

**PROPOSED ADJUSTMENT TO THE 1996  
UNAUTHORIZED INCREASE CHARGE (UAI-96R)**

**ADMINISTRATOR'S RECORD OF DECISION**

**BONNEVILLE POWER ADMINISTRATION**

**U.S. DEPARTMENT OF ENERGY**

**January 4, 2001**

# TABLE OF CONTENTS

<b>1.0</b>	<b>INTRODUCTION.....</b>	<b>1</b>
1.1	BACKGROUND.....	1
1.2	PROCEDURAL HISTORY OF THIS RATE PROCEEDING.....	2
1.3	WAIVER OF ISSUES BY FAILURE TO RAISE IN BRIEFS .....	2
1.4	LEGAL GUIDELINES GOVERNING ESTABLISHMENT OF RATES.....	3
1.5	BROAD RATEMAKING DISCRETION VESTED IN THE ADMINISTRATOR.....	4
1.6	CONFIRMATION AND APPROVAL OF RATES.....	4
1.7	STANDARD OF JUDICIAL REVIEW .....	4
<b>2.0</b>	<b>SUBSTANTIVE ISSUES.....</b>	<b>5</b>
2.1	INTRODUCTION .....	5
2.2	NON-COST BASED PENALTY CHARGES FOR ENERGY AND DEMAND UNAUTHORIZED OVERRUNS.....	5
2.3	IMBALANCE SERVICE VERSUS UAI CHARGE .....	8
2.4	EMERGENCY SERVICE AND THE 96 EMERGENCY RATE.....	11
2.5	BASIS FOR CALCULATING THE LEVEL OF THE UAI .....	11
2.6	CALIFORNIA MARKET INDEXES .....	14
2.7	LEVEL OF ADJUSTED UAI.....	19
2.8	USE OF “COST” AND “OPPORTUNITY COSTS” .....	28
2.9	RETROACTIVE RATE MAKING.....	30
2.10	CREDIT FOR NEGATIVE PF.....	32
<b>3.0</b>	<b>CONTRACT ISSUES .....</b>	<b>35</b>
<b>4.0</b>	<b>PROCEDURAL ISSUES.....</b>	<b>41</b>
4.1	THE STIPULATIONS BY PARTIES .....	41
4.2	THE INCORPORATION BY REFERENCE OF THE 1996 RATE CASE .....	42
4.3	THE WAIVER OF CROSS-EXAMINATION .....	43
4.4	ENVIRONMENTAL COMPLIANCE.....	43
4.5	PARTICIPANT COMMENTS .....	43
<b>5.0</b>	<b>CONCLUSION.....</b>	<b>43</b>

## COMMONLY USED ACRONYMS

AA7	Amendatory Agreement No. 7 to 1981 Utility Power Sales contracts.
AC	Alternating Current
AER	Actual Energy Regulation
AGC	Automatic Generation Control
aMW	Average Megawatt
ASC	Average System Cost
BASC	BPA Average System Cost
BO	Biological Opinion
BPA	Bonneville Power Administration
Btu	British Thermal Unit
CalPX	California Power Exchange
CBFWA	Columbia Basin Fish & Wildlife Authority
CCCT	Combined-Cycle Combustion Turbine
CEC	California Energy Commission
Cfs	cubic feet per second
COB	California-Oregon Border
COE	U.S. Army Corps of Engineers
COSA	Cost of Service Analysis
CP	Coincidental Peak
CRC	Critical Rule Curves
CSPE	Columbia Storage Power Exchange
CT	Combustion Turbine
CWA	Clear Water Act
CY	Calendar Year (Jan-Dec)
DC	Direct Current
DJ mid-C	Dow Jones Mid Columbia Index
DMP	Data Management Procedures
DOE	Department of Energy
DROD	Draft Record of Decision
DSI	DSI (only the DSI represented by Murphy under DS)
DSIs	Direct Service Industrial Customers
ECC	Energy Content Curve
EIA	Energy Information Administration
EIS	Environmental Impact Statement
Energy Northwest	Formerly Washington Public Power Supply System (Nuclear) Project
EPA	Environmental Protection Agency
EPP	Environmentally Preferred Power
ESA	Endangered Species Act
F&O	Financial and Operating Reports
FBS	Federal Base System
FCRPS	Federal Columbia River Power System
FCRTS	Federal Columbia River Transmission System
FELCC	Firm Energy Load Carrying Capability
FERC	Federal Energy Regulatory Commission

Fourth Power Plan	NWPPC's Fourth Northwest Conservation and Electric Power Plan
FPA	Federal Power Act
FSEA	Federal Secondary Energy Analysis
F&WCA	Fish and Wildlife Coordination Act
FY	Fiscal Year (Oct-Sep)
GRI	Gas Research Institute
GRSPs	General Rate Schedule Provisions
GSP	Generation System Peak
GSU	Generator Step-Up Transformers
GWh	Gigawatthour
HELM	Hourly Electric Load Model
HLH	Heavy Load Hour
HNF	Hourly Non-Firm
IJC	International Joint Commission
IOUs	Investor-Owned Utilities
ISO	Independent System Operator
KAF	Thousand Acre Feet
kcfs	kilo (thousands) of cubic feet per second
ksfd	thousand second foot day
kV	Kilovolt (1000 volts)
kW	Kilowatt (1000 watts)
kWh	Kilowatthour
LCP	Least-Cost Plan
LLH	Light Load Hour
LME	London Metal Exchange
LOLP	Loss of Load Probability
L/R Balance	Load/Resource Balance
m/kWh	Mills per kilowatthour
MAