relevant to the REP. This is the manner contemplated by the Northwest Power Act for providing IOU residential and small farm loads with an equitable share of benefits while ensuring some measure of rate protection to BPA's statutory preference customers.

Moreover, BPA's Subscription Strategy is predicated on a variety of goals: to spread the benefits of the FCRPS as broadly as possible, with special attention given to the residential and rural customers of the region; to avoid rate increases through a creative and business-like response to markets and additional aggressive cost reductions; to allow BPA to fulfill its fish and wildlife obligations while assuring a high probability of U.S. Treasury payment; and to provide market incentives for the development of conservation and renewables as part of a broader BPA leadership role in the regional effort to capture the value of these and other emerging technologies. *See* Subscription Strategy, at 3-4. BPA believes that its proposed rates achieve these goals.

Attaining these goals does not depend upon a specific type of a utility receiving a specific proportion of perceived economic benefits. BPA's goal of spreading the benefits of the FCRPS as broadly as possible, with special attention given to the residential and rural customers of the region, is reflected in the Subscription Strategy by BPA's proposed settlements of the REP with regional IOUs. *Id.* at 8-10, 16-17. BPA's rate case has proposed rates that would implement these proposed settlements. BPA's forecasted Residential Exchange benefits to the IOUs comprise approximately $37 million per year during the rate period. Wholesale Power Rate Development Study Documentation, WP-02-E-BPA-05A, at 91. In providing special attention to residential and rural customers of the IOUs and giving them an additional option in access to Federal benefits, BPA forecasted exchange settlement benefits to the IOUs that total approximately $140 million per year during the rate period. Tr. 122. Considered in light of all of the circumstances, this level of assured benefits reasonably and fairly accomplishes the goal of providing special attention to residential and small farm load of regional IOUs.

IOUs may, of course, choose to remain in the traditional exchange program, as reflected by the RPSA. If so, the statutorily prescribed formula will ultimately determine the actual level of benefits received over the course of the rate period. The two options, taken together, do provide a meaningful choice that is consistent both with statutory requirements and the goals articulated in the subscription strategy. Unfortunately, there are constraints on the options available, and it is simply not possible to make the two choices equally attractive for each participating utility.

Decision

The proposed sale under the RPSA is based upon a lawfully developed PF Exchange rate and other contractual terms that properly implement relevant statutory provisions. The RPSA therefore represents a meaningful and appropriate choice for exchanging utilities.

V. REVISION OF ASC METHODOLOGY

Issue

Whether BPA should revise the 1984 ASC Methodology.

Parties' Positions

Avista and PSE argue that BPA should immediately revise its ASC Methodology to include income taxes and return on equity in utilities' ASCs. Avista, IOURESEXC:001; PSE, IOURESEXC:018.

BPA's Position

BPA has not yet received a request to revisit the current ASC Methodology under the procedures established in the Methodology. BPA's current ASC Methodology continues to perform an important function of prohibiting abuse of the REP. Important issues that would directly affect the development of a new ASC Methodology are currently pending in the region. Attempting to immediately revise the ASC Methodology would likely require immediately revising any new methodology when those issues have been resolved. It is therefore not appropriate to revise the ASC Methodology at this time. However, BPA will begin discussions whether BPA should develop a new ASC Methodology during the next rate period.

Evaluation of Positions

Avista argues that BPA should negotiate a new ASC Methodology as an attachment to the RPSA or revise the approach to determining ASC for the term of the agreement. Avista, IOURESEXC:001. Avista argues that BPA proposes to continue with the 1984 ASC Methodology, which arbitrarily excludes customers of relatively lower-cost utilities from any benefit, while potentially paying significant benefits to other parts of the region. *Id.* Similarly, PSE requests that BPA initiate a consultation process as provided in section 5(c) of the Northwest Power Act with respect to the ASC Methodology to be applied after June 30, 2001, to the REP. PSE, IOUEXC:018. PSE argues that the continued exclusion after June 30, 2001, of income taxes and return on equity from the ASC methodology will help prevent the fair distribution of benefits for residential and small farm customers of investor-owned utilities. *Id*. These arguments will be addressed in greater detail below.

It is helpful to first provide some background regarding the implementation of the REP. Section 5(c) of the Northwest Power Act created the REP. Section 5(c) provides:

> Whenever a Pacific Northwest electric utility offers to sell electric power to the Administrator at the average system cost of that utility's resources in each year, the Administrator shall acquire by purchase such power and shall offer, in exchange, to sell an equivalent amount of electric power to such utility for resale to that utility's residential users within the region.

16 U.S.C. § 839c(c)(1). The REP was created to provide the regional utilities' residential and small farm customers a form of access to low-cost Federal power. *See* H.R. REP. NO. 96-976 (I), at 29 (1980), *reprinted in* 1980 U.S.C.C.A.N. 5989, 5995; H.R. REP. NO. 97-976 (II), at 34 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6023, 6032. Under the REP, each electric utility may elect to sell power to BPA at the "average system cost [ASC] of that utility's resources" and, in return, BPA sells an equivalent amount of power back to the utility at BPA's PF Exchange rate. 16 U.S.C. § 839c(c)(1). The amount of power purchased and sold is based on 100% of the qualifying residential and small farm load of the exchanging utility. *Id*. § 839c(c)(2). In most circumstances, no actual power is exchanged. Rather, in the case where BPA's rate is lower than the ASC, BPA pays the utility the difference between the utility's ASC and BPA's PF Exchange rate in cash, which the utility then passes directly through to its residential and small farm customers. If a utility's ASC is less than the PF Exchange rate under the 1981 RPSA, BPA allowed the utility to elect to "deem" its ASC equal to the PF Exchange rate. By doing so, the utility avoids making actual payments to BPA. The amount that the utility would otherwise pay BPA is tracked in a "deemer account."

Section 5(c)(7) of the Northwest Power Act requires BPA to develop a "methodology" for determining each utility's ASC. *Id*. § 839c(c)(7). BPA consults with interested parties in the region in developing the methodology, but the Administrator must establish the methodology rule, subject to review and approval by FERC. *Id*. Section 5(c)(7) of the Northwest Power Act provides:

> The "average system cost" for electric power sold to the Administrator under this subsection shall be determined by the Administrator on the basis of a methodology developed for this purpose in consultation with the [Northwest Power Planning] Council, the Administrator's customers, and appropriate State regulatory bodies in the region. Such methodology shall be subject to review and approval by the Federal Energy Regulatory Commission.

Id. The Northwest Power Act provides that utilities' ASCs shall not include:

> (A) the cost of additional resources in an amount sufficient to serve any new large single load of the utility;

> (B) the cost of additional resources in an amount sufficient to meet any additional load outside the region occurring after December 5, 1980; and
> (C) any costs of any generating facility which is terminated prior to initial commercial operation.

Id. § 839c(c)(7)(A)-(C).

BPA established an initial ASC Methodology ("1981 ASC Methodology") pursuant to section 5(c)(7) of the Northwest Power Act in a Record of Decision issued on August 26, 1981. *Administrator's Record of Decision, Bonneville Power Administration*, (August 1981). BPA filed the 1981 ASC Methodology with FERC on August 27, 1981, and FERC granted interim approval effective as of October 1, 1981. *Sales of Electric Power to the Bonneville Power Administration, Filing Rate Schedules, Interim Rule*, 46 Fed. Reg. 50,517 (1981), corrected 46 Fed. Reg. 55,952 (1981). FERC granted final approval of the 1981 ASC Methodology on October 6, 1983, retroactive to October 1, 1981. *Sales of Electric Power to the Bonneville Power Administration, Methodology and Filing Requirements*, 25 FERC ¶ 61,005, 48 Fed. Reg. 46,970 (1983) (codified at 18 C.F.R. 301.1 (1997)).

Beginning in 1983, BPA's direct service industrial customers and public agency customers requested a change in the ASC Methodology based on numerous concerns, including perceived abuses in the system related to the attempted inclusion of terminated plant costs in ASC in violation of section 5(c)(7) of the Northwest Power Act. BPA, however, addressed many issues in revising the ASC Methodology, including the source data for the ASC Methodology, the determination of whether transmission costs should be considered resource costs, the subsidization of construction work in progress, the treatment of equity return, the treatment of income taxes, the determination of generating resources includable in computing ASC, the treatment of affiliated fuel costs, conservation costs includable in ASC, and the functionalization between subsidized and non-subsidized accounts. *Average System Cost Methodology, Administrator's Record of Decision, Bonneville Power Administration* (June, 1984) (hereinafter "1984 ASC ROD"). On October 7, 1983, BPA initiated the ASC consultation proceeding by publishing a "Request for Recommendations" in the Federal Register. *Reconsultation of Average System Cost Methodology, Request for Comments and Recommendations*, 48 Fed. Reg. 45,829 (1983). After reviewing comments, BPA published a "Proposed Methodology for Determining the Average System Cost of Resources for Electric Utilities Participating in the Residential Exchange." *Proposed Methodology for Determining the Average System Costs of Resources for Electric Utilities Participating in the Residential Exchange Program Established by Section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act*, 49 Fed. Reg. 4,230 (1984). In conjunction with the proposal, BPA also published an "Issue Alert" that summarized the issues. After further hearings and comments, BPA published the 1984 ASC ROD on June 4, 1984. The Northwest investor-owned utilities challenged the ASC Methodology change in the FERC proceeding in which BPA sought approval of the revised methodology. FERC approved the ASC Methodology. *Methodology for Sales of Electric Power to the Bonneville Power*

Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and *Methodology for Sales of Electric Power to the Bonneville Power Administration*, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985).

Avista and PSE note that BPA's change in the ASC Methodology removed, among other costs, income taxes and return on equity from the ASC calculation. Avista, IOURESEXC:001; PSE, IOURESEXC:018. Avista and PSE argue that BPA's rationale for changing the ASC Methodology was to correct alleged abuses in ASC calculations, in particular the treatment of terminated nuclear plant costs. *Id.* Avista and PSE note that a number of Northwest investor-owned utilities challenged this change, but BPA's decision was upheld on appeal in the United States Court of Appeals for the Ninth Circuit. *PacifiCorp v. Fed. Energy Regulatory Comm'n*, 795 F.2d 816, 823 (1986) (hereinafter *PacifiCorp*). Avista and PSE argue that the court upheld the 1984 ASC Methodology as a "temporary" change to address the terminated plant cost issue and that the court did not sanction permanent implementation of the 1984 ASC Methodology. Avista, IOURESEXC:001; PSE, IOURESEXC:018. While Avista's and PSE's descriptions are partially correct, they have failed to fully describe the court's opinion. The court's opinion in PacifiCorp did not use the word "temporary." The court did state that:

> In upholding BPA's ASC determinations in this case, however, we do not sanction any permanent implementation of these exclusions. We uphold the exclusions in this instance because we conclude that we must defer to BPA's view that the statute authorizes such adjustments in ASC in response to BPA's experience with the program and the need to avoid abuses. The record in this case reflects that this is such a situation. *The statute itself, however, neither commands nor proscribes these adjustments in the ASC methodology.*

PacifiCorp, 795 F.2d at 823 (emphasis added). Thus, the court recognized that BPA's changes in the 1984 ASC Methodology were *consistent* with the Northwest Power Act. In addition, the court's language is unclear. While the court refers to BPA's "exclusions in this instance" and "BPA's experience with the program and the need to avoid abuses," in fact there was only one issue, the issue of return on equity, where these circumstances arose. *Id*. In the court's lengthy discussion of the issue of income taxes, the court did not mention *any* relationship of income taxes to issues of experience or abuse. *Id.* at 822. It appears that the court did not consider the issue of income taxes to be within its language of "not sanction[ing] any permanent implementation of these exclusions." *Id*. at 823. This is supported by the concurring opinion of Judge Wallace, who disagreed with the grudging acceptance of the court of BPA's exclusion of return on equity from ASC. *Id*. at 825. Judge Wallace's discussion of the court's language of "not sanction[ing] any permanent implementation of these exclusions," like the court's opinion itself, is also limited to the issue of return on equity and does not relate to the income tax issue whatsoever. *Id.* Thus, it appears that BPA's income tax decision was not subject to the court's statement regarding permanent implementation. Avista's and PSE's argument that the court permitted BPA to exclude income taxes and equity as a means of

preventing inclusion in ASC of certain terminated plant costs is therefore incorrect because the income tax issue was not related to the terminated plant issue.

In addition, the concurring opinion included sound reasoning supporting the exclusion of return on equity. Judge Wallace stated:

> I see no reason to limit our deference to the BPA's decision to exclude return on capital from ASC. Applying reasonable accounting classifications, the BPA logically determined that return on capital incorporates certain costs that are not resource costs within the meaning of the Regional Act. These nonresource costs include terminated plants costs as well as the more general costs of bearing the risk of business enterprise. I therefore disagree that the exclusion is supported only by evidence that terminated plant costs have been disguised as part of return on equity. Because the rationale for the exclusion is broader and reflects reasonable accounting classifications, I would give the exclusion full approval.

Id. In any event, however, BPA does not view the ASC Methodology as permanent because BPA may develop a new ASC Methodology in future consultation proceedings.

As noted above, Avista and PSE argue that the court permitted BPA to exclude income taxes and return on equity as a means of preventing inclusion of certain terminated plant costs in average system cost. Avista, IOURESEXC:001; PSE, IOURESEXC:018. Avista and PSE argue that the costs of these unfinished nuclear plants will be completely written off by all of the investor-owned utilities prior to BPA's next rate period beginning in 2001. *Id.* Avista and PSE argues that BPA's rationale for excluding income taxes and return on equity from the ASC Methodology no longer applies. *Id.* As noted previously, however, BPA's rationale for excluding income taxes was not based on the treatment of terminated plant costs and the court did not relate income taxes with terminated plant costs. Therefore, BPA's rationale for excluding income taxes still applies. With regard to the costs of the terminated plants being written off by the IOUs prior to BPA's next rate period, this does not mean that BPA's rationale for excluding return on equity no longer applies. The exclusion of return on equity was instigated in large part by the abuses of a utility and a state utility commissioner who attempted to include terminated plant costs in return on equity in violation of state and federal law. The principle for the exclusion, however, goes much farther. The establishment of a return on equity is a subjective judgment made by a state utility commission. As such, it is extremely difficult to determine what a commission may try to include in return on equity. The REP involves a great deal of money and utilities and state utility commissions have identical interests in maximizing the amount of benefits provided by BPA. There have been numerous times in the past when BPA has identified costs that had not been correctly characterized by the filing utility or in the underlying commission's order. Many times, FERC has held that BPA properly corrected the utilities' mischaracterizations of costs that, if not discovered and corrected, would have improperly provided utilities with windfall exchange benefits at the expense of BPA's other customers. *See, e.g., Order Accepting Rates and Rejecting Proposed Adjustment, Noting Interventions, Granting Intervention, and Terminating*

Docket, 43 FERC ¶ 61,097 (1988), (regarding IPUC's implementation of refund based on "mismanagement," where Utah Power & Light characterized refund as a "[r]eturn of equity capital to the ratepayers in settlement of a dispute . . ." and not exclusively energy related, but FERC found the "root" cause of the refund to be excessive fuel costs and denied Utah's proposed ASC adjustments); *Order Accepting Average System Cost Determination and Denying Motion for Hearing And Appointment of Joint State Board***,** 75 FERC ¶ 61,329 (1996); *Order Rejecting Request for Amendment to Average System Cost Determination and Accepting Rates for Filing*, 59 FERC ¶ 61,005 (1992). BPA must have the ability to ensure that all costs that are the basis of determining ASC can be reviewed for consistency with established requirements.

Avista argues that since Avista was not the utility that attempted to include terminated plant costs in return on equity, the exclusion of return on equity should not apply to Avista. Avista, IOURESEXC:001. This argument is not persuasive. First, the terminated plant cost issue was not the sole reason to revise the ASC Methodology. As noted in BPA's 1984 ASC Methodology ROD, there were many issues that needed to be revisited, including the source data for the ASC Methodology, the determination of whether transmission costs should be considered resource costs, the subsidization of construction work in progress, the treatment of equity return, the treatment of income taxes, the determination of generating resources includable in computing ASC, the treatment of affiliated fuel costs, conservation costs includable in ASC, and the functionalization between subsidized and non-subsidized accounts. *See* 1984 ASC ROD. In addition, the provisions of the ASC Methodology must apply to all exchanging utilities. 16 U.S.C. § 839c(c)(7). BPA cannot apply one standard in its ASC Methodology rule to one utility and not apply it to another utility. While Avista may not have committed the abuse of the ASC Methodology regarding terminated plant costs, Avista and other utilities have the ability to do so with other costs in the same manner that was done by the utility that abused the methodology. As noted in greater detail above, the principle for the exclusion of return on equity in the 1984 ASC Methodology is much broader than a simple remedy for a particular abuse. Therefore, it is not clear that BPA should simply allow return on equity to be included in ASC. The current exclusion of return on equity from ASC has worked effectively in precluding the inclusion of improper costs in return on equity and thus in utilities' ASCs and is therefore serving a current useful purpose. Any proposal to change this provision would require much further examination.

Avista and PSE argue that changes made in the 1984 ASC Methodology were not intended to be permanent. PSE argues that BPA itself has recognized that the "ASC Methodology can be revised" and that if it is, the "forecasted exchange benefits would increase significantly." *Id.*, citing Bonneville Power Administration's 2002 Wholesale Power Rate Adjustment Proceeding, BPA Docket No. WP-02, Exhibit WP-02-E-BPA-30, at 3-4. First, BPA does not view the 1984 ASC Methodology as permanent. The Administrator can revise the ASC Methodology and parties can raise relevant issues, including income taxes and return on equity, during any ASC Methodology consultation proceeding. PSE's claim that BPA admitted that if the ASC Methodology were revised, that forecasted exchange benefits would increase significantly, mischaracterizes BPA's

2002 rate case testimony. BPA noted that if the ASC Methodology were revised *in the manner in which the IOUs would like to revise it*, exchange benefits would increase. *See* Boling and Doubleday, WP-02-E-BPA-30, at 3-4. BPA did not state that *any* revision to the ASC Methodology would increase exchange benefits. *Id.* The effects of a change in the ASC Methodology cannot be known until a new methodology is established. A revised ASC Methodology could either increase or decrease exchange benefits.

As noted above, however, BPA believes that the exclusions made in the 1984 ASC Methodology were well-founded and continue to play an important role in the implementation of the REP today. It is troubling that Avista and PSE focus solely on *BPA's* failure to initiate a consultation proceeding to revise the 1984 ASC Methodology. A very significant point that Avista and PSE fail to mention is that, under the 1984 ASC Methodology, *exchanging utilities* have the ability to request BPA to initiate a consultation proceeding. *See* 1984 ASC Methodology, Section IV. The 1984 ASC Methodology provides that:

> The Administrator, at his or her discretion, or upon written request from three-quarters of the Utilities that are parties to contracts authorized by section 5(c) of the Northwest Power Act, or from three-quarters of BPA's preference customers, or from three-quarters of BPA's direct service industrial customers, may initiate a consultation process as provided for in section 5(c) of the Northwest Power Act. After completion of this process, the Administrator may propose a new ASC Methodology to the Commission.
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> * * *

Id. at Section IV, p. 7. During the term that the 1984 ASC Methodology has been in effect, BPA has never received a request from three-quarters of the exchanging utilities, three-quarters of BPA's preference customers, or from three-quarters of BPA's direct service industrial customers to initiate a consultation process to revise the ASC Methodology.

PSE makes a number of policy arguments regarding the alleged need to revise the ASC Methodology. PSE argues that the Ninth Circuit described congressional intent with respect to the REP under the Northwest Power Act:

> One of the goals of the Act is to ensure that residential customers served by Northwest IOU's have wholesale rate parity with residential customers served by publicly owned utilities and public cooperatives, BPA's preference customers. Parity is achieved through Residential Purchase and Sale Agreements between BPA and IOUs.

PSE, IOURESEXC:018, citing *Public Utility Commissioner of Oregon v. Bonneville Power Administration*, 767 F.2d 622, 625 (9th Cir. 1985). This case, however, did not involve a substantive ruling on the REP. Instead, the court merely held that it lacked jurisdiction to review the case because the action was required to be final before it was

reviewable. *Id.* at 628. More important, however, is that the term "wholesale rate parity" means exactly what it says: parity of wholesale rates charged by BPA to its preference and exchange customers. This is achieved in the Northwest Power Act by providing that the wholesale power rates for BPA's sales to its preference customers and the wholesale power rates for BPA's sales to IOUs for the REP will be at the same rate, that is, the PF rate. This was true for the first five years of the Northwest Power Act because of the Act's rate directives. 16 U.S.C. 839e. This is not always true today, however, because the Northwest Power Act also includes section 7(b)(2), which, after July 1, 1985, can result in an allocation of costs such that the PF rate paid by exchanging utilities is higher than the PF rate paid by preference customers. 16 U.S.C. 839e(b)(2).

PSE argues that the benefits from Federal power in the Northwest are estimated to be enormous -- up to two billion dollars a year. IOURESEXC:018. PSE argues that Congress intended that the region's residential and small farm consumers receive a fair share of those benefits. *Id.* PSE argues that under BPA's current subscription proposal and draft Settlement Agreement (and Block Sale Agreement), 60% of the region's customers -- the six million residential and rural customers served by the Northwest investor-owned utilities -- will receive less than 23% of the benefits of the Federal power for that five-year period. *Id.* PSE argues that under the draft RPSA, BPA estimates that the total benefits to the residential customers of the region's investor-owned utilities will be only $48 million per year, which is less than 8% of the expected benefits of Federal power. *Id.* PSE attempts to focus the blame for this distribution on the draft RPSA and the 1984 ASC Methodology. PSE, however, fails to mention the impact of properly implementing section 7(b)(2) of the Northwest Power Act. PSE's argument also must be viewed in the context of the statutory framework that provides benefits to all of BPA's customers. The primary law establishing these obligations is the Northwest Power Act. Implementation of the directives of the Northwest Power Act results in benefits of the Federal power system that flow to BPA's customers and, where applicable, to retail consumers of those customers. One of the most fundamental requirements of the Northwest Power Act is that public bodies and cooperatives have preference and priority to the purchase of Federal power to meet their net requirements. 16 U.S.C. §832(a); 16 U.S.C. §839c(a). This power is used to serve all requirements loads of such preference customers, including residential, commercial, and industrial loads. Preference customers also pay the PF Preference rate for their power purchases. BPA's rate directives establish the manner in which BPA must allocate costs in establishing the PF rate, which applies to BPA's preference customers and utilities participating in the REP. 16 U.S.C. §839e(b)(1). (As discussed in greater detail below, the PF rate for utilities participating in the REP is subject to adjustment pursuant to 7(b)(2) of the Northwest Power Act, 16 U.S.C. §839e(b)(2).) Due to the cost allocation directives of section 7 of the Northwest Power Act, and the fact that FBS power can be priced well below other sources of power, the PF Preference rate is currently BPA's lowest rate for firm power requirements service. Therefore, under the law, BPA's preference customers receive substantial benefits from the Federal power system by being able to purchase their net requirements at the PF Preference rate.

IOUs, however, may benefit in a number of ways from the Northwest Power Act. First, like BPA's preference customers, IOUs may place their net requirements load on BPA. 16 U.S.C. §839c(b)(1). The rate directives for IOUs' requirements power, unlike those for BPA's preference customers, are contained in section 7(f) of the Northwest Power Act. The rate paid by IOUs for their net requirements is the NR rate. A second way in which IOUs benefit from the Northwest Power Act is the REP. 16 U.S.C. §839c(c). Under the REP, BPA provides the participating utility cash payments that represent the difference between the power "purchased" by BPA and the generally less expensive power "sold" to the participating utility. *Id*. Such benefits may also be provided in firm power through in lieu transactions. 16 U.S.C. 839c(c)(5).

As noted above, under the REP, IOUs pay the PF Exchange rate for power purchased from BPA. This rate, however, may not be the same level as the PF Preference rate. The Northwest Power Act established what is called the 7(b)(2) rate test. 16 U.S.C. §839e(b)(2). This test is designed to protect preference customers from certain costs incurred under the Northwest Power Act, including Residential Exchange costs. If the 7(b)(2) rate test does not trigger, the PF Preference rate and the PF Exchange rate are equal. If the 7(b)(2) rate test triggers, however, the PF Exchange rate is subject to a surcharge and is higher than the PF Preference rate. The lower the PF Exchange rate, the higher the exchange benefits. The higher the PF Exchange rate, the lower the exchange benefits. This is the manner in which rates must be established by BPA under the Northwest Power Act. Where, as in BPA's most recent rate case, the 7(b)(2) rate test triggers, it is not at all surprising that consumers of preference customers would receive greater "benefits" than the IOUs' residential consumers. This is the way that the Northwest Power Act works. In years when the 7(b)(2) rate test did not trigger, as has occurred periodically over the last 15 years, the IOUs receive greater benefits. In years when the 7(b)(2) rate test triggers, the IOUs receive lesser benefits. In summary, while different customer classes may receive greater or lesser benefits of the Federal system in any particular rate period, this is a result of the implementation of the directives of the Northwest Power Act. While it is unfortunate that some customer classes may receive greater benefits than other customer classes, BPA cannot unilaterally change the law.

While PSE briefly mentions the legislative history of the REP, it fails to include a discussion of congressional intent in establishing the 7(b)(2) rate test. As noted in BPA's discussion of the background of the 7(b)(2) rate test, there are direct connections between these two features of the Northwest Power Act. In addition, PSE cites no provision that establishes a particular level of Residential Exchange benefits. Instead, there are general statements in legislative history that the Northwest Power Act would provide "a share in the economic benefits of the lower-cost Federal system for the residential consumers of the non-preference customers," and would "extend the benefits of low-cost federal power to consumers served by investor-owned utilities." These statements, however, establish no particular amount of benefits. BPA's statutory and legislative history analysis concludes that Congress contemplated that section 7(b)(2) could completely eliminate exchange benefits for utilities with ASCs less than BPA's PF Exchange rate.

While the Northwest Power Act established the REP to provide utilities a monetary form of access to low-cost Federal power, this access, or "share in the economic benefits" of Federal power, was limited by a "rate ceiling" for preference customers to ensure that "[c]ustomers of preference utilities will not suffer any adverse economic consequences as a result of this exchange . . ." H.R. Rep. No. 976, Part II, 96th Cong., 2d Sess. 35 (1980); *see also* H.R. Rep. No. 976, Part I, 96th Cong., 2d Sess. 34 (1980); S. Rep. No. 272, 96th Cong., 1st Sess. 15 (1979). The preference customer "rate ceiling" was established in section 7(b)(2) of the Northwest Power Act. 16 U.S.C. 839e(b)(2). Section 7(b)(2) provides that after July 1, 1985, the rates charged for firm power sold to public body, cooperative, and Federal agency customers (exclusive of amounts charged those customers for costs specified in section 7(g) of the Northwest Power Act) may not exceed in total, as determined by the Administrator, such customers' power costs for general requirements if specified assumptions are made. Id. The legislative history of section 7(b)(2) of the Northwest Power Act repeatedly and consistently recognizes that Residential Exchange benefits are subject to elimination or reduction due to the section 7(b)(2) rate ceiling. The report of the House Committee on Interior and Insular Affairs states:

> Section 5(c) of S. 885 contains provisions for a residential power "exchange." Under these provisions, any utility in the region would be entitled to sell to BPA an amount of power equal to the utility's residential and small farm load at the "average system cost" of such power and BPA would be required to sell back to each such utility an equivalent amount of power at a rate identical to what preference customers pay BPA for power to meet their "general requirements" (*subject to a "rate ceiling*").
>
> . . . This exchange will allow the residential and small farm consumers of the region's IOUs to share in the economic benefits of the lower-cost Federal resources marketed by BPA and will provide these consumers wholesale rate parity with residential consumers [of] preference utilities in the region. *Consumers of preference utilities will not suffer any adverse economic consequences as a result of this exchange since, as discussed below, the DSIs of BPA are required to pay the costs of the exchange during its initial years while a "rate ceiling" protects the customers of preference utilities during later years.*

H.R. Rep. No. 976, Part II, 96th Cong., 2d Sess. 35 (1980) (emphasis added). *See id*. at 36, 52. The intent that the section 7(b)(2) rate ceiling would protect preference customers from certain costs of the Northwest Power Act, including the costs of the REP, is also contained in the report of the House Committee on Interstate and Foreign Commerce. H.R. Rep. No. 976, Part I, 96th Cong., 2d Sess. 34, 68-69 (1980). The establishment of a rate ceiling for preference customers is also noted in the report of the Senate Committee on Energy and Natural Resources. S. Rep. No. 272, 96th Cong., 1st Sess. 20, 32, 56-59, 61-62 (1979). The report expressly recognizes that one item that may cause the rate test to trigger is an increase in the cost of the REP. The report states:

> The rate limit would reinstate the yardstick principle which has traditionally been used to support the multiple kind of utility ownership which exists in the PNW today. Other areas which appear to cause the rate limit to apply are slower preference customer load growth than IOU load growth, lower DSI loads, and *increased IOU exchange power costs.*

Id. at 62 (emphasis added).

In addition to section 7(b)(2) and its legislative history, section 5(c)(4) of the Northwest Power Act establishes that Congress was well aware that section 7(b)(2) could result in reduction or complete elimination of Residential Exchange benefits for utilities participating in the REP. Section 5(c)(4) provides:

> An electric utility may terminate, upon reasonable terms and conditions agreed to by the Administrator and such utility prior to such termination, its purchase and sale under this subsection if the supplemental rate charge provided for in section 7(b)(3) is applied and the cost of electric power sold to such utility under this subsection exceeds, after application of the rate charge, the ASC of power sold by such utility to the Administrator under this subsection.

16 U.S.C. §839c(c)(4). *See* S. Rep. 272, 96th Cong., 1st Sess. 15 (1979). In other words, the Northwest Power Act expressly contemplates that section 7(b)(2) could completely eliminate exchange benefits for utilities whose ASC rate was less than BPA's PF Exchange rate.

Section 7(b)(3) of the Northwest Power Act governs the allocation of costs in the event the 7(b)(2) rate test triggers. Section 7(b)(3) provides that "[a]ny amounts not charged to public body, cooperative, and Federal agency customers by reason of paragraph (2) of this subsection shall be recovered through supplemental rate charges for all other power sold by the Administrator to all customers." 16 U.S.C. §839e(b)(3). In other words, if the rate test triggers (*i.e*., the rate ceiling for preference customers is exceeded), the costs in excess of the ceiling must be allocated to other power sales, including sales to utilities participating in the REP. These costs increase the PF Exchange rate, which is the rate at which BPA sells power to utilities participating in the Residential Exchange. When the PF Exchange rate increases, the difference between that rate and the utility's ASC rate decreases, resulting in a reduction of Residential Exchange benefits paid to the utility. Because each exchanging utility's ASC rate and residential load are different from those of other utilities, exchange benefits differ by utility. A utility receives no benefits when its ASC rate goes below BPA's PF Exchange rate. In summary, while the 7(b)(2) rate test may result in an increase in the PF Exchange rate and thus, a decrease in the amount of benefits BPA provides utilities participating in the REP, failure to implement the test properly would be contrary to law and would defeat Congress's intent to establish a rate ceiling for BPA's preference customers. The ASC Methodology, therefore, is not solely responsible for reductions in exchanging utilities' REP benefits.

PSE argues that a consultation process with respect to ASC methodology changes could be streamlined if BPA were to propose reverting from the temporary 1984 Average System Cost Methodology back to the 1981 Average System Cost Methodology. *Id.* PSE argues that the consultation process should be completed in a timeframe that would allow the new ASC methodology to be effective July 1, 2001. *Id.* First, as noted previously, under the 1984 ASC Methodology, *exchanging utilities* have the ability to request BPA to initiate a consultation proceeding. *See* 1984 ASC Methodology, Section IV. While Puget has made an individual request to revise the ASC Methodology in its comments, this does not satisfy the standard established in the 1984 ASC Methodology for requesting the Administrator to consider revision of the ASC Methodology. During the term that the 1984 ASC Methodology has been in effect, BPA has never received a request from three-quarters of the exchanging utilities, three-quarters of BPA's preference customers, or from three-quarters of BPA's direct service industrial customers to request BPA to initiate a consultation process to revise the ASC Methodology.

Furthermore, as noted previously, BPA's current ASC Methodology continues to perform an important function of prohibiting abuse of the REP. Reverting to the 1981 ASC Methodology would once again open the REP to the same potential for abuse that existed previously. Also, BPA recently established wholesale power rates were premised on REP cost forecasts using the 1984 ASC Methodology. If the ASC Methodology were immediately revised *as proposed by PSE,* BPA's forecasted REP costs for the next rate period would have been significantly understated and BPA's rates would have been based on incorrect costs. This would lead to a likely underrecovery of BPA's costs that would be shifted, in large part, to BPA's other customers. Such an event is not appropriate.

In addition, there have been many changes in the utility industry since the development of the 1981 ASC Methodology. Reverting to the antiquated 1981 ASC Methodology would be a step backward in implementing the REP in the context of the current circumstances of utility ratemaking. Indeed, there are a number of significant issues that are currently being addressed by the Pacific Northwest region. These issues would directly affect the development of a new ASC Methodology. For example, the region is currently in the process of establishing a Regional Transmission Organization (RTO). The establishment of an RTO would provide a single entity for operating the region's transmission system and providing the ancillary services necessary to operate the transmission system. Given that BPA has unbundled its wholesale power and transmission rates, the issue of unbundling transmission costs from ASC would be ripe. Until the RTO is resolved, however, BPA cannot responsibly revise the ASC Methodology on this issue.

Another issue currently pending in the region is that of state restructuring of the provision of power to residential and other consumers. Some Pacific Northwest states have already established rules for restructuring and others have pending efforts to do so. Other regional states have not yet addressed the issue. BPA needs greater certainty regarding the status of state restructuring in order to establish an ASC Methodology that would be able to be consistent with such restructuring and ensure that BPA can consistently and

fairly establish exchanging utilities' ASCs and ensure that all REP benefits are passed through to eligible residential and small farm loads. BPA also requires some experience with the existing methodology under restructuring in order to see what issues are raised by such restructuring that are not effectively addressed under the current methodology. Attempting to immediately revise the ASC Methodology would likely require immediate revision of that methodology when the foregoing issues have been resolved. It is therefore inappropriate to revise the ASC Methodology at this time. However, some amount of change will always be occurring and BPA does not intend to delay revisitation of the ASC Methodology indefinitely. It is essential, however, that BPA and regional parties have more time to see greater resolution of the foregoing issues, which are of an extraordinary nature, before revising the ASC Methodology. Therefore, BPA will begin discussions on the issue of whether to develop a new ASC Methodology during the next rate period.

Avista argues that the RPSA should be designed to implement the REP fairly and not, as it is currently drafted, to assure the elimination of the Program. Avista, RESEXC:001. Avista states that in previous comments in other forums it has explained why it believes that the administration of the REP is flawed. *Id.* These comments include a February 8, 1999, letter from Avista commenting on BPA's Subscription Strategy in general and key provisions for Subscription contracts. Issues regarding the development of BPA's Subscription Strategy and Supplemental Subscription Strategy are addressed in BPA's respective Records of Decision. *See* BPA Power Subscription Strategy, Administrator's Record of Decision, December 21, 1998; BPA Power Subscription Strategy, Administrator's Supplemental Record of Decision, April, 2000. Avista also cites a February 8, 1999, letter from PacifiCorp on draft standard contract provisions. These comments were reviewed by BPA and considered in the development of the standard contract provisions. Another cited document is a January 7, 2000, letter from Avista, IPC, MPC, PacifiCorp and PSE commenting on BPA's Draft Prototype Power Sales Agreements. These comments were reviewed by BPA in developing the block power sale agreement that was negotiated with interested parties and such agreement is addressed in BPA Record of Decision regarding Subscription Settlement Agreements. Avista cites a January 7, 2000, letter from Avista, PGE, IPC, MPC, and PacifiCorp and a January 6, 2000, letter from Avista, both commenting on the proposed increase of settlement benefits and the allocation of those benefits among regional IOUs. These comments were reviewed and used in BPA's decision to increase settlement benefits to the IOUs and in developing a proposed allocation of those benefits, and are addressed in BPA's Supplemental Subscription Strategy ROD. *See* BPA Power Subscription Strategy, Administrator's Supplemental Record of Decision, April, 2000. Avista notes a letter dated January 14, 2000, from Avista commenting on the draft RPSA and draft settlement contract prototypes. These comments were reviewed and used negotiations and in the development of the RPSA and settlement agreements. Issues regarding the settlement agreements are addressed in a separate ROD. Issues regarding the RPSA are addressed in this ROD. Finally, Avista cites a June 28, 1999, letter from Avista commenting on BPA's draft Section 5(b)/9(c) Policy and a November 29,1999, letter from Avista on BPA's revised draft Section 5(b)/9(c) Policy. BPA reviewed these comments in developing its Section 5(b)/9(c) Policy. Issues regarding BPA's Section 5(b)/9(c) Policy

are addressed in BPA's ROD on that subject. *See* Section 5(b)/9(c) Policy, Administrator's Record of Decision, May 2000.

Decision

BPA will not immediately revise the 1984 ASC Methodology but will informally discuss possible revisions. BPA will hold informal discussions on the issue of whether to revise the ASC Methodology.

VI. ELIGIBILITY REQUIREMENTS

Issue

Whether BPA has properly defined "eligible" utilities.

Parties' Positions

The WUTC, OPUC, MPSC, PGE, MPC and MCC argue that the proposed definition of "Qualified Entity" as "an entity authorized under state law or by order of the applicable state regulatory authority to serve all or a portion of «Customer Name»'s Residential Load" is appropriate and is needed to address the restructuring of retail electric service in the coming years. WUTC, IOURESEXC:016; OPUC, IOURESEXC:014; MPSC, IOURESEXC:005; PGE, IOURESEXC:021; MPC, IOURESEXC:004; MCC, IOURESEXC:009.

PSE and Avista support the offer of a fair settlement of the REP through Subscription, but in the continuing absence of a fair REP and a fair subscription settlement offer, PSE and Avista reserve their rights to address the equity of any allocation flowing from new eligibility standards resulting from deregulation of commodity service to residential customers. PSE, IOURESEXC:018; Avista, IOURESEXC:001.

PacifiCorp notes that under the Northwest Power Act, any "Pacific Northwest utility," including regional IOUs, may participate in the REP. PacifiCorp, IOURESEXC:011. PacifiCorp notes that from the inception of the REP, BPA has recognized utilities as Pacific Northwest utilities regardless of the state of incorporation or location of the utility's headquarters or shareholders. *Id.*

Central Lincoln notes that BPA's statement that it ". . . believes the intent of Congress under section 5(c) is that benefits of the Federal Columbia River Power System are intended to flow to residential consumers" reflects the plain language of the Northwest Power Act, a law that did not in any way anticipate the restructuring of any utility systems and certainly not the selling off of generating resources by large utilities." Central Lincoln, IOURESEXC:007. Central Lincoln emphasizes that no IOU or marketer should be entitled to make any economic profit from the passed-through energy and power. *Id.*

Northern Wasco, Whatcom County and SUB argue that the Northwest Power Act sets forth the qualifications for participation in the REP. Northern Wasco, IOURESEXC:013; Whatcom County, IOURESEXC:022; SUB, IOURESEXC:003. They argue that at least three criteria must be met by the participating utility for it to obtain the benefits of the REP: first, the utility must be a Pacific Northwest electric utility, with an ASC; second, it must have qualifying regional loads to which the benefits of the REP may be passed; and third, the utility must pass the benefits directly to its regional residential and small farm loads. *Id.*

PPC and EPUD argue that it is impermissible for BPA to offer a "settlement" of the Exchange, with substantial associated financial benefits, to a utility that would not have originally qualified for the Exchange. PPC, IOURESEXC:006; EPUD, IOURESEXC:023. In short, BPA cannot use the Agreement to provide benefits to non-Pacific Northwest utilities that would otherwise be ineligible for the Exchange. *Id.*

ESI, like some public agencies noted above, argues that the Northwest Power Act sets three criteria that must be met before a utility can participate in the Residential Exchange. ESI, IOURESEXC:008. ESI argues that none of the potential Settlement participants have calculated their ASC under the 1984 ASC Methodology that FERC approved for implementing the provisions of the REP. *Id.*

The DSIs argue that BPA has proposed to offer benefits to IOUs whose ASCs would not qualify for benefits under the REP and to guarantee the continuation of such benefits even if residential consumers were to be served by entities that do not qualify for the REP. *Id.*

BPA's Position

In section 5(c) of the Northwest Power Act, Congress intended that benefits of the Federal Columbia River Power System would to flow to residential consumers of Pacific Northwest utilities. BPA believes that, given the current restructuring of regional retail electric service in the coming years, BPA must address eligibility consistent with section 5(c) and in a manner that would permit benefits to continue to flow to residential and small farm consumers. The proposed Settlement Agreements define "Qualified Entity" as "an entity authorized under state law or by order of the applicable state regulatory authority to serve all or a portion of «Customer Name»'s Residential Load."

Evaluation of Positions

As noted previously, section 5(c) of the Northwest Power Act established the REP. Under section 5(c)(1) of the Northwest Power Act, BPA offers to purchase amounts of power offered for sale by Pacific Northwest electric utilities at the individual utility's "average system cost," or ASC, in exchange for an equivalent amount of power priced at BPA's PF Exchange rate. 16 U.S.C. § 839c(c)(1). The amount of the exchange power is equal to the utility's eligible residential and small farm load." 16 U.S.C. § 839c(c)(2).

The cost benefits of this exchange "shall be passed through directly to such utility's residential loads within such State." 16 U.S.C. § 839c(c)(3). Since enactment of the Northwest Power Act, the residential and small farm consumers of regional electric utilities - public utilities and IOUs - have enjoyed cash credits to their power bills resulting from the Residential Exchange. Pacific Northwest electric utilities serving such loads qualified for Residential Exchange benefits on the basis of the relationship of their ASCs to BPA's PF Exchange rate. Following an Appendix 1 filing with BPA, a Pacific Northwest electric utility would obtain a cash payment from BPA to be passed directly on to the utility's residential and small farm loads. These REP benefits provide a sharing of the benefits of the federal hydropower system with those consumers.

The WUTC supports ways in which residential customers may still receive benefits even in the event they are supplied with power by entities other than their current utilities. WUTC, IOURESEXC:016. The WUTC notes that currently for Washington State, the three investor-owned utilities it regulates are eligible under section 5(c) of the Northwest Power Act to request benefits. *Id.* The WUTC notes that each serves residential and small farm consumers under state law and subject to its regulation. *Id.* The WUTC also notes that public utilities serving residential and small farm consumers are also eligible to request benefits. *Id.* The WUTC notes that Washington is not currently restructuring retail utility service, but changes could occur in the next ten years, and it is prudent for the contract to anticipate them. *Id.* The WUTC notes that if alternative power suppliers develop in Washington it would anticipate that they would require certification of some kind from the state. *Id.* The WUTC notes that a provision in the contract requiring such state certification could help both BPA and the state ensure that federal power benefits remain available to eligible customers and that they are passed through. *Id.* The suggestion of including a provision requiring state certification was also supported by the OPUC, as discussed immediately below.

As a matter of policy, the OPUC believes there are several key guiding objectives with respect to the REP. OPUC, IOURESEXC:014. The objectives are:

> (1) All of the benefits of the exchange provided to utilities must be flowed through to qualifying residential and small farm consumers.
> (2) All qualifying consumers being served by distribution facilities owned by an IOU should receive an equal share of benefits.
> (3) The REP should not act as a barrier to a state's effort to create competitive electric markets.

Id. The OPUC believes that it is critical that both BPA and the OPUC work together to achieve these objectives. *Id.* The OPUC can work towards this end through carefully designing certification requirements for Energy Service Suppliers (ESSs). *Id.* Under 1999 Oregon legislation SB 1149, the OPUC has the authority to establish conditions ESSs must meet in order to be certified to sell power to retail electricity consumers. *Id.* But the OPUC believes that, together, the OPUC and BPA can do more to ensure the above objectives are met. *Id.*

The OPUC believes that BPA can work cooperatively with the states. OPUC, IOURESEXC:014. The OPUC notes that one alternative in this regard is for BPA to require an entity first to be certified by the state to receive section 5(c) benefits on behalf of residential customers served by IOU distribution utilities before BPA declares the utility as an eligible utility. *Id.* The OPUC believes that such a condition would help ensure that BPA carries out its Federal statutory requirements that all of the Federal system benefits are flowed through to qualifying customers. *Id.* From the OPUC's review of the contract prototypes, it does not appear that the RPSA includes the state certification requirement. *Id.* The OPUC believes such a requirement is a prudent business action. *Id.* The OPUC argues that this issue is ripe. *Id.* Under SB 1149, small farm consumers of PacifiCorp and PGE will have the option to purchase power from alternative suppliers. *Id.* Residential consumers will have a portfolio of energy products available. *Id*

BPA believes the States should determine the appropriateness of certification requirements for establishing eligibility to supply residential retail loads under State law. While such requirements are matters of State law, Federal law governs the issue of which entities are eligible to receive section 5(c) benefits on behalf of residential consumers. Section 5(c) of the Northwest Power Act requires BPA to enter exchanges with Pacific Northwest utilities in the amount of such utilities' residential and small farm loads. If a State allows an entity to provide retail service to residential and small farm loads, that entity is an eligible utility for purposes of section 5(c). While BPA believes State requirements to centralize the administration of the REP in a single entity are desirable, BPA doesn't believe such requirements are mandated by Federal law. Instead, BPA believes the certification requirements proposed by the OPUC and the WUTC may be established by States, but should not be a requirement of BPA's contracts if a State does not choose to establish such requirements. BPA will cooperate in the implementation of the REP with the States that establish such certification requirements. BPA's definition of Qualified Entity is limited to those entities qualified to serve small residential loads under state law.

The last objective noted by the OPUC relates to creating a fair and open energy marketplace. OPUC, IOURESEXC:014. The OPUC argues that the availability of Residential Exchange benefits should not impede or act as a barrier to a state's effort to create competitive electric markets. *Id.* The OPUC notes that barriers can be raised if residential customers face the loss of exchange benefits in the event the provider of electric power is no longer the incumbent utility. *Id.* The OPUC notes that, conversely, qualifying consumers should not be induced to seek changes in ownership or power supplier in order to capture a greater share of fixed federal system benefits. *Id.* BPA agrees with the OPUC that, ideally, the availability of exchange benefits should not impede a state's efforts to create competitive electric markets. BPA also acknowledges that residential consumers could potentially face the loss of such benefits if the provider of electric power is no longer the incumbent utility. Also, ideally, residential consumers should not be provided incentives to change power supplier in order to capture a greater share of fixed federal system benefits. However, BPA must address these concerns within the requirements of existing law.

BPA cannot control how a State decides to restructure its provision of electric service. Nor does BPA believe the eligibility of residential consumers under the REP should be dependent on State laws. BPA has structured its proposed Settlement to require that the benefits of the settlement be assigned to BPA if a new supplier begins serving the residential loads of the IOUs. BPA has allowed the States and the IOUs to develop agency relationships allowing the incumbent utility to administer the REP on behalf of the new supplier instead of assigning the benefits back to BPA. BPA will also allow a distribution utility to administer the REP in a centralized manner under a state designed program approved by BPA. If a new supplier is not required by state law to treat one REP in a centralized manner as a condition of its right to supply electric service to residential and small farm consumers and chooses to approach BPA for an RPSA instead of signing an agency agreement or an agency arrangement is not established by an IOU and state commission, BPA will provide an RPSA or negotiate a settlement with that entity at that time.

The MPSC notes that with the passage of the 1997 Electric Utility Industry Restructuring and Customer Choice Act, Montana embarked on a path to customer choice and competition in electricity supply. MPSC, IOURESEXC:005. The MPSC notes that this bold move, an early action in what is unfolding as a national trend, challenges many of the region's traditional institutions. *Id.* The MPSC believes the proposal by BPA recognizes this trend and Montana's unique needs. *Id.* The MPSC notes that in Montana Power's service territory, it is not yet clear who will own the transmission and distribution system (and thus the utility obligation to serve), nor who will take on the duty and privileges of serving as default supplier. *Id.* The MPSC argues that, therefore, it is essential that the rights and benefits under BPA's residential exchange program be assignable. *Id.*

PGE argues that the residential exchange benefit under section 5(c) of the Northwest Power Act was intended to correct a grievous imbalance in the price of electricity between residential and small farm customers (residential customers) of “preference" utilities and residential customers of utilities not so favored. PGE, IOURESEXC:021. In other words, argues PGE, the benefits of the federal power are meant to go to residential customers regardless of what type of utility serves them. *Id.* PGE argues that given the power supply situation in the Northwest and the still-huge price disparity between BPA's cost-based power and the market, any qualified entity serving residential loads in the Northwest should be eligible to request and receive REP benefits on behalf of those loads. *Id.* PGE argues that the hope is that as open access is implemented, energy providers other than the traditional "utilities” will offer electricity to all consumers in the region. *Id.* PGE notes that to make this possible there must be equity among all competitors, including allowing these new energy providers to supply federal system benefits to residential customers, cannot be done under present statutes, then the statutes must be changed to make all qualified entities eligible that serve residential loads. *Id.* PGE argues that the aim is to create a level playing field by allowing residential customers not served by preference utilities to retain their rights to the benefits of the federal hydropower system. *Id.* PGE argues that to do otherwise would be anti-

competitive and frustrate the intent of the Federal government to open retail electricity markets to competition. *Id.* PGE argues that failure to make this work will only serve to increase the pressure from outside the region to raise BPA's rates to market. *Id.*

MPC notes that the context of the residential exchange is defined by the overall goals of the subscription process as expressed by the Comprehensive Review. MPC, IOURESEXC:004. In the opening paragraph of its recommendations for Federal Power Marketing, the Review stated that the subscription process "is to be consistent with emerging competitive markets." *Id.* The Review made clear its meaning of competitive markets, stating: "The Steering Committee recommends no later than July 1, 1999 all retail distribution utilities offer open retail market access for those customers that desire direct market access." *Id.* MPC argues that BPA recognizes this fundamental goal on page 6 of its decision document, where its states: "The Power Subscription Strategy seeks to implement the subscription concept created by the 1996 Comprehensive Review through contracts for the sale of power and the distribution of federal benefits in the deregulated wholesale electricity market." *Id.*

MPC notes that BPA is proposing to accomplish a distribution of a share of the federal benefits to those regional citizens that have retail choice, consistent with the recommendations of the Review. MPC, IOURESEXC:004. MPC notes that while MPC is the first regional utility to implement customer choice as recommended by the Review, other states are beginning their implementation process or are in various stages of legislative and regulatory activity. *Id.* MPC argues that BPA's process must facilitate this eventuality, or it will be an impediment to the region's movement to competition, and at odds with the expressed desires of Congress and the present Administration. *Id.* MPC argues that BPA is clearly correct in its belief that the intent of Congress under section 5(c) is that benefits of the FCRPS are intended to flow to residential customers" and that "'Pacific Northwest electric utilities" for purposes of section 5(c) are "those entities serving the residential and small farm loads of the region as authorized by State law or order of the applicable State regulatory authority." *Id.* The Northwest Power Act does not define "eligible utility" directly, but rather infers that an entity that serves regional residential load is an eligible utility. *Id.* MPC argues that this inference is clear from the method that the Act outlines for the delivery of benefits and by the definition of what constitutes regional residential load through definitions of "residential use" and "Pacific Northwest" or "regional." *Id.* MPC argues that an eligible utility is one that serves the power needs of regional residential load, and is therefore capable of exchanging resources with BPA. *Id.* MPC argues that if an entity is serving load, it follows that it has acquired access to resource for serving that load, and therefore has resource costs to exchange. *Id.*

Montana Consumer Counsel, in general, agrees with the comments submitted by MPC. MCC, IOURESEXC:009. MCC believes that BPA's proposal recognizes Montana's unique needs. *Id.* MCC notes that it is not yet clear who will ultimately own and operate the MPC transmission and distribution system, or who will have the obligation to serve as the default provider. *Id.* However, as MPC notes, Congress clearly intended that the

benefits of the FCRPS flow to residential customers. *Id.* Therefore, MCC believes it is essential that the rights and benefits under the REP be assignable. *Id.*

PSE notes that under section 5(c) of the Northwest Power Act, only an entity that is a "Pacific Northwest electric utility" is eligible to participate in the REP. PSE, IOURESEXC:018. PSE states that it has incurred significant costs to acquire new resources to serve load since the adoption of the Northwest Power Act in 1980. *Id.* PSE argues that the utilities eligible for Residential Exchange under section 5(c) must be determined in light of the intent of the Northwest Power Act to provide benefits for the residential and small farm customers of utilities such as Puget that have experienced rapid load growth since 1980 and that have needed to acquire new resources-especially during the 1980's when new resource costs were high. *Id.* PSE and Avista argue that while the move to deregulation in some states has caused the commodity service to some customers otherwise eligible to participate in the REP to be separated from their "local" distribution service, the states in which PSE and Avista serve continue to require that the sale of electric power to residential and small farm customers at retail be subject to state regulation, and service continues to be bundled service for these utilities. PSE, IOURESEXC:018; Avista, IOURESEXC:001. Accordingly, PSE and Avista see no new issues in their states concerning "eligible utilities," as there as been no change since the Act was adopted. *Id.* PSE argues that the eligible utility should be the utility that has been providing service and incurring costs of new generation to provide that service. PSE, IOURESEXC:018.

PSE and Avista note that with respect to eligibility in other states, because BPA is unable or unwilling to offer full participation in an REP with a true ASC Methodology for one hundred percent of their residential and small farm loads, eligibility in other states that have deregulated cannot be applied in a manner which shifts benefits to those states. PSE, IOURESEXC:018; Avista, IOURESEXC:001. In this respect, PSE and Avista support the offer of a fair settlement of the REP through Subscription, but in the continuing absence of a fair REP and a fair subscription settlement offer, PSE and Avista reserve their rights to address the equity of any allocation flowing from new eligibility standards resulting from deregulation of commodity service to residential customers. *Id.* BPA disagrees with PSE's and Avista's characterization of BPA's offer to participate in the REP through the RPSA. BPA is giving Avista and PSE a choice of participating in the REP through an RPSA or entering a Settlement Agreement that settles the disputes between BPA and the companies on how to implement the REP. Participation in the REP under the RPSA would employ an ASC Methodology that has been approved by both FERC and the United States Court of Appeals for the Ninth Circuit for one hundred percent of the utilities' residential and small farm loads. *See e.g.* Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1994); Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985), and *PacifiCorp v. Fed. Energy. Regulatory Comm'n*, 795 F.2d 816 (9th Cir. 1986). Benefits under the REP will not be shifted from one state to another, but will be based one each utility's ASC as compared to BPA's PF Exchange Program rate. With regard to providing a fair settlement offer, BPA believes the extensive record in the separate settlement proceeding

shows that the total benefits offered under BPA's proposed Settlement Agreements are fair. BPA is offering a significant amount of benefits under the proposed Settlement Agreements, and the allocation of those benefits among the IOUs was first proposed by the four regional state utility commissions and adopted by BPA after a public comment proceeding.

Northern Wasco, Whatcom County, SUB and ESI argue that the Northwest Power Act must be complied with in the implementation of the REP. Northern Wasco, IOURESEXC:013; Whatcom County, IOURESEXC:022; SUB, IOURESEXC:003; ESI, IOUEXC:008. These parties argue that BPA should regard the Northwest Power Act as a minimum baseline for the proposals currently offered to regional IOUs. *Id.* The parties argue that the proposed offers fail that baseline test. *Id*. The parties argue that the Northwest Power Act sets forth the qualifications for participation in the Residential Exchange and that three threshold criteria are evident from the Act; each must be met by the participating utility for it to obtain the benefits of the Residential Exchange for pass-through to the residential and small farm consumers it serves. *Id.* First, the utility must be a Pacific Northwest electric utility, with an ASC, citing 16 U.S.C. § 839c(c)(1). *Id.* Second, it must have qualifying regional loads to which the benefits of the REP may be passed. *Id.* Third, the utility must pass the benefits directly to its regional residential and small farm loads. 16 U.S.C. §839c(c)(3). *Id.* The parties argue that these statutory requirements must apply to the future participants of the REP, as they have applied to past participants in that program. *Id.* The parties argue that BPA cannot "settle" REP benefits if the beneficiary is not qualified to receive such benefits under the threshold statutory test. *Id.*

BPA agrees that utilities and qualified entities must meet the standards of the Northwest Power Act. Also, BPA's definition includes only those entities that serve the power needs of regional load. Further, if an entity is serving load, it follows that it has acquired access to resources for serving that load, and therefore has resource costs to exchange, that is, an ASC. Finally, Section 10 of the RPSA expressly requires that any benefits be passed through only to residential and small farm consumers.

With regard to the first criterion, Northern Wasco, among others noted above, argues that a participant must be a qualifying Pacific Northwest electric utility whose ASC entitles its residential and small farm consumers to benefits from the REP. Northern Wasco, IOURESEXC:013. Northern Wasco argues that the REP participant must be a "Pacific Northwest electric utility" pursuant to Section 5 of the Northwest Power Act. *Id.* Northern Wasco argues that that term is not defined in the Act, yet one may conclude that a "Pacific Northwest electric utility" must be located in the Pacific Northwest (a defined region; *see* 16 U.S.C. § 839a(14)); and that the "electric utility" must have power supply resources with an ASC against which BPA's Priority Firm power rate may be measured; *see* 16 U.S.C. § 839c(c)(1). *Id*. These arguments are not persuasive. First, as a general matter, where a term is not defined in a statute, the courts have consistently recognized that BPA, as the agency responsible for implementing the Northwest Power Act, must interpret the statute to fill in the gaps left by Congress. In this

case the Act is clear. The Act does not require that exchanging utilities be *located* in the Pacific Northwest. Rather, the Act refers to the utilities' "residential users within the region." 16 U.S.C. §§ 839c(c)(1); 839c(c)(2); and 839c(c)(3). The definition of Qualified Entities limits such entities to those that serve regional residential load.

PPC, supported by EPUD, argues that BPA appears to attempt to amend, administratively, the eligibility provisions of the Northwest Power Act. PPC, IOURESEXC:006; EPUD, IOURESEXC:023. PPC and EPUD note that section 5(c)(1) of the Act declares that:

> Whenever a *Pacific Northwest electric utility* offers to sell electric power to the Administrator at the average system cost of 'that utility's resources in each year, the Administrator shall acquire by purchase such power and shall offer, in exchange, to sell an equivalent amount of electric power to such utility for resale to that utility's residential customers within the region.

16 U.S.C. 839c(c)(1) (emphasis added). PPC and EPUD argue that the Settlement Agreements and the RPSA abrogate the statutory language regarding eligibility, and replace it with the following diluted language: to be a "Qualified Entity", a utility must be "an entity authorized under state law or by order of the applicable state regulatory authority to serve all or a portion of <Customer Names>'s Residential Load" *(see* 2(h) on page 3 of the Agreement). The drafts thereby drop the requirement that the "Qualified Entity" be a "Pacific Northwest electric utility". PPC and EPUD believe that BPA is exceeding its authority by so doing. Contrary to PPC's and EPUD's claims, BPA has not dropped the requirement that a Qualified Entity be a Pacific Northwest electric utility. Such a requirement is implicit in the definition of Qualified Entity. As PPC notes, the Settlement Agreement states that a Qualified Entity is "an entity authorized under state law or by order of the applicable state regulatory authority to serve all or a portion of <<Customer Name>>'s Residential Load." The definition of Residential Load is limited by the contract for residential and small farm land eligible for service under the Northwest Power Act. *See* section 2.

All of the utilities with whom BPA may sign Settlement Agreements are Pacific Northwest utilities that have previously executed RPSAs and received REP benefits. These utilities have been viewed as eligible "Pacific Northwest utilities" for nearly 20 years. These utilities, including numerous changes in ownership, were serving residential and small farm loads within the Pacific Northwest region long before the enactment of the Northwest Power Act and the establishment of the REP. Because the Settlement Agreement language refers to entities authorized under state law or by order of the applicable state regulatory authority to serve all or a portion of an existing eligible Pacific Northwest utility's regional residential and small farm load, the benefits that may be provided under the Settlement Agreement will only be provided to regional residential and small farm loads that have previously received benefits from the REP. Thus, "Pacific Northwest" has already been incorporated in the Settlement Agreement definition.

PPC commented during development of the Settlement Agreement and the RPSA that only "utilities" were eligible for the REP. Earlier this year, BPA reaffirmed its traditional standards of service, which identified the requirements for an entity to receive net requirements power service from BPA under section 5(b) of the Northwest Power Act. *See* Final Policy on Standards for Service, Administrator's ROD, December 1999. These standards for purchasing BPA power include, among other requirements, ownership of a distribution system and the obligation to serve all customers in a geographic area. These requirements flow from the original purposes of the Bonneville Project Act. The Northwest Power Act requires that these standards for service be applied to BPA's power sales under section 5(b) of that Act. *See* 16 U.S.C. § 839c(b)(4). BPA's Standards for Service Policy only applies to sales under section 5(b) of the Act and not all sales under section 5.

BPA believes the intent of Congress under section 5(c) of the Northwest Power Act is that benefits of the Federal Columbia River Power System are intended to flow to regional residential and small farm consumers. Congress established the REP in such a manner that REP benefits are passed through to those consumers through their electricity supplier. BPA believes that "Pacific Northwest electric utilities," for purposes of section 5(c), are those entities serving the residential and small farm loads of the region as authorized by state law or order of the applicable state regulatory authority. BPA sees no intent of Congress to exclude residential consumers from receiving the benefits of the Federal Columbia River Power System based on how a state structures its electric power industry.

Similar to Whatcom County, PPC and EPUD, SUB disagrees with BPA's definition of entities that qualify to sign an RPSA agreement with BPA. SUB, IOURESEXC:003. SUB notes that section 5(c)(1) of the Northwest Power Act refers to "Pacific Northwest utilit[ies]" and that the Act defines the term "Pacific Northwest." SUB then cites the administrative provisions of the Northwest Power Act, which state:

> No "company" (as defined in section 79b(a)(2) of title 15), which owns or operates facilities for the generation of electricity (together with associated transmission and other facilities) primarily for sale to the Administrator under section 839d of this title shall be deemed an "electric utility company" (as defined in section 79b(a)(3) of title 15), within the meaning of any provision or provisions of chapter 2C of title 15, if at least 90 per centum of the electricity generated by such company is sold to the Administrator under section 839d of this title, and if (A) the organization of such company is consistent with the policies of section 79a(b) and (c) of title 15, as determined by the Securities and Exchange Commission, with the concurrence of the Administrator, at the time of such organization; and (B) participation in any facilities of such "company" has been offered to public bodies and cooperatives in the region pursuant to section 839d(m) of this title.

16 U.S.C. 839f(h)(1). SUB's reliance on the foregoing provision is misplaced. The references to "company" and "electric utility company" are not definitions established for purposes of the Northwest Power Act, much less for the REP, but rather are found in an entirely different statute. Indeed, after the mention of the term "company" is the reference to "section 79b(a)(2) of title 15," and after the mention of the term "electric utility company" is the reference to "section 79b(a)(4) of title 15." These are not definitions that apply to the determination of a "Pacific Northwest utility" for purposes of the REP under section 5(c) of the Northwest Power Act. 16 U.S.C. 839c(c).

Northern Wasco, among others noted above, argues that a participant must be a qualifying Pacific Northwest electric utility whose ASC entitles its residential and small farm consumers to benefits from the REP. Northern Wasco, IOURESEXC:013. Northern Wasco argues that the REP participant must be a "Pacific Northwest electric utility" pursuant to Section 5 of the Northwest Power Act. *Id.* Northern Wasco argues that that term is not defined in the Act, yet one may conclude that a "Pacific Northwest electric utility" must be located in the Pacific Northwest (a defined region; *see* 16 U.S.C. § 839a(14) (1994 & Supp. III 1997)); and that the "electric utility" must have power supply resources with an ASC against which BPA's Priority Firm power rate may be measured; *see* 16 U.S.C. § 839c(c)(1) (1994 & Supp. III 1997)). *Id*. Northern Wasco's conclusion that exchanging utilities must be located in the region is not persuasive. In this case the Act clearly does not require that exchanging utilities be *located* in the Pacific Northwest. Rather, the Act refers to the utilities' "residential users within the region." 16 U.S.C. §§ 839c(c)(1), (c)(2), and (c)(3) (1994 & Supp. III 1997). Furthermore, as a general matter, where a term is not defined in a statute, the courts have consistently recognized that BPA, as the agency responsible for implementing the Northwest Power Act, must interpret the statute to fill in the gaps left by Congress. *Aluminum Co. of Am. v. Cent. Lincoln Peoples Util. Dist*., 467 US 380, 389 (1984); *Ass'n of Pub. Agency Customers v. Bonneville Power Admin*., 126 F.3d 1158, 1180 (9th Cir. 1997); *Dept. of Water & Power of the City of Los Angeles v. Bonneville Power Admin.*, 759 F.2d 684, 690-91 (9th Cir.1985). BPA has interpreted the Act consistent with its plain meaning. Qualified entities must serve regional residential load, but need not have their headquarters located in the region or be incorporated in the region.

Northern Wasco argues that there is no history, before BPA or the Federal Energy Regulatory Commission, wherein an entity outside of the Pacific Northwest was authorized to obtain the benefits of the statutory REP. Id. Northern Wasco argues that nor is there precedent wherein the exchanging utility's focus of control and authority truly resided outside of the Pacific Northwest. *Id.* Northern Wasco argues that two potential cases exist today, Enron and Scottish Power, both such cases are untested before BPA, the Federal Energy Regulatory Commission, or the federal Courts, and as such, offer no guidance. *Id.* Neither entity has yet filed for benefits under the Residential Exchange. *Id*. Northern Wasco's arguments on this issue are factually inaccurate and are not persuasive. The rebuttal to Northern Wasco's argument is perhaps best stated in the comments filed by PacifiCorp, as discussed below.

PacifiCorp notes that under the Northwest Power Act, any "Pacific Northwest utility" may participate in the program. PacifiCorp, IOURESEXC:011. PacifiCorp notes that although the term "Pacific Northwest utility" is not defined in the statute, the legislative history of the Northwest Power Act identified Congress' intent to provide benefits from low-cost federal generation to residential and small farm customers of the investor-owned utilities operating in the Pacific Northwest region. *Id.* Similarly, Avista notes that Congress intended in crafting Northwest Power Act section 5(c) that residential and small farm customers would be permitted to participate in the REP irrespective of the type of local utility serving those customers. Avista, IOURESEXC:001. PacifiCorp notes that since 1980, BPA has determined that PacifiCorp and its predecessors, Pacific Power & Light Company ("Pacific Power") and Utah Power & Light Company ("Utah Power"), are Pacific Northwest utilities. PacifiCorp, IOURESEXC:011. Before the PacifiCorp-Utah Power merger in 1989, Pacific Power provided Residential Exchange benefits to its customers in the four jurisdictions within the Pacific Northwest region - Idaho, Oregon, Montana and Washington - and Utah Power provided benefits to its southeastern Idaho customers. *Id.* Both before and after the PacifiCorp-Utah Power merger, from 1981 through 1996, and the PacifiCorp-Scottish Power merger in 1999, PacifiCorp's residential and small farm customers have continued to receive benefits from the REP. *Id.*

PacifiCorp notes that under BPA's implementation of the Northwest Power Act, the relevant consideration for investor-owned utilities is whether the utility provides state-regulated retail service to residential and small farm customers within the Pacific Northwest. PacifiCorp, IOURESEXC:011. PacifiCorp notes that from the inception of the REP, BPA has recognized utilities as Pacific Northwest utilities regardless of the state of incorporation or location of the utility's headquarters or shareholders. *Id.* For example, BPA recognized Pacific Power as an eligible utility from the inception of the program even though the utility was a Maine corporation when the initial contracts were executed. *Id.* Pacific Power changed its name to PacifiCorp in 1984 and became an Oregon corporation in 1989. *Id.* Utah Power was a Utah corporation headquartered in Salt Lake City, Utah when the initial contracts were executed. *Id.* Utah is outside the Pacific Northwest region, yet BPA recognized Utah Power as a utility eligible to participate in the REP in order to provide benefits to its Idaho residential and small farm customers within the region. *Id.* When PacifiCorp and Utah Power merged and PacifiCorp acquired new shareholders -those of Utah Power - BPA did not inquire into the geographical residence of the new shareholders. *Id.* The same was true when PacifiCorp merged with Scottish Power and became a wholly owned subsidiary of Scottish Power, as noted in correspondence with BPA confirming the continuing eligibility of PacifiCorp after it was acquired by Scottish Power. *Id.*

Northern Wasco argues that the second element of the legal predicate to participating in the REP is that the participating utility has average system costs sufficient to qualify. Northern Wasco notes that the methodology for determining eligible costs is the 1984 ASC Methodology, 18 C.F.R. § 301.1 (1998); *see also* 18 C.F.R. §§ 35.30-35.31. The 1984 ASC Methodology was developed by BPA and approved by the Federal Energy Regulatory Commission (FERC) for implementation of BPA's REP. *Id.* The 1984 ASC

Methodology prescribes the method by which a utility calculates its ASC and establishes those utility costs that are eligible for inclusion in ASC. *Id.* Accordingly, a utility's ASC is determined by dividing Contract System Costs (the exchanging utility's transmission and production costs) by the Contract System Load (the exchanging utility's total load). 18 C.F.R. § 301.1(b), Appendix 1. *Id.*

Northern Wasco and ESI argue that they are unaware of any utility ASC calculations that have been performed and submitted under the 1984 ASC Methodology for the post-October, 2001, period. Northern Wasco, IOURESEXC:013: ESI, IOURESEXC:008. Prior to participation in the REP under the RPSA, an exchanging utility must file an Appendix 1 with BPA and establish an ASC. Northern Wasco argues that there is no indication in the BPA materials that are the subject of its comments that BPA intends to obtain ASC filings from the prospective beneficiaries of the Settlement Agreements. *Id.* Northern Wasco argues that BPA must do so, for to ignore the ASC calculation is to permit potentially unqualified entities to take REP benefits, either through the program or through settlement of the program, at the expense of BPA customers such as Northern Wasco that pay for the Exchange program. *Id.* Northern Wasco assumes that if an IOU opted out of the settlement and instead chose to participate in the REP, that it would have to provide BPA with an ASC filing as directed in the Methodology and so too should participants in the settlement. *Id.* Similarly, ESI argues that a utility must meet the requirements of the Northwest Power Act to legally participate in the REP. ESI, IOURESEXC:008.

As noted previously, the Northwest Power Act established the REP. 16 U.S.C. 839c(c). Under the Act, BPA "purchases" power from each participating utility at that utility's ASC. *Id.* The Administrator then offers, in exchange, to "sell" an equivalent amount of electric power to the utility at BPA's PF Exchange power rate. *Id.* The amount of power purchased and sold is the qualifying residential and small farm load of each utility participating in the REP. *Id.* The Northwest Power Act requires that the net benefits of the REP be passed on directly to the residential and small farm customers of the participating utilities. *Id.* The REP does not involve a conventional purchase and sale of power. Under the normal implementation of the REP, no actual power is transferred either to or from BPA. The "exchange" has been referred to as a "paper" transaction, where BPA provides the participating utility cash payments that represent the difference between the power "purchased" by BPA and the less expensive power "sold" to the participating utility. Actual power sales may occur, however, under "in-lieu" transactions, where BPA purchases power from a source other than the utility and sells actual power to the utility. With regard to the current status of the REP, Residential Exchange Termination Agreements have been negotiated with all but one of the previously active exchanging utilities. *Id.* The only remaining utility with an "active" RPSA is MPC, which is currently in "deemer" status. *Id.*

As noted above, Northern Wasco argues that BPA must obtain new ASC filings from the prospective beneficiaries of the Settlements Agreements in order to ensure that potentially unqualified entities do not take Exchange benefits, either through the REP or through settlements of the REP, at the expense of BPA customers such as Northern

Wasco that pay for the REP. First, with regard to IOUs that choose to participate in the traditional implementation of the REP, such utilities must submit ASC filings to BPA in order to establish initial ASCs and proceed with the REP.

Under the current ASC Methodology, the review period to establish a utility's ASC is 210 days, or approximately 7 months. Even after the seven months, an IOU's ASC is subject to review and approval by FERC. FERC's review period allows comments from interested parties and, obviously, takes additional time. Furthermore, ASC determinations are final actions that are subject to appeal in the United States Court of Appeals for the Ninth Circuit. Under the RPSAs, IOUs could make Appendix 1 filings as late as October 1, 2001, because a utility's as-filed ASC becomes the ASC used to calculate exchange benefits until BPA issues its final ASC report.

SUB argues that transferring the definition of what entities may qualify to the discretion of states is not consistent with statutory language. SUB, IOURESEXC:003. Contrary to SUB's claims, BPA is not transferring the definition of eligible entities to the states. Section 4 of the RPSA requires a utility file an Appendix 1 starting development of its ASC to initiate participation in the REP. Section 5 of the RPSA establishes the amount of power eligible for REP benefits as the amount of the eligible residential and small farm load actually served by a utility. This is simply an affirmation of the manner in which BPA has previously provided REP benefits throughout the term of the RPSAs. This language was included in the definition of Qualified Entities in order to ensure that only Pacific Northwest utilities would be eligible to receive benefits from the Settlement Agreements. BPA has previously used information from the state commissions in implementing the REP. For example, in the 1984 ASC Methodology, the commission's order provides the starting point for BPA's review of utilities' proposed ASCs. *Methodology for Sales of Electric Power to Bonneville Power Administration*, 29 FERC ¶ 61, 013, 49 Fed. Reg. 39,293 (1984). States have traditionally determined the entities eligible to serve retail loads including residential and small farm loads under State law. BPA has required purchasers of Federal requirements power under section 5(b)(1) of the Northwest Power Act to have a general utility responsibility to serve under State law. *See,* BPA Standards for Service Policy. While BPA has interpreted the standards an entity must meet to receive benefits under Federal law, BPA has used State decisions regarding the provision of utility service in establishing those standards. BPA is using a similar test to determine eligible utilities under section 5(c). Thus, BPA has not transferred the definition of Qualified Entities to the discretion of the states.

SUB argues that BPA should amend its definition of "Qualified Entity" in its proposed Settlement Agreement and add the definition of a Qualified Entity in its RPSA and IOU Firm Power Block agreements such that it complies with federal laws. SUB, IOURESEXC:003. SUB suggests that the definition of "Pacific Northwest" be added to the Settlement Agreement. Such a change, however, is unnecessary. As noted above, the Settlement Agreement states that a Qualified Entity is "an entity authorized under state law or by order of the applicable state regulatory authority to serve all or a portion of <<Customer Name>>'s Residential Load." The definition of Residential Load in the Settlement Agreement and the RPSA limits such loads to those loads eligible for benefits

under the Northwest Power Act. All of the utilities with whom BPA may sign Settlement Agreements are Pacific Northwest utilities that have previously executed RPSAs and received REP benefits. These utilities have been viewed as eligible "Pacific Northwest utilities" for nearly 20 years. These utilities, including numerous changes in ownership, were serving residential and small farm loads within the Pacific Northwest region long before the enactment of the Northwest Power Act and the establishment of the REP. Because the Settlement Agreement language refers to entities authorized under state law or by order of the applicable state regulatory authority to serve all or a portion of an existing eligible Pacific Northwest utility's residential and small farm load, the benefits that may be provided under the Settlement Agreement will only be provided to residential and small farm loads that have previously received benefits from the REP. Thus, "Pacific Northwest" has already been incorporated in the Settlement Agreement definition.

SUB also argues that the definition of a Qualified Entity should include a reference to owning generating or contractual resources, which provide electricity to its retail residential customers. SUB, IOURESEXC:003. This proposed change is unnecessary. The requirement of contractual or generating resources is already implicit in the proposed definition of Qualified Entity. A Qualified Entity is one that serves the power needs of regional residential load. In order to serve residential load, an entity must have resources. That entity is therefore capable of exchanging resources with BPA. If an entity is serving load, it follows that it has acquired access to resources for serving that load, and therefore has resource costs to exchange.

SUB argues that a change in an RPSA holder's status is not inconceivable. *Id.* SUB argues that Montana Power, which met the historic definition of a Pacific Northwest utility, is in the process of restructuring and as a result may not longer meet the definition of a Pacific Northwest utility. SUB, IOURESEXC:003. MPC's eligibility to receive REP benefits under the RPSA is no different than any other Qualified Entity as discussed below.

SUB also argues that, should the status of a RPSA/IOU Block contract holder change such that they no longer meet the definition of a Qualified Entity, then the contract should terminate. SUB, IOURESEXC:003. SUB argues that language to that effect should be added to Section 16 of the IOU Firm Power Block Contract and Section II of the RPSA. *Id.* This proposed change is unnecessary. The requirement that a Qualified Entity is authorized to serve Residential Load and is actually serving such load is already implicit in the proposed definition of Qualified Entity and in the operation of the RPSA. Section 8(a) of the RPSA requires Qualified Entities to provide invoiced amounts of Residential Load they served in a previous month to receive any REP benefits. These provisions ensure that Qualified Entities are actually serving residential and small farm loads in the Pacific Northwest under the RPSA.

Central Lincoln notes that BPA's discussion of this issue in its May 5, 2000, paper distributed to Customers and Interested Parties stated that it ". . . believes the intent of Congress under section 5(c) is that benefits of the Federal Columbia River Power System are intended to flow to residential consumers." Central Lincoln, IOURESEXC:007.

Central Lincoln argues that that seems to be the plain language of P. L.96-501, a law that did not in any way anticipate the restructuring of any utility systems and certainly not the selling off of generating resources by large utilities. *Id.* Central Lincoln argues that, in the first place, no IOU or marketer would be entitled to make any economic profit from the passed-through energy and power from BPAs Exchange. *Id.* Central Lincoln argues that that part should not change, *i.e*., any power purchased from BPA on behalf of residential and small farm consumers should not provide an economic profit to the direct seller. *Id.* If BPA is instead subsidizing with cash those same consumers, one hundred percent of the subsidy should be passed through to them. *Id.* This concern is expressly addressed in Section 10 of the RPSA in which Qualified Entities are required to pass all of the RPSA benefits to their residential and small farm customers.

In addition, MPC notes that it presently serves most of the eligible load in its distribution service territory. MPC, IOURESEXC:004. It presently acquires the full power needs of its eligible load through a full requirements contract and Qualifying Facility contracts. *Id.* MPC argues that, therefore, for the purposes of entering into either an exchange contract or a Settlement Agreement on behalf of its customers, it meets the definition of an eligible utility. *Id.* MPC notes that when full competition begins in the state of Montana, the MPSC will have selected a default supplier that will have the obligation to serve. *Id.* MPC argues that the possibility that MPC may not be selected as default supplier at some point in the future in no way compromises MPC's residential customers' rights under the Northwest Power Act. *Id.* MPC notes that the role of an eligible utility will appropriately flow to whatever entity is serving eligible load in the future whether the supplier is the default supplier or a competitive supplier. *Id.*

MPC notes that in the BPA Power Rate Case proceedings, both the Direct Service Industries (DSIs) and the Public Power Council (PPC) questioned the right of MPC to sign a Settlement Agreement with BPA for several reasons based on their perceptions of the restructuring process taking place in Montana. MPC, IOURESEXC:004. MPC notes that BPA correctly concludes in its ROD that: "MPC still has obligations to its residential consumers under Montana law. BPA has no evidence that MPC does not intend to fulfill these obligations. It is reasonable for BPA to believe that MPC or any successor will meet the needs of the residential consumers of Montana." *Id.* MPC notes that it has made explicit statements to this effect in its communications regarding the sale of the utility, and the MPSC is obligated to ensure that this is in fact the case. *Id.* MPC notes that at the present moment MPC is serving these loads and therefore has a right to enter into the Settlement Agreement or RPSA on behalf of its customers. *Id.*

MPC notes that the DSIs have suggested that because MPC is being sold that this somehow compromises MPC's residential customers' rights to federal benefits. MPC, IOURESEXC:004. MPC notes that the sale of MPC is no different than the sale of either Portland General or PacifiCorp, and no one has questioned the rights of their customers. *Id.* MPC notes that this is because there is no reason to question these customers' rights. *Id.* MPC argues that it does not matter who owns the serving utility, but rather that the utility is serving eligible load. *Id.*

The third criterion cited by some parties was that the utility must pass the settlement benefits directly to its residential and small farm load. E.g., Central Lincoln, IOURESEXC:007. These parties did not elaborate further on this issue. This issue, however, is directly addressed by the proposed RPSA. Section 10 of the RPSA, entitled "Passthrough of Benefits," provides:

> (a) Monetary benefits received by «Customer Name» under this Agreement shall not be included by «Customer Name» as a revenue, expense, or cost of «Customer Name» in its accounting used in establishing «Customer Name»'s revenue requirement for its retail rates.
>
> (b) Except as otherwise provided in this Agreement, monetary amounts received by «Customer Name» from BPA under this Agreement shall be passed through, in full by Jurisdiction, to each residential and small farm consumer, as a credit against the charges for electric service to «Customer Name»'s qualified residential and small farm consumers. Benefits from In-Lieu PF Power received by «Customer Name» shall, subject to review by the applicable State regulatory authority, be passed through in full as a credit against the charges for electric service to «Customer Name»'s qualified residential and small farm consumers.
>
> (c) Monetary payments shall be distributed to the Residential Load in a timely manner. The amount of benefits held in the account described in section 10(d) at any time shall not exceed the expected receipt of monetary payments from BPA under this Agreement over the next 180 days. If the annual monetary payment is less than $600,000, then «Customer Name» may distribute benefits on a less frequent basis provided that distributions are made at least once each year.
>
> (d) Monetary payments shall be identified on «Customer Name»'s books of account. Funds shall be held in an interest bearing account, and shall be maintained as restricted funds, unavailable for the operating or working capital needs of «Customer Name». Benefits shall not be pooled with other monies of «Customer Name» for short-term investment purposes.
>
> (e) Nothing in this Agreement shall require any power be delivered on an unbundled basis to residential or small farm customers of «Customer Name» or that «Customer Name» provide retail wheeling of any power.

Clearly, the RPSAs require all benefits received thereunder must be passed through to regional residential and small farm consumers.

The DSIs refer to their comments on BPA's "Power Subscription Strategy Proposal." DSI, IOURESEXC:012. These comments were addressed in BPA's Subscription Strategy Records of Decision, which are incorporated by reference.

Decision

The proposed RPSA is available to entities authorized under state law or by order of the applicable state regulatory authority to serve all or a portion of «Customer Name»'s Residential Load.

VII. DEEMER ACCOUNTS

Issue

Whether IOUs with deemer account balances should pay such balances to BPA before receiving REP benefits under a new RPSA.

Parties' Positions

Avista argues that BPA has incorrectly calculated alleged deemer balances and improperly based such calculations on BPA's 1984 ASC Methodology. Avista, IOURESEXC:001.

BPA's Position

BPA believes it has properly calculated deemer balances under the 1981 RPSA. Deemer balances must be paid before a utility can be eligible to receive REP benefits under a new RPSA.

Evaluation of Positions

Avista argues that BPA's preliminary calculation of alleged deemer balances is incorrect and based improperly on calculations using BPA's 1984 ASC Methodology. Avista, IOURESEXC:001. Avista argues that BPA has not abandoned the use of the deemer balances, which arose from the revised 1984 ASC Methodology, and proposes to repeat this feature of the REP in the new RPSAs. *Id.* Avista argues that through a uniform surcharge to all REP customers, BPA proposes to implement the results of the 7(b)(2) rate test in a manner that affects customers of lower-cost utilities similar to the implementation of the 1984 ASC Methodology. *Id.* Avista argues that as a result of these discretionary decisions by BPA, Avista's customers would not qualify for any exchange benefits whenever the rate test triggers by any significant amount. *Id.* Avista's position continues to be that the administration of the REP can be fairly achieved by revising the ASC methodology or fixing the ASC at the outset of the exchange period for a shorter exchange agreement, abandoning the use of the deemer account, and fairly applying any surcharge under Section 7(b)(2) to avoid geographical disparity in administration of benefits. *Id.* BPA's responses to Avista's arguments regarding the ASC Methodology are addressed in Section VI. of this ROD. Avista's arguments regarding the section 7(b)(2) rate test involve an issue that is not being decided in this

forum and, by law, can only be resolved in a hearing pursuant to section 7(i) of the Northwest Power Act. 16 U.S.C. § 839c(c)(1). All issues regarding BPA's implementation of the section 7(b)(2) rate test, including issues raised by Avista, were addressed in great detail in BPA's 2002 Final Rate Proposal, Administrator's Record of Decision, WP-02-A-02, Section 13. BPA's responses to Avista's arguments regarding deemer balances are discussed below.

It is helpful to first provide some background regarding the implementation of the REP. Section 5(c) of the Northwest Power Act created the REP. Section 5(c) provides:

> Whenever a Pacific Northwest electric utility offers to sell electric power to the Administrator at the average system cost of that utility's resources in each year, the Administrator shall acquire by purchase such power and shall offer, in exchange, to sell an equivalent amount of electric power to such utility for resale to that utility's residential users within the region.

16 U.S.C. § 839c(c)(1). The REP was created to provide the regional utilities' residential and small farm customers a form of access to low-cost Federal power. *See* H.R. REP. NO. 96-976(I), at 29 (1980), *reprinted in* 1980 U.S.C.C.A.N. 5989, 5995; H.R. REP. NO. 97-976(II), at 34 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6023, 6032. Under the REP, each electric utility may elect to sell power to BPA at the "average system cost [ASC] of that utility's resources" and, in return, BPA sells the same amount of power back to the utility at BPA's PF Exchange rate. 16 U.S.C. § 839c(c)(1). The amount of power purchased and sold is equal to the qualifying residential and small farm load of the exchanging utility. In most circumstances, no actual power is exchanged. Rather, in the case where BPA's rate is lower than the ASC, BPA pays the utility the difference between the utility's ASC and BPA's PF Exchange rate in cash, which the utility then passes directly through to its residential and small farm customers. If a utility's ASC is less than the PF Exchange rate, the utility may elect to "deem" its ASC equal to the PF Exchange rate. By doing so, the utility avoids making actual payments to BPA. The amount that the utility would otherwise pay BPA is tracked in a "deemer account."

Section 5(c)(7) of the Northwest Power Act requires BPA to develop a "methodology" for determining each utility's ASC. *Id*. § 839c(c)(7). BPA consults with interested parties in the region in developing the methodology, but the Administrator must establish the methodology, subject to review and approval by FERC. *Id*. Section 5(c)(7) of the Northwest Power Act provides:

> The "average system cost" for electric power sold to the Administrator under this subsection shall be determined by the Administrator on the basis of a methodology developed for this purpose in consultation with the [Northwest Power Planning] Council, the Administrator's customers, and appropriate State regulatory bodies in the region. Such methodology shall be subject to review and approval by the Federal Energy Regulatory Commission.

Id. The Northwest Power Act provides that utilities' ASCs shall not include:

> (A) the cost of additional resources in an amount sufficient to serve any new large single load of the utility;
> (B) the cost of additional resources in an amount sufficient to meet any additional load outside the region occurring after December 5, 1980; and
> (C) any costs of any generating facility which is terminated prior to initial commercial operation.

Id. § 839c(c)(7)(A)-(C).

BPA established the initial ASC Methodology ("1981 ASC Methodology") pursuant to section 5(c)(7) of the Northwest Power Act in a Record of Decision issued on August 26, 1981. *Administrator's Record of Decision*, Bonneville Power Administration, (August 1981). BPA filed the 1981 ASC Methodology with FERC on August 27, 1981, and FERC granted interim approval effective as of October 1, 1981. Sales of Electric Power to the Bonneville Power Administration, Filing Rate Schedules, Interim Rule, 46 Fed. Reg. 50,517 (1981), corrected 46 Fed. Reg. 55,952 (1981). FERC ultimately granted final approval of the 1981 ASC Methodology on October 6, 1983, retroactive to October 1, 1981. Sales of Electric Power to the Bonneville Power Administration, Methodology and Filing Requirements, 25 FERC ¶ 61,005, 48 Fed. Reg. 46,970 (1983) (codified at 18 C.F.R. 301.1 (1997)).

Beginning in 1983, BPA's direct service industrial customers and public agency customers requested a change in the ASC Methodology based on numerous concerns, including perceived abuses in the system related to the attempted inclusion of terminated plant costs in ASC in violation of section 5(c)(7) of the Northwest Power Act. BPA addressed many issues in revising the ASC Methodology, including the source data for the ASC Methodology, the determination of whether transmission costs should be considered resource costs, the subsidization of construction work in progress, the treatment of equity return, the treatment of income taxes, the determination of generating resources includable in computing ASC, the treatment of affiliated fuel costs, conservation costs includable in ASC, and the functionalization between subsidized and non-subsidized accounts. *Average System Cost Methodology, Administrator's Record of Decision*, Bonneville Power Administration (June, 1984) (hereinafter "1984 ASC ROD"). On October 7, 1983, BPA initiated the ASC consultation proceeding by publishing a "Request for Recommendations" in the Federal Register. Reconsultation of Average System Cost Methodology, Request for Comments and Recommendations, 48 Fed. Reg. 45,829 (1983). After reviewing comments, BPA published a "Proposed Methodology for Determining the Average System Cost of Resources for Electric Utilities Participating in the Residential Exchange." Proposed Methodology for Determining the Average System Costs of Resources for Electric Utilities Participating in the REP Established by Section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act, 49 Fed. Reg. 4,230 (1984). In conjunction with the proposal, BPA also published an "Issue Alert" that summarized the issues. After further hearings and comments, BPA published

the 1984 ASC ROD on June 4, 1984. The Northwest investor-owned utilities challenged the ASC methodology change in the FERC proceeding in which BPA sought approval of the revised methodology. FERC approved the ASC Methodology. Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and, Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985).

Avista notes that BPA's change in the ASC Methodology removed, among other costs, income taxes and return on equity from the ASC calculation. Avista, IOURESEXC:001. Avista argues that BPA's rationale for changing the ASC Methodology was to correct alleged abuses in ASC calculations, in particular the treatment of terminated nuclear plant costs. *Id.* Avista notes that a number of Northwest investor-owned utilities challenged this change, and BPA's decision was upheld on appeal in the United States Court of Appeals for the Ninth Circuit. *PacifiCorp v. Fed. Energy Regulatory Comm'n*, 795 F.2d 816, 823 (1986) (hereinafter *PacifiCorp*). Avista argues that the court upheld the 1984 ASC Methodology as a "temporary" change to address the terminated plant cost issue and that the court did not sanction permanent implementation of the 1984 ASC Methodology. Avista, IOURESEXC:001. While Avista's description is partially correct, Avista has failed to fully describe the court's opinion. The court's opinion in PacifiCorp did not use the word "temporary." The court did state that:

> In upholding BPA's ASC determinations in this case, however, we do not sanction any permanent implementation of these exclusions. We uphold the exclusions in this instance because we conclude that we must defer to BPA's view that the statute authorizes such adjustments in ASC in response to BPA's experience with the program and the need to avoid abuses. The record in this case reflects that this is such a situation. *The statute itself, however, neither commands nor proscribes these adjustments in the ASC methodology.*

PacifiCorp, 795 F.2d at 823 (emphasis added). Thus, the court recognized that BPA's changes in the 1984 ASC Methodology were consistent with the Northwest Power Act. In addition, the court's language is unclear. While the court refers to BPA's "exclusions in this instance" and "BPA's experience with the program and the need to avoid abuses," in fact there was only one issue, the issue of return on equity, where these circumstances arose. *Id*. In the court's lengthy discussion of the issue of income taxes, the court did not mention *any* relationship of income taxes to issues of experience or abuse. *Id.* at 822. It appears that the court did not consider the issue of income taxes to be within its language of "not sanction[ing] any permanent implementation of these exclusions." *Id*. at 823. This is supported by the concurring opinion of Judge Wallace, who disagreed with the grudging acceptance of the court of BPA's exclusion of return on equity from ASC. *Id*. at 825. Judge Wallace's discussion of the court's language of "not sanction[ing] any permanent implementation of these exclusions," like the court's opinion itself, is also limited to the issue of return on equity and does not relate to the income tax issue whatsoever. *Id.* Thus, it appears that BPA's income tax decision was not subject to the court's statement regarding permanent implementation. Avista's argument that the court

permitted BPA to exclude income taxes and equity as a means of preventing inclusion in the average system cost of certain terminated plant costs is therefore incorrect because the income tax issue was unrelated to the terminated plant issue.

In addition, the concurring opinion included sound reasoning supporting the exclusion of return on equity. Judge Wallace stated:

> I see no reason to limit our deference to the BPA's decision to exclude return on capital from ASC. Applying reasonable accounting classifications, the BPA logically determined that return on capital incorporates certain costs that are not resource costs within the meaning of the Regional Act. These nonresource costs include terminated plants costs as well as the more general costs of bearing the risk of business enterprise. I therefore disagree that the exclusion is supported only by evidence that terminated plant costs have been disguised as part of return on equity. Because the rationale for the exclusion is broader and reflects reasonable accounting classifications, I would give the exclusion full approval.

Id.

Avista argues that the court permitted BPA to exclude income taxes and return on equity as a means of preventing inclusion of certain terminated plant costs in average system cost. Avista, IOURESEXC:001. Avista argues that the costs of these unfinished nuclear plants will be completely written off by all of the investor-owned utilities prior to BPA's next rate period beginning in 2001. *Id.* Avista argues that BPA's rationale for excluding income taxes and return on equity from the ASC Methodology no longer applies. *Id.* As noted previously, however, BPA's rationale for excluding income taxes was not based on the treatment of terminated plant costs and the court did not relate income taxes with terminated plant costs. Therefore, BPA's rationale for excluding income taxes still applies. With regard to the costs of the terminated plants being written off by the IOUs prior to BPA's next rate period, this does not mean that BPA's rationale for excluding return on equity no longer applies. The exclusion of return on equity was instigated in large part by the abuses of a utility and a state utility commissioner who attempted to include terminated plant costs in return on equity in violation of state and federal law. The principle for the exclusion, however, goes much farther. The establishment of a return on equity is a subjective judgment made by a state utility commission. As such, it is extremely difficult to determine what a commission may try to include in return on equity. The REP involves a great deal of money and utilities and state utility commissions have identical goals of maximizing the amount of benefits provided by BPA. There have been numerous times in the past when BPA has identified costs that had not been correctly characterized by the filing utility or in the underlying commission order. Many times, FERC has held that BPA properly corrected utilities' mischaracterizations of costs that, if not discovered and corrected, would have improperly provided utilities with greater exchange benefits than they were entitled. Order Accepting Rates and Rejecting Proposed Adjustment, Noting Interventions, Granting Intervention, and Terminating Docket, 43 FERC ¶ 61,097 (1988), (regarding

IPUC's implementation of refund based on "mismanagement," where Utah Power & Light characterized refund as a "[r]eturn of equity capital to the ratepayers in settlement of a dispute . . ." and not exclusively energy related, but FERC found the "root" cause of the refund to be excessive fuel costs and denied Utah's proposed ASC adjustments); Order Accepting Average System Cost Determination and Denying Motion for Hearing And Appointment of Joint State Board**,** 75 FERC ¶ 61,329 (1996); Order Rejecting request for Amendment to Average System Cost Determination and Accepting Rates for Filing, 59 FERC ¶ 61,005 (1992). BPA must have the ability to ensure that all costs that are the basis of determining ASC can be reviewed for consistency with established requirements.

Avista notes that it was not responsible for the alleged abuses referred to by various customers and BPA. Avista, IOURESEXC:001. Avista states that it has no record of BPA ever directing a complaint to Avista concerning abuses in its administration of the 1981 RPSA or ASC computation. *Id.* Avista states that BPA referenced examples of abuses by utilities other than Avista, citing 1984 ASC ROD at 13. *Id.* Avista notes that during the hearings on the methodology change, BPA indicated that it was trying to stop abuses while maintaining a viable exchange program. *Id.* Avista notes a statement by BPA's Administrator at the time, Peter T. Johnson:

> It is certainly not the intention of Bonneville or of myself to wipe out the exchange. Some people have suggested that is the intent of this action of Bonneville to reform the average system cost methodology. Absolutely not the case at all. One of the underlying philosophical points of the Regional Power Act was to bring relative wholesale rate parity to all ratepayers of the Region, whether they were in public power or private power B [sic] reasonably free access to the benefits of the Federal Base System which I am telling you I am trying to protect.
>
> * * * *
>
> Again, I am not wiping out the exchange. It is an exceedingly important objective in the Regional Power Act by Congress. My object is not to legislate; it is to interpret the law fairly and to apply it consistently.
>
> What we are doing at the present time is reforming abuses to which the current methodology has been put.

Hearings in the matter of Proposed Methodology For Determining the Average System Cost of Resources for Electric Utilities Participating in the Residential Exchange Established by Section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act, Before the Bonneville Power Administration, April 20, 1984, p.7, lines 6-15 and p.8, lines 7-12 (introductory comments by Peter T. Johnson, Administrator, Bonneville Power Administration). As noted above, the fact that Avista was not the utility that attempted to include terminated plant costs in return on equity does not mean that the exclusion of return on equity should not apply to Avista. First, the terminated plant cost issue was not the sole reason to revise the ASC Methodology. As noted in

BPA's 1984 ASC Methodology ROD, there were many issues that needed to be revisited, including the source data for the ASC Methodology, the determination of whether transmission costs should be considered resource costs, the subsidization of construction work in progress, the treatment of equity return, the treatment of income taxes, the determination of generating resources includable in computing ASC, the treatment of affiliated fuel costs, conservation costs includable in ASC, and the functionalization between subsidized and non-subsidized accounts. 1984 ASC ROD. In addition, the provisions of the ASC Methodology must apply to all exchanging utilities. 16 U.S.C. § 839c(c)(7). BPA cannot apply one standard in its ASC Methodology rule to one utility and not apply it to another utility. While Avista may not have committed the abuse of the ASC Methodology regarding terminated plant costs, Avista and other utilities have the ability to do so with other costs in the same manner that was done by the utility that abused the methodology. The principle for the exclusion of return on equity in the 1984 ASC Methodology is much broader than a simple remedy for particular abuse. Due to the subjective nature of a state utility commission's establishment of return on equity, it is extremely difficult to determine what costs a commission may try to include in return on equity. Utilities and state utility commissions have identical goals of maximizing the amount of benefits provided by BPA under the REP. There have been numerous times when BPA has identified costs that had not been correctly characterized by the filing utility or in the underlying commission's order. Many times, FERC has held that BPA properly corrected utilities' mischaracterization of costs that would have improperly provided the utilities with greater exchange benefits than they were entitled. Order Accepting Rates and Rejecting Proposed Adjustment, Noting Interventions, Granting Intervention, and Terminating Docket, 43 FERC ¶ 61,097 (1988), (regarding IPUC's implementation of refund based on "mismanagement," where Utah Power & Light characterized refund as a "[r]eturn of equity capital to the ratepayers in settlement of a dispute . . ." and not exclusively energy related, but FERC found the "root" cause of the refund to be excessive fuel costs and denied Utah's proposed ASC adjustments); Order Accepting Average System Cost Determination and Denying Motion for Hearing And Appointment of Joint State Board**,** 75 FERC ¶ 61,329 (1996); Order Rejecting request for Amendment to Average System Cost Determination and Accepting Rates for Filing, 59 FERC ¶ 61,005 (1992). Order Accepting Rates and Rejecting Proposed Adjustment, Noting Interventions, Granting Intervention, and Terminating Docket, 43 FERC ¶ 61,097 (1988), (regarding IPUC's implementation of refund based on "mismanagement," where Utah Power & Light characterized refund as a "[r]eturn of equity capital to the ratepayers in settlement of a dispute . . ." and not exclusively energy related, but FERC found the "root" cause of the refund to be excessive fuel costs and denied Utah's proposed ASC adjustments); Order Accepting Average System Cost Determination and Denying Motion for Hearing And Appointment of Joint State Board**,** 75 FERC ¶ 61,329 (1996); Order Rejecting Request for Amendment to Average System Cost Determination and Accepting Rates for Filing, 59 FERC ¶ 61,005 (1992). BPA must have the ability to ensure that all costs that are the basis of determining ASC can be reviewed for consistency with established requirements. Therefore, it is not clear that BPA should simply allow return on equity to be included in ASC. The current exclusion of return on equity from ASC has worked effectively in precluding the inclusion of improper costs in

return on equity and thus in utilities' ASCs and is therefore serving a current useful purpose. Any proposal to change this provision would require much further examination.

Avista notes that Avista, in comparison to the other regional utilities, received very few benefits prior to 1984. Avista, IOURESEXC:001. Avista states that the total benefits received by Avista's residential and small farm customers prior to 1984 amounted to $6.73 million. *Id.* Avista states that after the change in ASC in 1984, no benefits were received by Avista's customers. *Id.* Avista notes that during the period after 1984, Avista accumulated a deemer balance that BPA now calculates at $93.8 million. *Id.* Avista notes that it has not independently verified BPA's calculation of the deemer balance. *Id.* Avista cites Total REP benefits paid to the residential and rural customers of the Northwest investor-owned utilities under the 1981 ASC Methodology compared to the 1984 ASC Methodology and estimated deemer balances. *Id.* These figures show that Avista's REP benefits were eliminated after FY 1983 and that Avista incurred an alleged deemer balance of over $93 million. *Id.* The statistics cited by Avista, however, simply demonstrate the proper implementation of the REP. Avista fails to note that Avista (formerly Washington Water Power) was already in deemer status under the 1981 ASC Methodology at the time the 1984 ASC Methodology was being developed. *See* 1984 ASC ROD at 3. Avista also fails to note that, unlike most other regional utilities, much of its generation is hydroelectric and the cost of power produced by such resources is much lower than power produced by thermal generation. Hydro resources serve approximately 43 percent of Avista's loads. Thus, Avista's retail rates are among the lowest in the Pacific Northwest region. As Avista itself points out, the purpose of the REP was to provide the residential and small farm customers of regional utilities a form of access to the benefits of the Federal Columbia River Power System. Avista, IOURESEXC:001. *See also*, H.R. REP. NO. 96-976(I), at 29 (1980), *reprinted in* 1980 U.S.C.C.A.N. 5989, 5995; H.R. REP. NO. 97-976(II), at 34 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6023, 6032. The REP provides benefits to utilities based on the average system cost of their resources. *See*, H.R. REP. NO. 96-976(I), at 29 (1980), *reprinted in* 1980 U.S.C.C.A.N. 5989, 5995; H.R. REP. NO. 97-976(II), at 34 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6023, 6032. Where a utility has a low average system cost of power, such as a utility with a large hydro resource base, its ASC will be lower. Where a utility's ASC is lower, there is a smaller gap between the utility's ASC and BPA's PF Exchange rate, resulting in fewer benefits to the utility to be passed through to its residential and small farm consumers. Thus, Avista's limited REP benefits prior to the revision of the ASC Methodology in 1984 make perfect sense. Similarly, as noted above, BPA properly established the 1984 ASC Methodology. BPA's Methodology was approved by FERC. Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and, Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985). BPA's Methodology was also affirmed by the United States Court of Appeals for the Ninth Circuit. *PacifiCorp*, 795 F.2d 816 (1986). When the new ASC Methodology was implemented, BPA properly determined utilities' ASCs in accordance with the Methodology. Where these ASCs were less than BPA's PF Exchange rate, utilities did not receive exchange benefits and became subject to the

contractual provisions of their RPSAs, which provided for the development of deemer accounts. RPSA, Section 10.

Avista notes that not only did Avista no longer receive any positive benefits after 1984, but the change in ASC caused Avista to begin accruing a large deemer balance. Avista, IOURESEXC:001. Avista argues that it is unfair to insist that deemer balances from the 1981 to 2001 contract period for the REP be carried over to the post-2001 period. *Id.* Avista argues that BPA's currently calculated deemer balances are not the result of comparing a participating utility's true average system cost with BPA's, as anticipated by the enabling legislation and the initial 1981 Residential Purchase and Sale Agreements ("1981 RPSA"). *Id.* In response to Avista's arguments, BPA believes that the argument that BPA's calculations of deemer balances are incorrect because they do not reflect a utility's true average system cost is simply wrong. BPA's calculations of deemer balances were based on an ASC Methodology that was approved by both FERC and the Ninth Circuit. *See* Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and, Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985); *PacifiCorp*, 795 F.2d 816 (1986). BPA's PF Exchange rates that were compared with utilities' ASCs were developed in hearings under section 7(i) of the Northwest Power Act and were confirmed and approved by FERC. *See* Order Confirming and Approving Rates on a Final Basis, 23 FERC ¶ 61,378 (1983); Order Confirming and Approving Rates on a Final Basis and Terminating Dockets, 32 FERC ¶ 61,014 (1985); Order Confirming and Approving Rates on a Final Basis and Terminating Dockets, 39 FERC ¶ 61,078 (1987); Order Confirming and Approving Rates on a Final Basis, 54 FERC ¶ 61,235 (1991); Order Confirming and Approving Rate on a Final Basis and Granting Request for Waiver, 53 FERC ¶ 61,318; Order Confirming and Approving Rate Schedules on a Final Basis, 58 FERC ¶ 62,101 (1992); Order Confirming and Approving Rates on a Final Basis and Granting Waiver of Five-Year Limitation on Rate Approval Periods, 67 FERC ¶ 61,351 (1994); Order Confirming and Approving Rate Schedules on a Final Basis, 75 FERC ¶ 62,010 (1996); Order Confirming and Approving Rates on a Final Basis, 80 FERC ¶ 61,118 (1997). Because calculation of deemer balances must be based on the difference between a utility's ASC and BPA's PF Exchange rate, BPA's calculations of deemer balances are clearly the result of comparing a participating utility's true average system cost with BPA's PF Exchange rate, and is consistent with the Northwest Power Act and the 1981 RPSAs.

Avista argues that the large deemer balances result, in large measure, from the 1984 modification of the ASC methodology. Avista, IOURESEXC:001. Avista argues that, by way of example, before the change in methodology, Avista had an average system cost of 24.9 mills/kWh. *Id.* Avista notes that BPA's preference rate at the time was 22.3 mills/kWh. *Id.* Avista states that after the change in methodology, according to BPA's calculations, Avista's ASC for the REP dropped to approximately 19.5 mills/kWh. *Id.* Avista argues that its true average system cost was higher as evidenced by the ASC calculations in Avista's 15-year sale to Puget Sound Energy, filed with and accepted at FERC at rates ranging between 29.05 and 32.33 mills/kWh for the period 1987 through 1994. *Id.* Avista's argument that BPA has not reflected Avista's true average system

cost is simply wrong. First, BPA agrees that Avista's ASC was lower under the 1984 ASC Methodology than under the 1981 ASC Methodology. This is simply the result of BPA implementing a new methodology that was approved by FERC and approved by the Ninth Circuit. Indeed, because BPA's 1984 ASC Methodology was valid and in effect, BPA had no choice but to calculate Avista's ASC in accordance with the 1984 ASC Methodology. Not applying the 1984 Methodology in calculating Avista's ASC would have been a clear violation of law. Section 5(c)(7) of the Northwest Power Act requires that "[t]he 'average system cost' for electric power sold to the Administrator under this subsection *shall be determined by the Administrator on the basis of a methodology developed for this purpose* . . .." 16 U.S.C 839c(c)(7) (emphasis added). That Avista's ASC was lower is simply a truism of properly implementing the 1984 ASC Methodology and the REP. In addition, Avista fails to mention that it was in deemer status under the 1981 ASC Methodology. In other words, regardless of the change in methodology, Avista was accruing a deemer balance.

While Avista argues that its "true average system cost" was higher, as evidenced by the ASC calculations in Avista's 15-year sale to Puget Sound Energy, Avista is clearly mixing apples and oranges. Avista's power sale contract with PSE has nothing whatsoever to do with the REP. Avista's alleged "ASC calculations" in its power sale to PSE are *not* calculations of a utility's ASC under the REP as established in section 5(c) of the Northwest Power Act. Instead, Avista has taken a contract for a power sale to PSE that uses the term "Average Power Cost Methodology," and argues that it is the same thing as an ASC calculated under the REP. This argument is simply wrong. Avista, IOURESEXC:001. As noted above, the Northwest Power Act provides that "[t]he 'average system cost' for electric power sold to the Administrator under this subsection shall be determined by the Administrator on the basis of a methodology developed for this purpose . . .." 16 U.S.C 839c(c)(7). Avista's contractual "Average Power Cost Methodology" with PSE is simply a contractual term developed only by those utilities and used solely for a particular purpose in the power sale between those utilities and is not the methodology developed by the Administrator and approved by FERC and the Ninth Circuit. *See* Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and, Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985); *PacifiCorp*, 795 F.2d 816 (1986). Therefore, it does not, in any way, reflect Avista's ASC for purposes of the REP under the Northwest Power Act.

Avista argues that the deemer balances calculated as of 2001 using the 1984 ASC methodology should not be carried over to post 2001 contracts. Avista, IOURESEXC:001. It must be noted, however, that Avista's RPSA included a provision stating that "[u]pon termination of this agreement, any debit balance in such separate account shall not be a cash obligation of the Utility, but shall be carried forward to apply to any subsequent exchange by the Utility for the Jurisdiction under any new or succeeding agreement." RPSA, Section 10. As noted previously, Avista was accruing a deemer balance under the 1981 ASC Methodology, as well as under the 1984 ASC Methodology. Avista argues that the ASC change was only supposed to be temporary. *Id.* This issue was addressed previously. BPA views the 1984 ASC Methodology as

temporary, not permanent. The 1984 ASC Methodology, however, is still performing an important function in preventing the abuse of the REP and preventing windfall exchange benefits to exchanging utilities that would improperly shift costs to BPA's other customers. As discussed in greater detail below, while the 1984 ASC Methodology contains provisions for requesting the Administrator to revise the ASC Methodology, no parties have complied with these requirements and thus no parties have properly made such a request to revise the ASC Methodology during the period about which Avista is complaining.

Avista argues that by using the 1984 ASC Methodology year after year, BPA has artificially created insurmountable deemer balances which, in Avista's case, for all practical purposes, permanently precludes participation by its customers in the REP. Avista, IOURESEXC:001. As noted above, however, BPA's 1984 ASC Methodology was approved by FERC and affirmed by the Ninth Circuit. *See* Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and, Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985); *PacifiCorp*, 795 F.2d 816 (1986). Section 5(c)(7) of the Northwest Power Act requires that "[t]he 'average system cost' for electric power sold to the Administrator under this subsection *shall be determined by the Administrator on the basis of a methodology developed for this purpose* . . .." 16 U.S.C 839c(c)(7) (emphasis added). Because BPA's 1984 ASC Methodology was valid and in effect, BPA had no choice but to calculate Avista's deemer balance using an ASC developed in accordance with the 1984 ASC Methodology. Not applying the 1984 Methodology in calculating Avista's ASC would have been a clear violation of law.

Avista argues that in Section 12 of the new proposed RPSA, Bonneville appears to be proposing that this deemer balance be carried over. Avista, IOURESEXC:001. Avista argues that the effect of the 1984 ASC Methodology change, notwithstanding Peter Johnson's comments, is that BPA has "wiped out" the Residential Exchange for Avista's customers. *Id.* Avista states that at the average annualized rate that Avista's customers were receiving benefits prior to 1984 ($3.365 million per year), and not counting any additional interest added to the deemer balance, it would take more than 28 years for Avista to work off BPA's currently-calculated deemer balance of $93.8 million. *Id.* Avista is assuming an ASC based in the past that may not reflect Avista's actual future ASC. In any event, even assuming that Avista's numbers were correct, this is simply the result of the proper implementation of the REP. BPA has always used an ASC Methodology to calculate utilities' ASCs that was approved by FERC and the 1984 ASC Methodology was also affirmed by the Ninth Circuit. *See* Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and, Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985); *PacifiCorp*, 795 F.2d 816 (1986). BPA has always used rates for calculating REP benefits (BPA's PF Exchange rate) that were confirmed and approved by FERC. BPA has always complied with the provisions of the RPSA regarding the calculation of deemer balances. As noted in a more detailed discussion below, Congress recognized that the Northwest Power Act did not

ensure that utilities would always receive benefits under the REP. *See* S. REP. NO. 96-272, at 27 (1979). Indeed, Congress recognized circumstances in which exchanging utilities may receive no benefits whatsoever. *Id*. Furthermore, utilities like Avista, that already have an abundance of low-cost hydro resources and thus a low ASC, are the most susceptible to lower REP benefits.

While Avista argues that changes made in the 1984 methodology were not intended to be permanent, BPA does not view the 1984 ASC Methodology as permanent. The Administrator can revise the ASC Methodology and parties can raise relevant issues, including income taxes and return on equity, during any such consultation proceeding. As noted above, however, BPA believes that the exclusions made in the 1984 were well-founded and continue to play an important role in the implementation of the REP today.

Avista argues that the question of whether the deemer balance based on a revised ASC Methodology would carry-over is a question of the parties' intent in making the contract. Avista, IOURESEX:001. Avista notes that the deemer account mechanism was created by the 1981 Residential Purchase and Sale Agreement. *Id.* Avista notes that there is no mention of a deemer account in the Northwest Power Act. *Id.* Avista argues that while Avista agreed in 1981 that its deemer balance, if any, would be carried over to the next contract, Avista believed that the intent was that the balance resulting from the original methodology be carried over, or a balance resulting from a revised ASC methodology that reflected minor modifications, such as changed accounting procedures, arrived at through regional consensus. *Id.* While Avista claims that the issue of deemer carry-over is a question of the parties' intent, this intent is already clearly set forth in the contract itself and an additional review is not needed. Even considering the parties' intent, such intent shows an agreement to establish carry-over deemer balances under a new ASC methodology. First, there is no dispute that Avista's RPSA provided that "[u]pon termination of this agreement, any debit balance in such separate account shall not be a cash obligation of the Utility, but shall be carried forward to apply to any subsequent exchange by the Utility for the Jurisdiction under any new or succeeding agreement." *See* RPSA, Section 10. This language is clear. In addition, the suggestion that the express language of the RPSA requiring the carryover of any deemer balances to the next exchange agreement was limited to the 1981 Methodology is refuted by the RPSA itself. *Id*. Section VI of Exhibit C to the RPSA expressly provides for the amendment of the ASC Methodology. *Id*. Therefore, the RPSA provides that the carryover of deemer balances would occur *regardless* of changes in the ASC Methodology. *Id*. There is no provision in the contract in which the RPSA terminates because of the development of a new methodology under Section IV. There is no provision in the contract in which the *deemer balance* terminates because of the development of a new methodology under Section IV. Furthermore, there is no basis in the contract whatsoever to support the argument that the changes in the ASC Methodology were to be limited in *any* manner, much less to "minor modifications, such as changed accounting procedures." *Id*.

Avista argues that to claim, as BPA has, that it could substantially lower a utility's average system cost for sixteen of the twenty years of the contract, over the objection of the participating utilities and state regulatory commissions, and then carry the resulting

deemer balance over to future exchange programs renders the agreement wholly unilateral. Avista, IOURESEXC:001. Avista argues that it does not believe that this was the intent of the 1981 contract. *Id.* Avista also argues that none of BPA's customers ever envisioned that BPA could unilaterally make such a drastic change to a negotiated contract, citing the DSIs' comments to FERC in the proceeding for the initial 1981 ASC Methodology. *Id*. These arguments are not persuasive. To the contrary, as noted above, BPA properly developed the 1984 ASC Methodology, which was approved by FERC and the Ninth Circuit. *See* Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and, Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985); *PacifiCorp*, 795 F.2d 816 (1986). The consultation process used to develop BPA's 1984 ASC Methodology was initiated by publishing a "Request for Recommendations" in the Federal Register, 48 Fed. Reg. 45,829 (1983). After reviewing comments received in response to the notice, BPA published a "Proposed Methodology for Determining the Average System Cost of Resources for Electric Utilities Participating in the Residential Exchange." 49 Fed. Reg. 4,230 (1984). This proposal solicited both comments and reply comments from interested parties. *Id*. Extensive written comments were filed by interested parties. By letter dated February 17, 1984, BPA announced that public meetings would be held in Spokane and Seattle, Washington; Portland, Oregon; and Idaho Falls, Idaho, to clarify technical aspects of the proposed methodology. *Id*. On March 2, 1984, BPA announced by letter that it would be holding a transcribed public meeting on April 20, 1984, to discuss all issues relating to the BPA proposal, initial comments, reply comments, and possible settlement of any issue. *Id*. The letter also noted that additional meetings would be scheduled with the Regional Council and state regulatory commissions and that BPA would consider requests for meetings with smaller groups of parties. *Id*. Additional public meetings were held between April 23 and 27, 1984. *Id*. Additional transcribed negotiating sessions were held between April 30 and May 4, 1984. *Id*. On April 30, 1984, BPA heard extensive oral argument by all interested parties. *Id*. On May 15, 1984, after reviewing the voluminous record, BPA staff released a proposed ASC Methodology. *Id*. Additional comments were taken on the proposed methodology. *Id*. BPA issued the final ASC Methodology on June 4, 1984. In summary, one can hardly characterize the development of the ASC Methodology as a unilateral decision.

It is the ASC Methodology that determines a utility's ASC, and BPA must use the then-effective ASC Methodology in determining utilities' ASCs. Exchanging utilities and state regulatory commissions, along with all other interested parties, had a complete opportunity to participate in BPA's consultation process where BPA's 1984 ASC Methodology was developed. *See* Reconsultation of Average System Cost Methodology, Request for Comments and Recommendations, 48 Fed. Reg. 45,829 (1983). Exchanging utilities and state regulatory commissions, along with all other interested parties, also had a complete opportunity to participate in review of the ASC Methodology before FERC and the Ninth Circuit. *See* Methodology for Sales of Electric Power to the Bonneville Power Administration, 29 FERC ¶ 61,013, 49 Fed. Reg. 39,293 (1984) and, Methodology for Sales of Electric Power to the Bonneville Power Administration, 30 FERC ¶ 61,108, 50 Fed. Reg. 4,970 (1985); *PacifiCorp*, 795 F.2d 816 (1986). Thus, the development of

the ASC Methodology was clearly not a unilateral process. By law, of course, it is the Administrator who must establish the ASC Methodology as a rule of the agency. 16 U.S.C. 839c(c)(7). As explained in great detail above, BPA's implementation of the REP has been completely consistent with the RPSA. While Avista argues that none of BPA's customers envisioned that BPA could unilaterally make a change to the contract, Avista's citation to the statement of the DSIs does not support its argument. Avista, IOURESEXC:001. First, BPA clearly did not make a unilateral change to the contract. The contract permits the development of a new ASC Methodology. Furthermore, the DSIs' statement supports BPA's position. The DSIs recognized that BPA developed the 1981 ASC Methodology in a consultation proceeding and, in that proceeding, parties were able to reach compromises on certain issues. The DSIs stated:

> Congress could have provided for the Administrator to make a unilateral determination concerning the methodology, with or without FERC review, and with or without a hearing process. But Congress did not choose any of those options. Instead, it provided for a consultation process which, by its very design, was intended to promote consensus and comity among regional interests.

Direct Service Industries' Reply to Comments of the Joint State Board on the Proposed Average System Cost Methodology, FERC Docket No. RM81-41, January 22, 1982, p.2. *Id.* The DSIs thus noted that Congress could have provided the Administrator the ability to make a unilateral determination, but it did not do so because it required that BPA develop the ASC Methodology in a consultation proceeding. *Id*. By conducting a consultation proceeding to revise the ASC Methodology in 1984, BPA did not make a unilateral determination. Similarly, the DSIs note that Congress could have provided the Administrator the ability to make a unilateral determination, but it did not do so because it required that FERC review and approve the ASC Methodology. *Id*. By filing the 1984 ASC Methodology with FERC and receiving FERC approval, BPA did not make a unilateral determination. The DSIs did *not* say that if BPA changed the ASC Methodology in the future, this would be a unilateral change in the contract. Indeed, they could not make such a statement because the RPSA expressly permits changes in the ASC Methodology under Section 9. RSPA, Section 9.

Avista notes that in 1993, Avista terminated its Residential Purchase and Sale Agreement with BPA based upon the trigger of the Section 7(b)(2) rate test. Avista, IOURESEXC:001. Avista notes that notice of this termination was given to FERC. *Id.* Avista notes that it had previously suspended its exchange with BPA in 1987 based upon an earlier trigger of the Section 7(b)(2) rate test. *Id.* Avista argues that at the time of termination, BPA attempted to get Avista to agree to carry over its deemer balance to any new REP contract. *Id.* Avista argues that BPA proposed carry-over language as a condition of agreeing to termination. *Id.* Avista argues that it did not agree with this condition, and sent its notice of termination without the language BPA requested. *Id.*

Avista argues that it had the right to terminate its 1981 Residential Purchase and Sale Agreement under the conditions of that Agreement, citing section 9 of the RPSA. Avista,

IOURESEXC:001. Avista argues that it was and is inappropriate for BPA to attempt to insist upon an agreement to carry over the deemer balance as a condition of agreeing to termination. *Id.* BPA does not disagree that the RPSA permitted Avista to terminate the agreement under the conditions of section 9 of that agreement. However, section 9 is not the only provision of the RPSA relating to termination. Avista's RPSA expressly provided that "[u]pon termination of this agreement, any debit balance in such separate account shall not be a cash obligation of the Utility, but shall be carried forward to apply to any subsequent exchange by the Utility for the Jurisdiction under any new or succeeding agreement." RPSA, Section 10. Obviously BPA, like any other party with such an agreement, would want to implement all of the relevant terms of the parties' agreement in a termination agreement. *Id.*

Avista argues that by attempting to require Avista to agree to the carry-over at that time, BPA was inserting an additional issue into the negotiation: specifically, the issue of whether the deemer balance carry-over provisions applied to any balance which might result from a significantly changed ASC methodology. Avista, IOURESEXC:001. Avista believes that it is entitled to a fair hearing of that issue, in court if necessary. *Id.* Avista intends to argue against language asking it to waive its claim such as that inserted into new agreements for administration of the program post-2001. *Id.* As noted previously, the issue of the carry-over of a deemer balance, regardless of which methodology it was under, is a logical issue in any termination discussion. The carry-over of deemer balances to a subsequent exchange agreement upon termination is a requirement of the RPSA. RSPA, Section 10. Indeed, even under Avista's theory, Avista still should have paid BPA the deemer balance it accumulated under the *1981* ASC Methodology. Avista simply refused to pay what was required under the RPSA.

Avista, as mentioned above, fails to note BPA's Oct. 19, 1993, letter responding to Avista's September 29, 1993, letter notifying BPA of its election to terminate its RPSA. In its letter, BPA stated:

> BPA accepts the termination subject to the following conditions, which are required by your Company's RPSA and authorized by the Suspension of Residential Purchase and Sale Agreement (Suspension Agreement) previously executed by you on behalf of the Company. The Company's deemer account balance through September 30, 1993 is $18,271,996 for its Washington Jurisdiction and $41,664,455 for its Idaho Jurisdiction. . . . Consistent with section 10 of the Company's RPSA, the balances in the Company's deemer accounts shall not be a cash obligation of the Company, but shall be carried forward to apply to any new or succeeding exchange agreement by the Company for the jurisdiction(s).
>
> Termination of the Company's RPSA in accordance with the above-stated conditions is agreed by BPA to meet the requirements of the Company's RPSA for termination and to satisfy the Company's obligations under paragraphs 4 and 6 of the Suspension Agreement concerning effective revocation of the Suspension Agreement. Termination of the Company's

> RPSA without the above-stated conditions is unacceptable to BPA as not meeting the requirements of the Company's RPSA and Suspension Agreement.

Plainly, Avista's termination requires the payment of its deemer balance prior to the execution of a new exchange agreement.

Avista argues that there are policy reasons why the revised ASC Methodology should not be used by BPA for purposes of calculating Avista's customers' exchange entitlements post-2001. Avista, IOURESEXC:001. Avista argues that since Avista's ASC is among the lowest of the six Northwest investor-owned utilities, any general modification of the ASC methodology (including the 1984 change) that results in across-the-board partial elimination of exchange program costs strikes first at participation by Avista's customers in its eastern Washington and northern Idaho service territories for no justifiable reason. *Id.* Avista states that during the periods after 1984, BPA paid over $2.25 billion in benefits under the program to other geographic areas, principally along the Interstate 5 corridor, without any benefits reaching customers in Avista's service area. *Id.* Avista argues that carrying over the artificially created deemer balances will sustain this inequity essentially forever, keeping generations of customers from receiving any benefit from the federal power system. *Id.* Contrary to Avista's argument, there is no policy reason for excluding the 1984 ASC Methodology in calculating deemer balances. As noted above, the fact that Avista would be particularly impacted because it has a low ASC is precisely the manner in which the REP was intended to work. Utilities' with high ASCs are those that have higher costs and generally higher retail rates. The consumers of these utilities receive substantial benefits from the REP. Customers of utilities with low ASCs, however, are already receiving substantial benefits by being consumers of a low-cost utility. This is the way Congress intended that the REP work. *See* S. REP. NO. 96-272, at 27 (1979). Utilities with high ASCs receive greater benefits than utilities with low ASCs.

Avista argues that such a result is inequitable because Avista's service territory is among the poorest in the region. Avista, IOURESEXC:001. Avista argues that in a comparison study done between the various Northwest Investor-Owned Utilities' service territories, it demonstrated that Avista's customers have a much lower median household income and a much larger percentage of the customers below poverty level compared to the customers of the utilities along the Interstate 5 corridor. *Id.* Avista argues that, thus, BPA's method of management of the REP has the unintended effect of providing zero benefits to low income customers in Avista's service territory while at the same time providing significant benefits to more affluent customers in other utilities' service territories. *Id.* Again, the rules of the REP, as established by Congress, are clear. Congress provided that greater benefits would go to utilities with higher ASCs. *See* H.R. REP. NO. 96-976(I), at 29 (1980), *reprinted in* 1980 U.S.C.C.A.N. 5989, 5995; H.R. REP. NO. 97-976(II), at 34 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6023, 6032. Congress did not establish the eligibility for REP benefits based upon the utility's service territory having particular median household incomes or a much larger percentage of customers below poverty level. *Id.*

Decision

BPA will require deemer accounts to be paid before delivering REP benefits under the RPSA.

VIII. IN-LIEU PROVISONS

Issue

Whether 30 days is sufficient notice that BPA intends to purchase an in-lieu resource.

Parties Position

Parties argued that BPA's notice period is too short. Several argued that the notice should match the time required to develop a new generation resource. Puget stated that this period is currently about four years and OPUC argued for a three year notice period. Puget, IOURESEXC:018; OPUC, IOURESEXC:014. The WUTC recommended a one year notice but stated that BPA should limit use of in-lieu transactions to instances where it was necessary to provide additional protection to BPA's preference customers. WTUC, IOURESEXC:016.

BPA's Position

BPA maintains that there is no statutory requirement that the in-lieu notice period be based on the time required to develop new generation, and such a requirement would defeat the purposes of the statutory provision. While BPA believes a thirty-day notice is reasonable under current conditions and comports with statutory requirements, BPA has agreed to establish a minimum notice period under an In Lieu Power Policy and make such period no less than 90 days.

Evaluation of Positions

Puget's and other comments maintain that BPA's proposed thirty-day notice period for in lieu transactions is inappropriate. Puget, IOURESEXC:018. Puget points out that, under the 1981 power sales contracts, no "in lieu" transactions have taken place. *Id*. The reason, Puget maintains, is because those agreements are predicated on the understanding that "in lieu" power would have to come from a new generation resource. *Id*. According to Puget, because it took seven years to build a new generating facility, the original residential purchase and sale agreements require BPA to give seven years' notice to a utility prior to BPA's acquiring in-lieu power. *Id*.

Puget then goes on to conclude that the draft RPSA, which would replace the 1981 RPSA, violates statutory requirements and intent by providing for a notice period of only thirty days prior to BPA's acquiring in-lieu power. *Id*. The draft RPSA would in fact allow the utility only 30 days' advance notice of in-lieu power acquisition and only 15 days in which to elect whether or not to take power deliveries based on such acquisitions.

Puget maintains that such short periods are unreasonable, arbitrary and capricious because they do not provide sufficient opportunity to react. *Id*. In support of its contention, Puget cites the Council Staff's indication that currently the time required to develop new generation is about four years. Accordingly, Puget recommends that the RPSA be modified to include a period of four years' advance notice to the utility of BPA's acquisition of in-lieu power. *Id*.

Avista asserted that no utility is in a position to plan its resources on the proposed thirty days' notice without experiencing significant adverse consequences to its non-exchanging customers. Avista, IOURESEXC:001. Avista recommended that the in-lieu amounts be fixed at the beginning of the agreement. *Id*. If that could not be done, then Avista proposed that the issue be moved into a separate methodology process which would not delay the offering of agreements in September, 2000, but would give the regional interests an opportunity to develop a workable in-lieu methodology.

PGE and OPUC took a similar approach but argued for a somewhat shorter notice period. PGE, IOURESEXC:021; OPUC, IOURESEXC:014. They stated that the current time frame for siting and building a new power plant is approximately three years and argued that such a notice period was needed in order to maintain maximum flexibility for providing service to residential consumers. *Id*. OPUC stated that this would allow the utilities it regulates the opportunity to avoid commencing construction of a resource that is not needed in the event BPA issues an in-lieu notice. *Id*.

OPUC raised issues regarding timing of an in lieu notice, arguing that since the spring is usually the Pacific Northwest's lowest power cost season, BPA is able to find a lower source of power by simply choosing its purchase date. OPUC, IOURESEXC:014. The OPUC was concerned about partial year in lieu notices due to the structure of the ASC Methodology and the evolving nature of the wholesale power markets. *Id*. The ASC Methodology is developed to provide an annual average cost of the generation and transmission used to serve the utility's loads. The wholesale price of power varies significantly by month and time of day. The OPUC is concerned that BPA would issue an in lieu notice covering a partial year where prices were lower than the annual average and reduce benefits to residential and small farm consumers. *Id*. This result occurred based on contract language in section 7(b)(4) that allowed deliveries of In Lieu PF Power for periods of one year or multiples thereof except for in lieu notices extending for the remaining term of the Agreement. The proposed language allowed a partial year in lieu notice during the last year of the contract. BPA modified the language in section 7(b)(4) to require deliveries of In Lieu PF Power to be made on a Contract Year basis for a period of one year or multiples thereof. This modification eliminated the potential for partial year in lieu notices.

The WUTC recommended a one-year notice period to provide the exchanging utility with sufficient time to prepare for and manage in-lieu power deliveries. WTUC, IOURESECH:016. Moreover, the WUTC argues that BPA should substitute "in-lieu" purchases for purchases of Average System Cost ("ASC") power from investor-owned

utilities only when necessary to protect its preference customers from paying above-market rates for their priority firm requirements service. *Id.*

BPA disagrees with the suggestion that notice must be based on the length of time needed for start-up of a new generation resource. A thirty day notice period is not unreasonable or contrary to the purpose of the statutory in-lieu provision. Under the Northwest Power Act, BPA "purchases" power from each participating utility at that utility's ASC. *Id.* The Administrator then offers, in exchange, to "sell" an equivalent amount of electric power to the utility at BPA's PF Exchange power rate. *Id.* The amount of power purchased and sold is the qualifying residential and small farm load of each utility participating in the REP. *Id.* The Northwest Power Act requires that the net benefits of the REP be passed on directly to the residential and small farm customers of the participating utilities. *Id.*

However, the REP generally does not involve a conventional purchase and sale of power. *Id.* Typically, no actual power is transferred either to or from BPA. *Id.* Thus, the "exchange" has been referred to as a "paper" transaction, where BPA provides the participating utility cash payments that represent the difference between the power "purchased" by BPA and the less expensive power "sold" to the participating utility. *Id.*

Actual power sales may occur, however, when BPA decides that a statutory "inlieu" transaction is appropriate. In such instances, BPA purchases power from a source other than the utility and sells actual power to the utility. *Id.* Section 5(c)(5) of the Northwest Power Act states:

> . . . [T]he Administrator *may* acquire an equivalent amount of electric power from other sources to replace power sold to such utility as part of an exchange sale if the cost of such acquisition is less than the cost of purchasing the electric power offered by such utility.

16 U.S.C. §839c(c)(5) (emphasis added). This acquisition of power from other sources is "in-lieu" of the "purchase" that would otherwise occur under the REP, and is designed to provide a mechanism to limit the net costs of the Program. Boling and Doubleday, WP-02-E-BPA-30, at 10. In other words, the in-lieu transaction can be used as a benchmark that sends appropriate pricing signals to exchanging utilities and promotes the use of lowest cost resources to serve residential and small farm customers. The statute does not specify a particular notice period. The only statutory requirement is that the cost of the "in lieu" acquisition be less than the cost of purchasing power at from the exchanging utility at the utility's average system cost.

Moreover, the legislative history supports this point of view. Senate Bill 885 included the following language:

> "(D) the Administrator may acquire the resources necessary to carry out the exchange sales from other resources, rather than purchase the electric power

> offered him by the utility pursuant to this subsection, if the cost of doing so is less than the cost of purchasing the electric power offered by the utility."

S. Rep. No. 96-272, 96th Cong., 1st Sess. 5 (1979). The Senate Report clarified this provision allowed the Administrator "to carry out the exchange power sales by purchasing power other than that offered by the exchanging utility if it is available at lower cost." Id at 27. Thus, in establishing the exchange provisions of the Act, Congress intended that BPA have the flexibility to purchase power from other sources if it was available at a lower cost.

Amendments of SB 885 made by the House Interstate and Foreign Commerce Committee (Commerce Committee) clarified that any purchases be made subject to sections 4 and 6 of the Northwest Power Act. This addition, however, did not alter the fundamental intent of the provision. It simply made it clear that the provision did not otherwise enlarge the scope Administrator's acquisition authority. Thus, any type of purchase authorized under BPA's statutory authorities could be made in lieu of purchasing the power offered by the exchanging utility.

In addition to meeting the simple statutory test, BPA must also determine that the transaction otherwise makes sense given incidental costs and other factors not included in the statute. In broad terms, this result would occur where the utility's ASC is significantly above the PF Exchange rate and when the cost of the in-lieu power is significantly below the utility's ASC. *Id.* Because these two factors, ASC and market conditions, are readily obvious to exchanging utilities, utilities generally should know, prior to receiving notice, whether they are candidates for an in-lieu transaction and whether market conditions make such a transaction appropriate. A thirty-day notice, in such circumstances, should not be particularly onerous.

Moreover, as in the 1981 contract, a utility has two options in the event that BPA decides that an in-lieu transaction is appropriate. The utility can either purchase actual power from BPA at the PF Exchange rate in the amount of the in-lieu transaction, or it can refuse the power and reduce its ASC to the cost of the in-lieu resource for the amount of the in-lieu transaction. *Id.* Under conditions where in-lieu resources are projected to cost considerably less than the PF Exchange rate, utilities would not seem to have any incentive to continue to purchase power from BPA at greater than market prices. *Id.* The utility would opt instead to reduce its ASC to the in-lieu resource cost. *Id.* The utility would then continue to receive exchange benefits for remaining load that was not subject to the in lieu transaction.

Additional safeguards will assure that the in-lieu provisions are implemented in a manner that fulfills the purpose of the statute without causing undue hardship to the participating utility. For example, in lieu transactions are not mandatory; instead, they are implemented subject to the Administrator's discretion consistent with applicable law and the applicable RPSA. Boling and Doubleday, WP-02-E-BPA-30, at 10. *See* PPC Brief, WP-02-B-PP-01, at 74. In exercising this discretion, the Administrator is not constrained to rely solely on economic considerations. *Id.* In its recent WP-02 rate case, BPA placed

considerable emphasis on certain noneconomic factors such as reducing the possible adverse impact that an in-lieu transaction might impose on an exchanging utility, and ensuring that some level of Federal power benefits would be available to the residential and small farm consumers of utilities that continue the REP. *Id.*

Thus, while the purpose of the in-lieu provision is to control REP costs, this does not mean that BPA is required to use in-lieu transaction to reduce REP costs as much as possible regardless of the circumstances. As the Northwest Power Act recognizes, "the Administrator *may* acquire an equivalent amount of electric power from other sources . . . ." 16 U.S.C. §839c(c)(5). BPA is therefore not required to conduct in-lieu transactions to the fullest extent possible. Boling and Doubleday, WP-02-E-BPA-30, at 10. While conducting extensive in-lieu transactions might benefit non-exchanging customers, it would severely harm the residential and small farm consumers of exchanging utilities, for whom the REP is their primary form of access to the benefits of the Federal power system. Exercising this flexibility does not result in BPA providing exchanging utilities additional benefits at the expense of others. Rather, it allows exchanging utilities to receive exchange benefits as provided in the Northwest Power Act, consistent with BPA's proposed in-lieu transactions. Boling and Doubleday, WP-02-E-BPA-53, at 16.

Due to the flexibility available to the Administrator and the limitations that BPA has already proposed, a thirty-day notice period is reasonable. This is particularly true in light of current market conditions. In today's climate, more and more retail utilities are, in fact, divesting their own generation resources and are themselves relying more and more upon wholesale market purchases. Marketers in the wholesale market place are constantly setting prices for the purchase and sale of electricity for varying periods. It is impossible to predict what the market will look like, and how utilities will be structured, even over a relatively near term horizon. Given the uncertainties and volatility in today's market, the longer notice periods requested by comments do not reflect today's wholesale market conditions. Wholesale market purchases which in the past took months to negotiate can now be arranged with one phone call, and price quotes are firm only for the duration of the call.

This market environment makes longer notice periods highly impractical. Since BPA must forecast the cost of the in lieu purchase when it issues an in lieu notice, a longer notice period would make forecasting such cost nearly impossible. The same is true with respect to resource acquisitions. Resource acquisition costs are highly dependent on commodity prices that change daily, making accurate forecasts the cost of a resource acquisition three to four years in the future extremely uncertain. In essence, the three and four-year notice periods requested by the IOUs would effectively prevent BPA from using any type of in-lieu transaction. Such a result would essentially freeze benefits in place regardless of market conditions or the cost of other sources of generation, and no matter whether the exchanging utility itself owned generation resources that an ASC could be based upon.

There is no indication, or any reason to believe, that Congress intended for the in-lieu provisions to be so restrictive that they could not be implemented in a period of

uncertainty like the present. In fact, the provision was drafted to provide considerable discretion to the Administrator so that, even in times of transition, it could serve its purpose of limiting the net cost of the exchange by sending appropriate market signals.

While BPA believes a thirty-day notice period is consistent with the statute and the purposes of section 5(c)(5) of the Northwest Power Act, BPA recognized the concern that such a period does not allow sufficient time to react to the notice. While BPA does not agree with the assertion that the notice must allow the construction of a resource, BPA is willing to consider the appropriate notice period in the development of an In Lieu Power Policy. BPA has also agreed to provide a minimum 90-day notice. Such notice period should provide sufficient time for State Commissions to hold hearings on the notice if they choose not to publish rules on how to respond to in-lieu notices.

Decision

While BPA believes a thirty-day notice is reasonable under current conditions and comports with statutory requirements, BPA has agreed to establish a minimum notice period under an In Lieu Power Policy and make such period no less than 90 days.

Issue

Whether BPA is required to acquire actual physical generating resources for the purpose of all in-lieu transactions.

Parties' Positions

Some parties have asserted that BPA cannot use market purchases or its own surplus power for in-lieu transactions. Instead, they maintain that such purchases must be new generation resources that comport with sections 4 and 6 of the Northwest Power Act. *Id*. One party maintained that BPA should at least revise the draft RPSA to provide that In-Lieu Power would have the meaning established by a notice and comment process to be commenced by BPA.

BPA's Position

It is appropriate to use both market purchases and BPA's own surplus where such resources make in-lieu transactions an appropriate choice. Limiting in-lieu transactions to actual generation resource acquisitions is not required by the statute and would essentially render the statutory provision unworkable given present circumstances and market conditions. BPA has agreed to identify the sources of In Lieu PF Power in an In Lieu Power Policy.

Evaluation of Positions

Puget, and the other IOUs and Commissions, generally contend that the statute requires in-lieu acquisitions to be from new generating facilities. First, Puget believes that BPA's

proposal to use market purchases for in lieu transactions is unfair. In its comments, Puget made the following observation:

> BPA's proposal to include its new, erroneous and untested interpretation of in-lieu power acquisition sources in the draft RPSA stands in stark contrast to BPA's treatment of a different disputed statutory interpretation that affects BPA's governmental and cooperative utilities, the meaning of "New Large Single Load" under the Northwest Power Act. In that case, BPA has agreed that it will conduct a separate process to interpret the meaning of that term, which allows those utilities to proceed with contracts and yet be fully free (and have a full opportunity) to dispute the appropriate interpretation of the statutory provisions regarding "New Large Single Load."

PSE, IOURESEXC:018.

In response to Puget and other commentator's comments, BPA has agreed to conduct a separate process to identify the sources of In Lieu PF Power. Such process will allow utilities to proceed with contracts and yet be fully free (and have full opportunity) to dispute the appropriate interpretation of the statutory provisions concerning the sources of in lieu resources. BPA will publish an In Lieu Power Policy that identifies the provisions for acquisition and delivery of in lieu power, including the source of power acquired by BPA in lieu of power offered by the utility under the RPSA, procedures for developing the expected costs of In Lieu Power, the minimum period of advance written notice that BPA will provide of its election to acquire In Lieu Power and the minimum period the utility will have to determine whether it will accepted deliveries of In-Lieu PF Power.

Moreover, Puget views BPA's proposal as bad policy in terms of providing the region with adequate, efficient power supplies. PSE, IOURESEXC:018. Puget notes that BPA has forecast a shortfall in regional power capacity, citing lack of new resources as the region's number one issue. *Id*. At the same time, Puget argues that BPA's proposal to use market purchases for in-lieu transactions is inconsistent with the Plan and the legal requirements of the Northwest Power Act. *Id*.

Puget maintains that acquisitions of in-lieu power by BPA are subject to certain requirements under the Northwest Power Act. *Id*. For example, Puget notes that Section 5(c) of the Northwest Power Act provides that any in-lieu acquisitions are subject to the provisions of sections 4 and 6 of the Northwest Power Act. *Id*. Under Northwest Power Act section 6(b), BPA's acquisition of resources must be consistent with the Regional Plan; if acquisitions are not consistent with the Regional Plan (or there is no Regional Plan), then acquisitions must be consistent with the criteria of section 4(e)(1) of the Northwest Power Act and the considerations of section 4(e)(2) of the Northwest Power Act. *Id*.

Moreover, Puget asserts that the Regional Plan must give priority to resources which the Council determines to be cost-effective and also establishes a priority among resources:

first priority to conservation, second, to renewable resources, third, to certain cogeneration and high-efficiency resources, and fourth, to other resources. Northwest Power Act, section 4(e)(1). *Id*. Puget concludes that "to the extent that BPA does not acquire resources identified in the Regional Plan, BPA must give a priority to conservation, renewables and certain cogeneration resources before acquiring resources from other sources." *Id*. Therefore, Puget recommends that the draft RPSA be revised to reflect a priority for conservation and renewables in the acquisition of in-lieu power. PSE, IOURESEXC:018. *See also,* PacifiCorp, IOURESEXC:011.

PGE notes that "[w]holesale market purchases do not provide either stability or low cost because the competitive market is still in its infancy and can be extremely volatile." PSE, IOURESEXC:018. PGE also asserts that the Residential Exchange was created to provide a way for Bonneville to acquire power - either from the investor-owned utilities or through the in lieu provision - to serve the residential loads of investor owned utilities at the cost-based rate of the federal system. *Id*. Thus, PGE concludes that, if BPA has sufficient surplus available to conduct an in-lieu transaction, then it should just sell the power to the investor-owned utilities for the net requirements of their residential consumers. *Id*. Finally, PGE argues that BPA's proposal is inconsistent with the purpose of the Residential Exchange to provide residential power consumers with stable prices that provided a share of the low-cost benefits of the federal system. *Id*.

BPA believes the IOUs and their regulators take a far more constricted view of the Northwest Power Act than was intended by Congress, as can be seen by the plain meaning of the statutory provisions. Section 5(c)(5) states that, in order to effect an in lieu transaction, the Administrator "may acquire an equivalent amount of electric power from other sources to replace power sold to such utility as part of an exchange sale." Notably, Congress used the term "electric power." That term is defined simply as "electric peaking capacity, or electric energy, or both." 16 U.S.C. §839a(9). It is not limited in any other way. Moreover, the statute states that the Administrator may obtain this power from any "source," not from the acquisition of a generating resource.

Indeed, the statute indicates that Congress was extremely careful not to use words that could be construed to place undue limitations on the Administrator's ability to provide an efficient and reliable power supply and meet other commitments. The term "resource" is defined in section 3(19) of the Northwest Power Act as: "(A) electric power, including the actual or planned electric power capability of generating facilities, or (B) actual or planned load reduction resulting from direct application of a renewable energy resource by a consumer, or from a conservation measure." 16 U.S.C. §839a(19)(A), (B). Thus, even when the Act speaks of "resources," the term must be construed as inclusive rather than exclusive. In short, had Congress intended to limit in lieu transactions to acquisition of capacity or output of specific generation resources, it was fully capable of, and would have written such a significant limitation into the law.

As noted above, the original version of this language in SB 885 authorized BPA to purchase power from other sources if it was available at a lower cost:

> "(D) the Administrator may acquire the resources necessary to carry out the exchange sales from other resources, rather than purchase the electric power offered him by the utility pursuant to this subsection, if the cost of doing so is less than the cost of purchasing the electric power offered by the utility."

Senate Report 96-272 at p.5. The Senate Report clarified that this provision allowed the Administrator "to carry out the exchange power sales by purchasing power other than that offered by the exchanging utility if it is available at lower cost." *Id* at 27. Thus, Congress's intent was to give the Administrator the flexibility to provide sales at the PF rate to residential consumers at the lowest possible cost to BPA.

Amendments of SB 885 made by the House Interstate and Foreign Commerce Committee (Commerce Committee) required that any purchases be made subject to sections 4 and 6 of the Northwest Power Act. However, as pointed out elsewhere, this simply meant that any purchase otherwise authorized by statute could serve as the source for an in lieu transaction.

Of course, the IOUs are correct to note that such acquisitions are "[s]ubject to the provisions of section 839b and 839d of this title." Those provisions, however, do not preclude the Administrator from conducting in lieu transactions in the manner proposed by BPA. The Northwest Power Act expressly recognizes that the Administrator may essentially acquire resources to meet her contractual obligations that remain after taking into account planned savings from conservation measures. The Northwest Power Act does not limit resource acquisitions to the amounts needed to meet preference loads. Section 6(a)(2) of the Northwest Power Act provides that:

> In addition to acquiring electric power pursuant to section 5(c), or on a short-term basis pursuant to section 11(b)(6)(i) of the Transmission System Act, *the Administrator shall acquire,* in accordance with this section, *sufficient resources to meet his contractual obligations* that remain after taking into account planned savings from measures provided in paragraph 1 of this subsection, and to assist in meeting the requirements of section 4(h) of this Northwest Power Act.

16 U.S.C. §839d(a)(2) (emphasis added).

Economically sound and otherwise prudent in lieu purchases exercising BPA's contractual right and statutory obligation are certainly within the compass of this provision. *Id*.

The scope of acquisition authority under the Northwest Power Act was discussed by the Commerce Committee. *See,* Commerce Committee Report at 38-40. The report noted that BPA could either purchase the output or the capability of resources under its new authority. Congress included the authority to purchase capability since it believed that it would be too speculative to rely on the preferred approach of having BPA purchase the

output of existing resources. *Id* at 39. Congress did not intend to limit BPA's acquisition authority to the capability of generating resources as asserted by Puget and other parties.

Puget argues that BPA must first acquire conservation before it can acquire other resources. Puget, IOURESEXC:018. Puget also argues that BPA cannot use its surplus generation to make deliveries under section 5(c). *Id*. Under Puget's theory of the Northwest Power Act, BPA must acquire 1000 aMW of conservation before acquiring in lieu resource, but cannot use the resulting 1000 aMW surplus created on BPA's system as an in lieu acquisition. Puget's interpretation is inconsistent with section 5(c)(5) and would completely frustrate that provision's intent of allowing BPA to acquire the lowest cost resource to meet its exchange sale obligations. Furthermore, Puget's interpretation is not persuasive even if legal requirements regarding conservation acquisitions are considered independently from the statutory scheme. First, it must be noted that the Northwest Power Act does not simply provide that conservation is automatically a first priority in acquiring resources. BPA's conservation acquisitions are complete if BPA's Administrator determines that such acquisitions are consistent with the Regional Council's Plan. 16 U.S.C. 839d(a)(1). The Northwest Power Act also imposes cost-effectiveness and other standards for conservation acquisitions. 16 U.S.C. 839a(4)(A). If conservation fails these requirements, BPA need not acquire it. The argument simply does not, and cannot, identify a legal requirement compelling the Administrator to take the proposed action.

The Administrator's acquisition authority is set forth in section 6 of the Northwest Power Act. 16 U.S.C. §839d. Subsection 6(a)(1) of the Northwest Power Act establishes a conditional priority for conservation and direct-access renewables to reduce the demand for electric power and thus to lessen the need to acquire power from physical generation resources. 16 U.S.C. §839d(a)(1). Subsection 6(a)(2) expands the Administrator's existing authority to acquire resources after taking into account planned savings from conservation:

> For the long-term, section 6 authorizes the BPA to acquire 'resources' to meet these contractual obligations. However, in providing this authority, the Committee was mindful of the concerns by some this authority not provide a 'blank check' to BPA to acquire whatever resources it deems appropriate. The Committee limited that authority and set priorities . . . Further, the Committee amendment provides that BPA must first 'take into account planned savings from conservation and conservation measures.'

Senate Rep. No. 96-976, Part I, 96th Cong., 2d Sess. at 37 (1979).

As described above, critical terms are defined so as to recognize the Administrator's flexibility with regard to acquisitions. The term "resource" is defined in section 3(19) of the Northwest Power Act and means: "(A) electric power, including the actual or planned electric power capability of generating facilities, or (B) actual or planned load reduction resulting from direct application of a renewable energy resource by a

consumer, or from a conservation measure." 16 U.S.C. §839a(19)(A), (B). Finally, the term "electric power" is defined in section 3(9) to mean "electric peaking capacity, or electric energy, or both." 16 U.S.C. §839a(9). Taken together, these terms demonstrate the linkage between the FBS's capability to produce electric power, and additional resources of whatever kind that are capable of meeting the Administrator's contractual obligations to deliver power.

The statute, then, attempts to achieve flexibility and provide direction. On the one hand, BPA is directed to seek reduction in demand for electric power consumption through conservation programs and renewable resources. On the other hand, notwithstanding the efforts to reduce demand through conservation, Congress understood that the FBS is in reality a set of physical generating resources where output or capability must be acquired to meet the Administrator's obligations to deliver power.

Congress did not intend to bar the Administrator from acquiring "conventional" resources until all conservation in the Regions had been acquired. Rather, Congress struck a balance between reducing demand for electric power consumption, on the one hand, and the need to acquire power, on the other. Because Congress specified criteria, the Administrator is compelled to "take a hard look" at non-conventional resources before determining whether other acquisitions are necessary. Both the Committee statements and the language of section 6 of the Northwest Power Act acknowledge acquired conservation consistent with the NWPPC's Plan when determining whether further power resources are needed: "Section 6(b) requires BPA to acquire sufficient resources to meet its contractual obligations, after taking into account planned savings from measures provided in section 6(a)…." *Id.* at 35.

Moreover, the Administrator cannot reduce efforts to acquire and implement conservation measures and resources. "Thus, sections 6(a) and 6(b) together require the Administrator to achieve all available conservation and prevent [her] from acquiring non-conservation resources without first taking into account planned savings from conservation." *Id.* at 37. In the context of acquisition of resources, BPA takes into account BPA's planned savings from conservation and then acquires additional output or capability from power producing resources.

Thus, the Administrator has authority to use market purchases and surplus, if available, in order to fulfill BPA's contractual obligations. In order to effect the purposes of the REP, these obligations include having the ability to implement BPA's contractual and statutory right to enter into an in lieu transaction. Moreover, as a matter of policy, it makes sense to use such sources for that purpose when possible. The volatility and uncertainty of the changing markets have made generation resource acquisition more problematic than ever for the time being, and BPA must have the flexibility to substitute market purchases, either standing alone or combined with available surplus. This approach is consistent with the 1995 BPA Business Plan (DOE/BP-2664) and the Regional Council's Fourth Northwest Power Plan, which identified 3000 annual average megawatts of wholesale market purchases available to meet Regional loads at a cost less

than the cost of building new resources. *See,* Draft Fourth Northwest Power Plan, Chapter 1 at p.5, adopted as final.

Puget further asserts that BPA's proposal to rely on surplus power or wholesale market purchases conflicts with the Northwest Power Act's purpose of assuring the Pacific Northwest an adequate, efficient, economical, and reliable power supply. PSE, IOURESEXC:018. Puget argues that the use of surplus power or wholesale purchases is inconsistent with the shortage of power capacity in the Region noted by the BPA Administrator. *Id*. Puget's assertion misses the point of in lieu acquisitions. BPA is authorized by section 5(c)(5) to acquire in lieu resources when they cost less than the power offered by an exchanging utility. BPA's wholesale market purchase of in lieu resources during such period would not change the regional power supply. The resource the utility was delivering to BPA would be available to the wholesale market to replace the in lieu resources delivered by BPA.

It is somewhat ironic that Puget's comments fail to note that BPA is effectively limited to wholesale purchases of generation by the Northwest Power Act. BPA may not own new generation. The Northwest Power Act clearly specifies in section 1(a)(1) that "Acquire" and "acquisition" shall not be construed as authorizing the Administrator to construct, or have ownership of, under this chapter or any other law, any electric generating facility.

This limitation basically means that BPA can only make acquisitions as a wholesale purchaser.

Decision

BPA will publish an In Lieu Power Policy identifying the provisions for acquisition and delivery of such power including the sources of power acquired by BPA in lieu of power offered by a utility under an RPSA. Procedures for developing the expected costs of In Lieu Power, and the minimum period of advance written notice that BPA will provide of its election to acquire In Lieu Power, and the minimum period the utility will have to determine whether it will accept delivery of In-Lieu PF Power.

Issue

Whether the cost of in-lieu power acquisition must be calculated as the actual cost incurred by BPA to acquire and deliver in-lieu power in the shape and amount of the residential load for which BPA is acquiring the in-lieu power.

Parties' Positions

Puget argues that BPA's cost of in-lieu power acquisition for purposes of the RPSA must be the actual cost incurred by BPA to acquire and deliver in-lieu power in the shape and amount of the residential load for which BPA is acquiring the in-lieu power. Puget, IOURESEXC:018. Other IOUs and Commissions generally agreed.

BPA's Position

An in-lieu transaction is authorized and will be considered based on an initial comparison between ASC and the expected cost of the in-lieu resource delivered to BPA's system. Since the utility is not actually required to accept In Lieu PF Power that BPA notifies a utility it intends to make available by the purchase of in lieu resources, it would not be reasonable to require the purchase of those resources BPA at the time it sends its notice of its intent to acquire in lieu resources. At this stage, as detailed above, an assessment of the economic viability of the transaction based on total transaction costs will be used to determine whether conducting the in-lieu transaction would be prudent.

Evaluation of Positions

Puget has stated that the cost of in lieu power acquisitions must be based on the actual cost incurred by BPA to acquire and deliver in-lieu power in the shape and the amount of the residential load for which BPA is acquiring the in lieu power. PSE, IOURESEXC:018. Puget asserts that cost estimates are not reasonable. In essence, any disagreement seems to center on at what point the assessment of cost of acquisition including transmission costs enters into the decision of whether or not to effect an in lieu transaction.

BPA is required to notify the utility of the cost of the In Lieu Power that will be delivered through the acquisition of in lieu resources in its notice to the customer of the transaction. It would be impossible for BPA to notify the utility of its actual costs before those costs are incurred. *See* Section 7(b) of RPSA. Since the utility has a choice whether or not to accept the delivery, it would not be reasonable to require BPA to acquire the power and then have the utility decline to accept the delivery.

Section 5(c)(5) of the Northwest Power Act states:

> Subject to the provisions of section 839b and 839d of this title, in lieu of purchasing any amount of electric power offered by a utility under paragraph (1) of this subsection, the Administrator may acquire *an equivalent amount of electric power from other sources to replace power sold to such utility* as part of an exchange sale if the cost of such acquisition is less than the cost of purchasing the electric power offered by such utility.

16 U.S.C. §839c(c)(5) (emphasis added). Puget appears to argue that the statute requires BPA to acquire exactly the same amount of power sold to the utility. Puget's result is neither required by the statute or a practical proposal

BPA has proposed to develop procedures for determining the expected costs of In-Lieu Power in its In Lieu Power Policy. The expected costs shall consist of BPA's forecast of the wholesale power costs of supplying In-Lieu Power to the delivery point in the amount and in the shape identified in the in lieu notice. *See* Section 7(b)(3) of RPSA. Such

expected costs include the cost of transmission and losses to integrate the power into the BPA system, to the extent they are incurred, the costs of power shaped to meet a uniform percentage of diurnally differentiates monthly amounts of Residential Load, the costs of additional operating reserves if such reserves are required by the Western Systems Coordinating Council procedures, the cost of the transmission component of the customer's ASC, and the costs BPA incurs to deliver the power to the transmission system connected to the distribution system in the Jurisdiction that is subject to the in lieu notice. *See* Section 7(b)(3), section 7(d), and section 7(f) of the RPSA.

BPA, in developing its cost estimate, must identify the period of the in lieu delivery, determine the shape of the exchange sale to be made to the utility, estimate the cost of the resources and transmission necessary to deliver the power to the utility, and estimate the cost of the power offered by the utility. All of these costs are estimates of future costs of forecasted loads. BPA has developed a methodology that identifies an equivalent amount of resources to power offered by the utility and a reasonable estimate of the costs that BPA will incur to make the sale. BPA must then determine if it is a prudent business decision to incur the costs of the in lieu resource instead of paying the costs of the power offered by the utility.

Decision

BPA has proposed a reasonable method for determining if the cost of acquiring an equivalent amount of electric power is less than the cost of purchasing power offered by the utility.

IX. LOAD FORECASTS AND IN-LIEU SALE AMOUNTS

Issue

Whether a utility, by means of a continuing over-forecast of loads, might receive excess in-lieu power that could be spread beyond the utility's eligible residential and small farm loads or sold on an open market, thereby creating a net gain to the utility.

Parties' Positions

Whatcom suggests that a jurisdictional utility receiving in-lieu power could continually over-forecast loads using excess in-lieu power to serve non-qualifying customers, making it problematic that benefits from an in-lieu transaction will be passed through to eligible consumers. Whatcom County PUD, IOURESEXC:022. Whatcom makes two recommendations. First, Whatcom suggests that the pass-through of in-lieu power not be "subject to review by the applicable State regulatory authority." Id. Second, Whatcom suggests that the monetary value of an over-delivery of power be credited to an account used for reducing the cost of power for the receiving utility's residential and small farm customers or, if the utility is receiving in-lieu power for its entire eligible load, that the amount be debited as an adder to the amount owed by the utility for the in-lieu power. *Id*.

BPA's Position

Both section 5(c)(3) of the Northwest Power Act and the RPSA, which defines the process and obligations of program participation in Section 10(b), require that benefits be passed through the participating utility's eligible customer load. 16 U.S.C. 839c(c)(3). In addition, the 1984 ASC Methodology, which is the rule under which the REP is administered, provides BPA the opportunity to closely examine the reasonableness of assumptions used in load forecasts that would become the basis for a decision to provide power in-lieu of monetary benefits. In addition, BPA may elect what percentage of a utility's eligible load it elects to serve with in lieu resources. If BPA thinks the utility's forecast overstates their load, BPA could elect to purchase in lieu resources for less than 100% of the load and continue to make cash payments based on the actual loads that appear for the remaining amount of the forecast load. Further, the RPSA incorporates not only a requirement that benefits flow through the utility only to its qualified load, but a method of ensuring that the obligation is met.

Evaluation of Positions

Whatcom correctly notes that " . . . an actual In-Lieu power sale is a different transaction than a mere pass-through of monetary benefits." However, Whatcom goes on to argue that " . . . a jurisdictional utility receiving In-Lieu power from BPA could continually over-forecast and use excess In-Lieu power received to serve non-qualifying customers." Section 5(c)(3) of the Northwest Power Act states, in part, that Residential Exchange Program benefits must " . . .be passed through directly to . . . [the] utility's residential loads . . ." Section 10(b) of the RPSA requires that " . . . monetary amounts received by [the utility] from BPA under this agreement shall be passed through, in full by jurisdiction, to each residential and small farm consumer . . ." and that in-lieu power " . . . shall, subject to review by the applicable State regulatory authority, be passed through in full . . .." Clearly, a utility participating in the Residential Exchange Program is required by both law and contract to pass all benefits through to the eligible residential and small farm load of the utility.

While Whatcom correctly notes that an in-lieu power sale is a different transaction than a pass-through of monetary benefits, Whatcom may not have considered how that difference necessitates a different method of benefit distribution. Section 10 of the RPSA, entitled "Pass-through of Benefits," describes at length how monetary benefits are to be treated, characterized, held and distributed. Monetary benefits must be distributed in a timely manner. The funds must be held as restricted funds in an interest bearing account, the monies may not be pooled with other funds for investment purposes and they may not be used for the working capital needs of the utility. Further, the funds may not be considered as revenue, expense, or cost, or used in establishing the revenue requirement of the utility. Each of these measures is intended to assure that monetary benefits, based on the monthly metering and invoicing of eligible loads, flow through the utility in a timely manner undistorted by the utility or the regulatory process.

However, the provision of power rather than dollars cannot be removed from the utility's planning and ratemaking processes. While a flow of segregated funds based on historic meter readings can be addressed as an arms-length administrative process, the receipt of energy over a period of time, which will displace other resources presumed to have been available, must be incorporated into the ongoing operations of the utility. Some discretion must be provided a regulatory authority to plan for the receipt and use of the in-lieu power as well as the allocation of the benefit derived from that power, to the residential and small farm customers of the utility. Again, any abuse of such discretion would be a violation of law and of the contract governing participation in the REP.

Whatcom's use of the word "continually," regarding load forecasts used to determine the amount of in-lieu power to be provided, implies an ongoing and often repeated process that may be slanted in a manner that would provide benefits greater than would otherwise have been received. Such is not the case. Section 7(b)(2) of the RPSA states, in part, that "[t]he monthly amounts of In-Lieu PF power shall be based on forecasts of <<Customer Name's>> Residential Load for any Jurisdiction using the then current Appendix 1 filing under this Agreement or final ASC determination under this Agreement." Therefore, the load forecasts on which the delivery of in-lieu power must be based are the load forecasts used by the utility to determine the rates and construct the tariffs under which it will provide service to its customers. Such forecasts will be amended only when the utility completes an analysis that has been reviewed and approved by its regulatory authority indicating that its then current rate structure will not meet expected changes in costs and/or loads and a change in retail rates has been approved. At that time, the utility will be required to file a new ASC submission, which must including the load forecasts on which retail rates were based. BPA will have one hundred and thirty five days (135) to question and consider the reasonableness of the loads used by the utility in establishing retail rates. Section III (D)(4)(a) of the 1984 ASC Methodology provides that "[a]ny challenge to the Contract System Load used by the Utility in computing ASC may be raised at this time only [the 135th day of ASC Review], and only by BPA."

Therefore, should BPA make an election to provide power equal to the utility's entire eligible load, the decision must be based on an examination and approval of load forecasts already subject to the "Jurisdictional Cost Approach," which is the starting basis, subject to BPA review, of costs and load used in ASC determinations. *See generally* 1984 ASC Methodology, Section 4. If in-lieu power is provided for an amount less than the entire load, Sections 8(a),(b), and (c) of the RPSA require that the benefit due each month be calculated, billed and settled, based on the total benefit less any amounts of in-lieu power that have been provided. If BPA felt the load forecasts used by the utility to establish their jurisdictional rates overstated the actual amount of residential and small farm load, BPA can elect to purchase in-lieu resources for less than 100% of the eligible load.

Decision

The law, contracts and rules that implement the REP require that Program benefits be passed in full only to a participating utility's eligible residential and small farm

consumers. Under these directives, BPA has sufficient authority to ensure that benefits received by the utility are properly allocated to eligible consumers.

X. EXCEPTIONS TO SECTION 5(c) LIMITATIONS

Issue

Whether there are any exceptions under the Northwest Power Act to provisions of section 5(c)(6) that provide that exchange sales to a utility under section 5(c) shall not be restricted below the amounts of power acquired from, or on behalf of a utility, under section 5(c).

Parties' Positions

PacifiCorp, the OPUC, the WUTC, Puget, and PGE commented that they found no exceptions in the statute to the limitations in section 5(c)(6) that preclude the restriction of exchange sales.

BPA's Position

BPA believes there are no exceptions to the limitations in section 5(c)(6) that preclude restriction of exchange sales.

Evaluation of Positions

Section 9(c) of the Northwest Power Act requires BPA to consider the export of resources by customers "in making any determination, under any contract executed pursuant to section 5". *See,* 16 U.S.C. 839f(c). In the development of BPA's 5(b)/9(c) Policy, BPA noted that the policy would apply to determinations made under section 5(b) of the Northwest Power Act. *See,* Section IV.C. of the 5(b)/9(c) Policy. BPA stated that any determinations under section 5(c), 5(d), or 5(f) would be made on a case-by-case basis. *Id.* BPA did not include any provisions regarding the use of regional resources in its proposed RPSA. The decision not to include provisions regarding the use of regional resources in the final RPSA is a BPA determination that there are no exceptions to the limitations on restrictions of exchange sales contained in section 5(c)(6). *See,* Administrator's Record of Decision on 5(b)/9(c) Policy, at p. 132.

PacifiCorp commented that section 5(c)(6) provides that the amount of power sold to an IOU shall not be less than the amount of power acquired from a utility under section 5(c) (or, in the alternative, acquired by BPA under section 5(c)(5)). *See,* PacifiCorp at 3. PacifiCorp notes that the express limitation in section 5(c)(6) would preclude any application of the language in section 9(c) to require a lowering of the amount of an exchange sale below the sale amount under section 5(c). *Id.*

Decision

Exchange sales under section 5(c) are not subject to restriction due to the operation of section 9(c).

XI. AVAILABILITY OF RPSA TO CONSUMER-OWNED UTILITIES

Issue

Whether the proposed RSPA prototypes are available to publicly-owned utilities.

Parties' Positions

While SUB believes the RPSA is generic enough to be used as a starting point for consumer-owned utilities, SUB believes these prototypes may need to be modified for consumer-owned utilities. SUB, IOURESEXCH:003

BPA's Position

BPA believes the RPSA prototypes will be applicable to all utilities that apply for the REP. BPA will modify any provision that is not applicable to a particular utility.

Evaluation of Positions

SUB has observed that

> "[w]hile much of the focus of the agreements has been directed at contractual relationships between BPA and investor owned utilities that have historically participated in the exchange, SUB is pleased that the contracts are, for the most part, generic enough such that qualifying consumer owned utilities who have not participated in the exchange may use the prototypes as a starting point should they desire a RPSA with BPA in the future."

However, SUB also notes that there may be areas of difference:

> "One area of the contract which is not applicable to consumer-owned utilities is language in the agreements which refer to how the benefits are transferred to residential customers. Springfield Utility Board, for example, is self-regulated by elected board members. How exchange benefits are distributed to residential customers should be the purview of the board. In addition, many of the modifications identified in the contract prototype are labeled "modified for IOUs". These modifications may not be applicable to consumer-owned utilities. Also, different modifications may be required for consumer-owned utilities, such as the definition of "Jurisdiction" in the draft RPSA (since a state commission does not approve SUB's retail rates)."

BPA believes the prototypes have been drafted to meet the needs of consumer-owned utilities. The section on pass-through of benefits refers to the applicable State regulatory authority. BPA recognizes the preference customer governing body as the applicable State regulatory authority where utilities are self-regulated under State law. *See,* Section I.K of the 1984 ASC Methodology. In the section on "Jurisdiction", the prototype uses the definition of State commission found in the ASC methodology. The ASC Methodology explicitly recognizes the authority of preference utility governing bodies in some states to approve retail rates.

Decision

BPA will use the prototypes as modified based on comments as the basis for all contracts under the REP. BPA will retain the flexibility to modify any provision that is not applicable to a particular utility.

XII. SECTION BY SECTION DESCRIPTION OF PROTOTYPE RPSA

The following section generally describes the component parts of the RPSA. The RPSA prototype is attached as Appendix A.

A. Section 1 – Term

This section provides that the RPSAs will extend until a date selected by the customer that cannot exceed September 30, 2011. New RPSAs can start as early as July 1, 2001, unless a customer has settled its rights to the REP for any period after that date.

B. Section 2 – Definitions

This section identifies standard defined terms used throughout the agreement.

C. Section 3 – Applicable PF Rate

This section identifies the PF rate applicable to the REP (PF Exchange Program rate). The section also provides a commitment not to change the initial rate approved by FERC on a final basis for a five-year period except as provided in the applicable rate schedule.

D. Section 4 – Establishment of ASC to Activate Agreement

This section establishes a requirement for a customer to file a new Appendix 1 under the ASC Methodology to activate its participation for any Jurisdiction. An Appendix 1 filing is the document that a customer files to initiate the process to establish a final ASC under the ASC Methodology. Customers may participate under the RPSA on a Jurisdiction by Jurisdiction basis. This section describes the purposes of sections 5, 6, and 7 under the agreement.

E. Section 5 – Offer by Customer and Purchase by BPA

This section describes the amount of power sold by the customer to BPA at its ASC. Amounts sold by the customer are limited to residential and small farm loads actually served by the customer. Customers must be authorized under State law or by order of the applicable State regulatory authority to serve such residential and small farm loads. Customers may participate on a Jurisdiction by Jurisdiction basis. Once a customer has initiated participation in the RPSA for any Jurisdiction, their participation in the REP for all residential and small farm load they serve in such Jurisdiction is governed by the terms of the Agreement for its remaining term. This section also authorizes a customer to propose agency agreements to BPA whereby they offer power for sale on behalf of residential and small farm loads for another utility subject to BPA's approval of the agreement including whether use of the customer's ASC is appropriate for such other utility.

F. Section 6 – Sale by BPA and Purchase by Customer

This section describes BPA's sale of power at the PF Exchange Program rate when the Agreement is operating to provide monetary benefits.

G. Section 7 – In-Lieu Transactions

This section contains a number of subsections describing BPA's right to purchase power in lieu of purchasing power from the customer at its ASC. BPA has agreed to develop an In-Lieu Policy that identifies the provision for acquisition and delivery of the power acquired by BPA including the sources of power acquired by BPA and procedures for developing the expected costs of In-Lieu power. The minimum period of advance written notice that BPA will provide of its election to acquire In-Lieu power and the minimum period the customer will have to determine whether to accept In-Lieu PF power. BPA's sale under the provisions of this section substitutes for that amount of load exchanged under the provisions of sections 5 and 6. This section includes reasonable terms and conditions allowing BPA to issue an in-lieu notice based on a forecast of the customer's residential and small farm load and the wholesale cost of other sources of power delivered to the customer in-lieu of purchasing the customer's power at its ASC. In-lieu deliveries must be made based on forecasted amounts of load instead of metered quantities. Use of forecasts is required to meet standard industry scheduling requirements and to reflect the standard industry practice of not measuring the actual amounts of a customer's residential and small farm load on an hourly basis. If BPA provides service under an in-lieu notice for a greater amount of residential and small farm load than the customer ultimately serves, BPA will deliver that power in accordance with its in lieu notice, i.e., the customer keeps the "excess". Any amounts of customer load not served by BPA's in lieu notice will receive monetary benefits under sections 5 and 6.

H. Section 7(a) – BPA's Right to In-Lieu

This section describes BPA's right to issue an in-lieu notice. BPA may base its in-lieu notice on an Appendix 1filing by a customer or a final ASC.

I. Section 7(b) – In-Lieu Notice

BPA may choose to use in-lieu power by providing a customer written notice for a period established in the In-Lieu Power Policy that will not be less than 90 days. This section describes the information BPA must include in its in-lieu notice.

J. Section 7(b)(1) – Source(s) of In-Lieu Power

This section describes the sources that BPA can use to acquire in-lieu power. Such sources will be defined in the In-Lieu Power Policy.

K. Section 7(b)(2) - Amount of In-Lieu PF Power

This section describes how BPA calculates the amount of power BPA provides at the PF Exchange Program rate under an in-lieu notice. BPA must issue in-lieu notices for a uniform percentage of diurnally differentiated monthly amounts of the customer's forecasted residential and small farm load.

L. Section 7(b)(3) – Expected Cost of In-Lieu Power

This section describes how BPA will identify the expected cost of the in-lieu power BPA acquires to deliver PF power to the customer. Since a customer is not required to take the in-lieu power, these costs must be forecasted. Customers must use BPA's identification of expected cost to decide whether to accept the delivery, reduce their ASC to BPA's expected cost of in-lieu power, or suspend their participation in the RPSA for the duration and amount of load specified in the in-lieu notice. BPA will include procedures on how such expected costs are developed in its In-Lieu Power Policy.

M. Section 7(b)(4) – Term and Quality of the In-Lieu PF Power Sale

This section specifies that In-Lieu PF Power will be a firm power delivery. BPA must issue in-lieu notices for contract years for a period of one-year or multiples thereof. The one-year period reflects the annual calculation of a customer's ASC placing the seasonal costs of the in-lieu power on the same basis as the customer's resources.

N. Section 7(c) – Customer Election to Either Receive in-Lieu PF Power or Reduce ASC

This section gives the customer a minimum period to determine whether to accept the In-Lieu PF Power and market its resources in the wholesale market or elect to continue the monetary exchange by reducing its ASC. The minimum periods will not be less than

fifteen days and shall be developed in the In-Lieu Power Policy. If the expected cost of the In-Lieu PF Power is below the PF Exchange Program rate, a customer may suspend its participation in the RPSA for the duration for all or a portion of the load specified in the notice. Under such circumstance, suspension of a customer's participation in the RPSA for power specified in an in-lieu notice would reduce the amount that would otherwise be debited to the customer's payment balancing account. The payment balancing account limits future benefits paid under the RPSA. Allowing a customer to suspend a portion of the load specified in the in lieu notice allows a customer to reflect reductions in the amount of its residential and small farm load from the amount it forecast at the time of its Appendix 1 filing.

O. Section 7(d) – Delivery and Payment for In-Lieu PF Power

This section describes BPA's delivery obligation for In-Lieu PF Power. BPA must select the point or points of delivery for the in-lieu power in its in-lieu notice in accordance with this section.

The section also specifies the customer's payment obligation for the in lieu power. Customers must pay for In-Lieu PF Power that BPA makes available. Customers must pay for In-Lieu PF Power they fail to schedule. BPA has agreed to continue payment of the transmission component of the ASC during In-Lieu PF Power deliveries. This payment minimizes the financial impact of in-lieu purchasing by BPA on the utility's residential and small farm consumers.

P. Section 7(e) – Scheduling of In-Lieu PF Power

This section describes the customer's obligation to preschedule amounts of In-Lieu PF Power. BPA has no obligation to deliver unless the customer submits a preschedule.

Q. Section 7(f) – Shaping of In-Lieu PF Power

This section describes how the monthly and hourly shape of the deliveries of In-Lieu PF Power are determined. These shapes will be based on customer forecasts that are provided by the customer at the same time as the customer's Appendix 1 filings. This section provides a default mechanism for determining the shape of the customer's residential and small farm load if the customer fails to provide a forecast.

R. Section 8 – Billing and Payment

This section describes the billing and payment mechanism for the monetary benefits and deliveries of In-Lieu PF Power. The section describes how the amount of residential and small farm load is determined on a monthly basis. It describes how and when BPA pays the customer if BPA owes the customer money. It also describes BPA's standard payment provisions if the customer owes BPA for In-Lieu PF Power. The section also requires customers to provide BPA with commercially reasonable credit information.

BPA may require customers to place any benefits received from BPA in an escrow account if they fail to meet BPA's credit standards.

S. Section 9 – Accounting, Review, and Budgeting

This section requires customers to retain their records documenting implementation of the RPSA. The section grants BPA the right to review and inspect these records. BPA may then take actions consistent with the results of such review and inspection. If BPA determines that any payments were improper, the customer is required to return the overpayment. If BPA determines that payments were not made by BPA, BPA will provide additional benefits. Any disputed payments will be treated under the disputed bill provisions.

T. Section 10 – Pass Through of Benefits

This section requires the customer to pass through the benefits it receives under this Agreement in full to each residential and small farm consumer as a credit on their power bill. The customer is precluded from including Program benefits in its retail ratemaking. Customers are required to pass through the benefits in a timely manner and keep the benefits in a separately identified interest bearing account. The section also includes a savings clause ensuring that nothing in the Agreement suggests the power must be directly delivered to individual consumers or that the customer is required to provide any retail wheeling.

U. Section 11 – Termination of Agreement

This section implements the customer's statutory right to terminate the Agreement if BPA develops new rates and applies a supplemental charge to the PF Exchange Program rate pursuant to section 7(b)(3) of the Northwest Power Act. The section also provides that either party may terminate the Agreement if the ASC Methodology is modified.

V. Section 12 – Payment Balancing Account

This section implements the provisions of the deemer account from the 1981 RPSA. BPA will not make cash payments under the RPSA until any amounts in the payment balancing accounts have been paid. Two payment balancing accounts are established: a long-term payment balancing account and an annual payment balancing account. The annual account does not charge interest on amounts debited to the account. This prevents a reduction in benefits under the Agreement that could occur when comparing a single annual ASC rate against BPA's twelve monthly seasonally differentiated PF Exchange Program rates. Any amounts carried over from the previous Agreement and any amounts added under this agreement for a period of more than one year accrue interest in the long-term payment balancing account.

W. Sections 13-16, 18, and 20 – Standard BPA Subscription Provisions

These sections are standard BPA Subscription provisions addressing notice, cost recovery, uncontrollable forces, governing law and dispute resolution, contract administration, and signatures.

X. Section 17 – Statutory Provisions

This section includes BPA's standard statutory provisions for Subscription contracts on annual financial reporting and retail rates, insufficiency and allocations, new large single loads, priority of Pacific Northwest customers, prohibition on resale, and BPA Appropriations Refinancing Act. The provision on insufficiency and allocation has been modified for the RPSA. It provides that In-Lieu PF Power may not be restricted during the term of an in-lieu notice.

Z. Section 19 – Notice Provided to Residential and Small Farm Consumers

This section requires the customer to include a notice on the consumer's bill that benefits under the RPSA are "Federal Columbia River Benefits supplied by BPA".

AA. Exhibit A – Residential Load Definition

This exhibit describes how residential and small farm loads are identified.

BB. Exhibit B – Load Factor Specification

This exhibit describes how monthly energy loads receive a load factor for purposes of applying the demand charge in the PF Exchange Program rate.

CC. Exhibit C – New Large Single Loads

This exhibit identifies any New Large Single Loads of the customer. The cost of resources to serve these loads are excluded from a customer's ASC. The provision requires the utility to provide information regarding its post Northwest Power Act loads upon execution of the Agreement.

DD. Exhibit D – Average System Cost Methodology

This exhibit attaches the current ASC Methodology for ease of reference. The ASC Methodology is a BPA rule and not a part of the contract.

EE. Exhibit E – Scheduling Provisions

This exhibit includes BPA's standard scheduling provisions for scheduling In-Lieu PF Power.

XIII. SECTION BY SECTION COMMENTS

Issue

Whether the term of the RPSA should be modified to recognize the possibility of termination under Section 11 of the RPSA.

Parties' Positions

Avista and Puget argue that Section 1 regarding the term should reflect the possibility of termination pursuant to Section 11. Avista, IOURESEXC:001; Puget, IOURESEXC:018. Puget also maintained that this section should indicate that, notwithstanding termination or expiration, all liabilities incurred under the Agreement continue until satisfied. Puget, IOURESEXC:018.

BPA's Position

BPA does not agree that the entire agreement should terminate upon confirmation an approval of new rates by FERC including a supplemental rate charge under section 7(b)(3) of the Northwest Power Act. BPA does not believe the language stating that all liabilities incurred under the Agreement shall continue until satisfied is legally necessary.

Evaluation of Positions

Puget and Avista proposed that the entire Agreement should terminate if a utility exercises its right to terminate its rights for a Jurisdiction under Section 11. Avista, IOURESEXC:001; Puget, IOURESEXC:018. Section 11 provides for the termination of the purchase and sale under the Agreement if a supplemental rate charge developed under section 7(b)(3) of the Northwest Power Act is applied to the PF Exchange Rate and the rate exceeds the utility's ASC.

BPA does not believe the entire Agreement should terminate if Section 11(a) is triggered. Such termination may be implemented by Jurisdiction such that the Agreement is terminated in one Jurisdiction and is still in effect in another Jurisdiction. BPA found the language proposed by Puget and Avista to be confusing.

BPA believes that any liabilities incurred under this Agreement continue until satisfied notwithstanding the termination or expiration of the Agreement. BPA does not believe adding a clause to that effect clarifies the Agreement.

Decision

BPA will not add a termination provision to the "Term" section of the Agreement or a clause regarding the satisfaction of liabilities upon expiration of the Agreement.

Issue

Whether additional terms should be added to the definitions in Section 2 of the RPSA or whether any of the proposed definitions should be modified.

Parties' Positions

Avista proposed the following changes to the definitions section:

1. The Agreement should explicitly state that no revision of the Wholesale Power Rate Schedule(s) or General Rate Schedule Provisions ("GRSPs") during the term of the Agreement shall apply unless customer gives written consent.
2. The "Cost of In-Lieu-Power" is a key concept and should be included in the definitions.
3. The "GRSPs" for FY 2002-2006 should be those established in WP-02, and should for FY 2007-2011 be those that are adopted in another BPA power rate case and that are similar in scope to the 2002-2006 GRSPs, so that it is clear which GRSPs apply during which period.
4. The "In-Lieu PF Power" should be identical in shapes and delivery periods to Residential Load.
5. The "In-Lieu Power" should be only power that meets the requirements of Northwest Power Act section 5(c)(5). The definition of this term should be established in a notice and comment proceeding.
6. The "Transmission Component of ASC" should be defined so that it can be properly reflected in the event BPA acquires in-lieu power.

Avista, IOURESEXC:001. Puget supported numbers 2, 4, and 5. Puget, IOURESEXC:018.

BPA's Position

The definitions as modified by BPA in response to comments are adequate, in conjunction with this ROD and relevant rate schedules, to reasonably implement the contract.

Evaluation of Positions

Puget and Avista believe the Agreement should explicitly state that no revision of the Wholesale Power Rate Schedule(s) or General Rate Schedule Provisions ("GRSPs") during the term of the Agreement shall apply unless the customer gives written consent. Puget, IOURESEXC:018; Avista, IOURESEXC:001. Puget and Avista also proposed that the "GRSPs" for FY 2002-2006 should be those established in BPA's 2002 power rate case and for FY 2007-2011 should be those that are adopted in another BPA power rate case and that are similar in scope to the FY 2002-2006 GRSPs, so that it is clear which GRSPs apply during which period. *Id*. BPA believes the wholesale power rate schedules and GRSPs are rate provisions that must be developed in a section 7(i)

administrative rate hearing. These provisions cannot be made subject to written customer consent without depriving other customers of their right to comment on these issues in the section 7(i) proceeding.

Puget and Avista believe the "Cost of In-Lieu-Power" is a key concept and should be defined in the Agreement. Puget, IOURESEXC:018; Avista, IOURESEXC:001. Puget and Avista also proposed that BPA address issues regarding the sources and cost of in lieu power purchases in an In Lieu Power Policy. *Id*. BPA has modified Section 7 of the Agreement to provide that the expected costs of in lieu power shall be developed in accordance with procedures developed in an In Lieu Power Policy. BPA has also modified the definition of In Lieu Power to establish the provisions for acquisition and delivery in an In Lieu Power Policy.

Puget and Avista propose modifying the definition of "In-Lieu PF Power," requiring that such power be identical in shapes and delivery periods to Residential Load. Puget, IOURESEXC:018; Avista, IOURESEXC:001. Issues regarding in-lieu transactions are addressed in earlier sections in this ROD and in response to comments in Section 7 below and will be fleshed out further in the planned public process on in-lieu practice and policy. No further refinement through definitions is necessary. BPA has similarly addressed the calculation of the in-lieu transaction costs.

Decision

BPA accepted some proposed changes to the definitions proposed by Puget and Avista. BPA defined "Diurnal", deleted the definition on "Prior RPSA" as superfluous, clarified the definition of "Residential Load", and included a definition for the "Transmission Component of ASC".

Issue

Whether Section 5 of the RPSA should be modified to expressly state that the ASC for load reductions pursuant to Section 7 are deemed equal to the greater of the PF Exchange Rate or the cost of In-Lieu Power.

Parties' Positions

Puget and Avista propose that Section 5 expressly state, with respect to in-lieu power equivalent to the amount, if any, of Residential Load for which customer has reduced ASC pursuant to section 7(c), that the ASC is deemed equal to the greater of the PF Exchange Rate or the Cost of In-Lieu Power. Puget, IOURESEXC:018; Avista, IOURESEXC:001.

BPA's Position

BPA included language in Section 7(c) clarifying that amounts of power suspended under Section 7(c) will not result in additions to the utility's payment balancing account under Section 12.

Evaluation of Positions

Puget and Avista were concerned that if a customer elected to suspend its participation in the RPSA pursuant to Section 7(c), they would build up a balance in their payment balancing account under Section 12. Puget, IOURESEXC:018; Avista, IOURESEXC:001. They proposed deeming their ASC equal to the greater of the PF Exchange Rate or the cost of in-lieu power if they elected to suspend under Section 7(c). *Id*.

Section 7(c) of the RPSA provides a contract right allowing a utility to reduce its ASC to the expected cost of In Lieu Power that BPA specifies in an in lieu notice. This contract right allows a utility an option to reduce its benefits under the RPSA instead of taking power from BPA at the PF Exchange Rate. Section 7(c) provides the utility a further right to suspend participation in the RPSA for the duration of the in lieu notice for the amount of power that BPA proposes to serve with In Lieu PF Power if the expected cost of the in lieu power is less than the PF Exchange Rate.

BPA included contractual language stating that the amounts of power suspended would not be included in the payment balancing account. Absent the language clarifying this intent, the contract could have been read to require a debit to be made to the payment balancing account when the customer reduced its ASC below the PF Exchange Rate. BPA's inclusion of language clarifying the application of the suspension provisions clarifies that the payment balancing account of Section 12 is only applicable when the utility's ASC is below the PF Exchange Rate, not when BPA expects to acquire In Lieu Power and a utility elects to reduce its ASC instead of accepting delivery of the In Lieu PF Power.

Decision

BPA will include language clarifying that amounts of power suspended under the provisions of Section 7(c) will not result in debits to the payment balancing account in Section 12.

Issue

Whether BPA's right to purchase In Lieu Power should be contractually limited to a uniform fraction of Residential Load for each hour.

Parties' Positions

Puget and Avista proposed a contractual provision in Section 7(a) contractually limiting an in lieu purchase to be an amount of In-Lieu Power that is a uniform fraction of Residential Load for each hour. Puget, IOURESEXC:018; Avista, IOURESEXC:001. Their comments to Section 7(b)(2) propose that the amount of In-Lieu PF Power be determined for each hour based on a customer forecast that may be adjusted each hour up to 30 minutes prior to the commencement of the hour without any review of the customer forecast. *Id*. Their comments on Section 7(f) propose that the shape of the In Lieu PF Power delivery be based on estimated amount of Residential Load that may be revised no later than 30 minutes prior to the hour. *Id*.

BPA's Position

BPA proposed that the monthly amount of In-Lieu PF Power shall be based on the latest customer forecast of Residential Load used in an Appendix 1 filing or ASC determination. *See* RPSA, Section 7(b)(2). BPA may issue an in lieu notice for a percentage portion of the Residential Load. *Id.* BPA must deliver In Lieu PF Power to the customer for a Contract Year or multiples thereof. *See RPSA*, Section 7(b)(4). BPA will deliver In Lieu PF Power in monthly amounts based on the forecast supplied by the customer with its ASC filing shaped into diurnal HLH and LLH amounts.

Evaluation of Positions

Puget and Avista argued that this section should specify that in-lieu power is to be a uniform fraction of residential load for each hour. Puget, IOURESEXC:018; Avista, IOURESEXC:001. They argued that they should have the right to revise their forecasts 30 minutes prior to the hour. *Id*. In meeting this obligation, Puget argued that in-lieu power must be acquired by BPA only from output from newly-constructed resources, only in accordance with Sections 4 and 6 of the Northwest Power Act, only in full yearly periods (to avoid unfair in-lieu actions during only portions of a year when power is relatively inexpensive), only for periods of 5 or more years (which would promote the Northwest Power Act's objective of an adequate and reliable power supply), and only from output not needed to meet BPA's obligations to supply firm power. Puget, IOURESEXC:018. For various acquisitions of in-lieu power, the cost should be a weighted, levelized average cost of such acquisitions, to ensure fair treatment of all customers under RPSAs. *Id*.

BPA does not agree with Avista and Puget's position. Puget and Avista would have BPA make long-term acquisitions beyond the term of an in lieu notice to meet a one hour Residential Load peak hour of which they have given BPA 30 minutes notice. If BPA were to adopt the positions advocated by Puget and Avista, BPA would frustrate the intent of Congress that BPA be able to supply the exchange sales under section 5(c) of the Northwest Power Act at the lowest possible cost. Congress specified in section 5(c)(5) that "the Administrator may acquire an equivalent amount of power sold to such utility as part of an exchange sale if the cost of such acquisition is less than the cost of

purchasing electric power offered by the utility." 16 U.S.C. 839c(c)(5). Contrary to the positions advocated by Puget and Avista, Congress did not direct BPA to establish an average system cost for serving such exchange sales. Congress directed BPA to acquire an equivalent amount of power. BPA believes diurnally differentiated forecasts of Residential Load are equivalent to the amounts offered by the utility. These amounts approximate the equivalent wholesale purchase amounts of the utility's Residential Load. Puget and Avista would have BPA acquire more in lieu power than necessary to serve the exchange sales since they require long-term acquisitions to meet peak loads, yet they make no provision in their proposal for the surplus resources on the BPA system created by the in lieu resources siting idle for all hours except the peak hours.

Even the utility does not have more than a forecast of its Residential Load. Puget and Avista have proposed that they only provide an estimate of their Residential Load on any hour. Puget, IOURESEXC:018; Avista, IOURESEXC:001. Their proposal recognizes that they do not have hourly meters on their Residential Loads and do not know the actual hourly amount of those loads.

Decision

Section 7 will not be modified to require hourly amounts of In Lieu PF Power delivered in the shape of the Residential Load for each hour.

Issue

Whether BPA's right to purchase in lieu power should be contractually limited to (i) acquisitions made for 5 years or more; (ii) acquisitions only from the output of newly-constructed resources (including conservation) identified in the conservation and power plan developed pursuant to section 4 of the Northwest Power Act; or (iii) acquisitions that have not previously been identified in an in lieu notice for another utility.

Parties' Positions

Puget and Avista requested significant modification of Section 7, dealing with in lieu transactions. Puget, IOURESEXC:018; Avista, IOURESEXC:001. Their position is that in lieu power must be acquired from newly constructed resources and that once a resource has been used once for an in lieu acquisition, the output of that resource cannot be used again for that purpose under the Northwest Power Act unless the utility terminates the purchase of the in lieu resource under Section 11 of the RPSA.

BPA's Position

BPA will establish the source of In Lieu Power in an In Lieu Power Policy.

Evaluation of Positions

Puget and Avista argued that this section should specify that in-lieu power must be acquired by BPA only from output from newly-constructed resources, only in accordance with Sections 4 and 6 of the Northwest Power Act, only for periods of 5 or more years (which would promote the Northwest Power Act objective of an adequate and reliable power supply), only in the hourly shape of Residential Load, and only from output not needed to meet BPA's obligations to supply firm power. Puget, IOURESEXC:018; Avista, IOURESEXC:001.

To the extent the sources of in-lieu power are not specified in the Agreement to be output from new generating facilities, Avista maintained that the source of in-lieu power should be specified in the Agreement as those to be defined in an in-lieu power notice and comment proceeding. Avista, IOURESEXC:001.

Finally, Avista maintained that the same power should not be used by BPA in more than one in-lieu notice (consistent with the intent of the Northwest Power Act, as described above, that in-lieu acquisitions be from the output of newly-constructed resources that increase the region's power supply). Avista, IOURESEXC:001. Puget's comments essentially mirrored Avista's in all material respects. Puget, IOURESEXC:018.

BPA does not agree with Avista and Puget's position. The basis for BPA's disagreement, and the justification or its own position, is fully articulated elsewhere in the ROD. *See* section IX. In-Lieu Provisions. BPA did agree to establish the source of in lieu power in an In Lieu Power Policy.

Decision

Section 7 will not be modified as proposed by Avista and Puget. BPA will establish the source of In Lieu Power in an In Lieu Power Policy.

Issue

Whether the cost components of in-lieu power proposed by Puget and Avista should be adopted.

Parties' Positions

Puget and Avista requested significant modification of Section 7, dealing with the cost of in lieu transactions. Puget, IOURESEXC:018; Avista, IOURESEXC:001. They proposed requiring in lieu acquisitions to be made in the hourly shape of their residential load from newly constructed generation, that the costs of load following and other ancillary services be included in the cost of the in lieu acquisition, that the cost of the Transmission Component of ASC be added to the cost of the in lieu acquisition, and that the cost of in lieu power acquisitions be melded together with all other in lieu acquisitions on a monthly basis. *Id*.

BPA's Position

BPA disagrees with the suggested revisions. BPA has agreed to establish the expected cost of In-Lieu Power in accordance with procedures developed in an In Lieu Power Policy.

Evaluation of Positions

Puget and Avista argued that in-lieu power must be acquired by BPA only from output from newly-constructed resources in the hourly shape of their residential load, and only from output not needed to meet BPA's obligations to supply firm power. Puget, IOURESEXC:018; Avista, IOURESEXC:001.

To the extent the sources of in-lieu power are not specified in the RPSA to be output from new generating facilities, Avista maintained that the source of in-lieu power should be specified in the Agreement as those to be defined in an in-lieu power notice and comment proceeding. Avista, IOURESEXC:001. Moreover, the cost of in-lieu power should include load following, reserves and other ancillary services and should include the Transmission Component of ASC applicable to such amount of power, because in-lieu power acquisitions must fulfill the same functions as the utility's resources in ASC and are not in lieu of the transmission costs represented by the Transmission Component of ASC. *Id*. For various acquisitions of in-lieu power the cost should be a weighted, levelized average cost of such acquisitions, to ensure fair treatment of all customers under RPSAs. *Id*.

Finally, Avista maintained that the same power should not be used by BPA in more than one in-lieu notice (consistent with the intent of the Northwest Power Act, as described above, that in-lieu acquisitions be from the output of newly-constructed resources that increase the region's power supply). Avista, IOURESEXC:001. Puget's comments essentially mirrored Avista's in all material respects. Puget, IOURESEXC:018.

BPA does not agree with Avista and Puget's position. BPA has agreed to develop procedures for determining the expected costs of In Lieu Power in an In Lieu Power Policy.

BPA has agreed to include the Transmission Component of ASC multiplied by the amount of In Lieu Power and the cost of transmission on the BPA transmission system in its calculation of the expected costs of in lieu. BPA does not believe these payments are required by section 5(c)(5) of the Northwest Power Act. Section 5(c)(5) of the Act provides that "the Administrator may acquire an equivalent amount of power sold to such utility as part of an exchange sale if the cost of such acquisition is less than the cost of purchasing electric power offered by the utility." 16 U.S.C. 839c(c)(5). In other words, BPA need only include the costs of BPA's acquisition of the in lieu power. This means that once BPA has acquired the power into BPA' system, there is no further transmission component to include. The statute does not require BPA to consider the cost of

transmission on the utility's system or the cost of transmission across BPA's system when making that decision. Nevertheless, BPA has included the "Transmission Component of ASC" and the cost of transmission on BPA's system to minimize the impact on the residential and small farm consumers of exchanging utilities when BPA makes a decision to acquire in lieu power. Without BPA's proposed payment of the Transmission Component of ASC, the consumers of the utility would lose the benefits provided by the transmission component of the utility's ASC under the REP even when the cost of In-Lieu Power was the same as a utility's ASC. BPA has included the cost of transmission on the BPA transmission system since it is prudent for BPA to consider this cost when deciding whether to acquire in lieu power as long as the cost of transmission is included in the PF Exchange Rate.

BPA currently includes the utility's cost of transmission in the 1984 ASC Methodology. Transmission costs were originally included in ASC Methodology because they were included in BPA's power rates. Because those costs were included in the exchange sales, it seemed fair to include those costs in the average system cost of the purchase. BPA has recently unbundled its transmission rates from its power rates. BPA has previously raised the issue whether transmission costs should be part of a utility's ASC and would expect to address this issue in any revisitation of the ASC Methodology. BPA would also revisit at that time whether the Transmission Component of ASC would be included in the expected cost of In-Lieu Power. Section 11(b) of the Agreement provides that either party may terminate the RPSA if the ASC Methodology is revised.

Decision

Section 7 will be modified to include consideration of the Transmission Component of ASC. Other procedures for determining the expected costs of In Lieu Power will be developed in an In Lieu Power Policy.

Issue

Whether Section 14 should be amended to include protection against any cost underrecovery charge.

Parties' Positions

Puget argues that the "RPSAs should include any protection against any power cost under-recovery charge afforded other BPA customers." Puget, IOURESEXC:018. Puget further elaborates on its proposal to preclude the use of cost underrecovery charges for establishing payments in the payment balancing account, conditioning the application of a cost recovery adjustment clause on uniform adjustments to all other power rates, including a most favored nations clause regarding any provision in any other power sales contract impacting cost underrecovery adjustment clauses, and allowing all rates to be adjusted for costs functionalized to transmission that FERC ultimately determines are power costs. *Id*.

BPA's Position

BPA has included a standard cost recovery provision in every power sales contract. The establishment of such charges and their application are established in BPA's section 7(i) rate hearings and in applicable rate schedules.

Evaluation of Positions

BPA has developed a standard cost recovery provision for all of its customers. That provision is included in the RPSA. *See* Section 14 of the RPSA.

Puget has asked that BPA not include the application of cost recovery adjustment clauses when determining whether a debit is required in the payment balancing account. Puget, IOURESEXC:018. The purpose of the payment balancing account in Section 12 is to defer payments that a utility would otherwise make to BPA under the REP when a utility's ASC was below BPA's PF Exchange Rate. While BPA has agreed that debits should not be made in that account due to an in lieu acquisition, BPA does not believe it is appropriate to set such account aside for application of a cost under-recovery charge. Establishment of wholesale rates with cost under-recovery charges allows BPA to establish its wholesale power rates at a level lower than would otherwise be required. If BPA had not included such charges, BPA would need to establish higher rates potentially requiring a debit into the payment balancing account.

Puget has requested that BPA contractually agree that all cost recovery adjustment charges be applied so that each customer is affected uniformly. Puget, IOURESEXC:018. BPA believes the design and application of such charges are a wholesale power rate matter that should be determined in a section 7(i) administrative hearing. BPA finds Puget's language to be vague and believes it would lead to many disputes in its application.

Puget requested a most favored nations clause providing Puget the same rights as any other customer regarding the cost recovery adjustment clauses. Puget, IOURESEXC:018. BPA as a matter of policy does not provide most favored nations clauses. BPA has found such clauses to be ambiguous in their application. BPA has developed a standard clause in this area and included such clause in all its contracts.

Puget has proposed a standard contract provision regarding the treatment of costs functionalized to transmission that are ultimately functionalized to power by FERC. Puget, IOURESEXC:018. BPA does not believe such a clause is necessary. BPA has addressed the functionalization of its costs between power and transmission in its wholesale power rate case. If FERC remands its power rates due to this issue, the RPSA allows BPA to apply the PF Exchange Rate ultimately approved by FERC.

Decision

BPA will not modify the Cost Recovery Section to contractually proscribe cost underrecovery charges.

Issue

Whether Section 17(d) of the RPSA should be modified to include only the first three sentences of section 9(c) of the Northwest Power Act.

Parties' Positions

Avista and PSE argue that "[o]nly the first three sentences of section 9(c) should be included in Section 17(d) of the RPSA because only the first three sentences pertain to BPA's statutory obligation to afford priority to Pacific Northwest customers." Avista, IOURESEXC:001; PSE, IOURESEXC:018.

BPA's Position

The first three sentences of section 9(c) of the Northwest Power Act are not the only provisions of section 9(c) relating to priority to Pacific Northwest customers. The reference to the entirety of section 9(c) is appropriate.

Evaluation of Positions

Avista and PSE argue that "[o]nly the first three sentences of section 9(c) should be included in Section 17(d) of the RPSA because only the first three sentences pertain to BPA's statutory obligation to afford priority to Pacific Northwest customers." Avista, IOURESEXC:001; PSE, IOURESEXC:018. This argument is factually incorrect. Sections 9(c) and 9(d) of the Northwest Power Act relate directly to regional preference. While the first three sentences of section 9(c) refer to regional preference, the following sentences expressly discuss fundamental regional preference issues. These issues include the establishment of the electric power requirements of any Pacific Northwest customer, *see* section 3(b) of the Regional Preference Act, 16 U.S.C. § 837b(b); conservation or retention of energy to meet regional loads, *see* section 3(d) of the Regional Preference Act, 16 U.S.C. § 837b(d); and sales of surplus as replacement for excluded energy, *id*. Similarly, section 9(d) of the Northwest Power Act, 16 U.S.C. § 839f(d), regards that sales from non-Federal resources must not increase the amount of firm power the Administrator is obligated to provide to any customer. *See* section 3(b) of the Regional Preference Act, 16 U.S.C. § 837b(b). In summary, the provisions of section 9(c) and 9(d) of the Northwest Power Act relate to regional preference and are properly referenced in the RPSA.

Decision

Section 17(d) of the RPSA properly references the entirety of sections 9(c) and 9(d) of the Northwest Power Act.

Issue

Whether Section 18(i) should be modified to state that the customer may seek judicial review of any acquisition of In-Lieu Power.

Parties' Positions

Puget and Avista argue that Section 18(i) should expressly state that the customer may seek judicial review of any acquisition of In-Lieu Power. Puget, IOURESEXC:018; Avista, IOURESEXC:001. They argue that this approach is consistent with the approach taken by BPA with respect to New Large Single Loads. *Id*.

BPA's Position

The RPSA does not impair the parties' rights to judicial review. The proposed statement is unnecessary and would only create confusion. BPA has agreed to establish an In Lieu Power Policy that describes its procedures for acquiring in lieu power. BPA has explicitly included such policy within the provisions of Section 18(i) of the RPSA.

Evaluation of Positions

The RPSA is not intended to affect the rights of signatories to seek judicial review of any BPA final action. In fact, any attempt to do so would be an impermissible attempt to affect the jurisdiction of the courts, which no agency has the authority to do. The review rights of parties are established by the Northwest Power Act. Those rights cannot be enlarged, diminished, or made more or less certain by a contractual provision to the effect that the customer may seek judicial review of any acquisition of In-Lieu Power. Thus, parties are entitled to judicial review of individual in-lieu purchases to the full extent permitted by law.

Decision

It is unnecessary and inappropriate to modify the RPSA to state that a customer may seek judicial review of any in-lieu purchase.

XIV. CONCLUSION

I have reviewed and evaluated the comments received by BPA on the foregoing issues regarding BPA's proposed Residential Purchase and Sale Agreements with Pacific Northwest Utilities. Based upon the record compiled in this proceeding, the decisions expressed herein, and all requirements of law, I hereby adopt the proposed Residential Purchase and Sale Agreements. The evaluations and decisions used in the development

of the proposed RPSAs are consistent with the environmental analysis conducted for BPA's 1998 Power Subscription Strategy, and are consistent with BPA's Business Plan EIS and Business Plan ROD.

Issued at Portland, Oregon, this 4 th day of October ,2000.

/s/ J. A. Johansen

Administrator and Chief Executive Officer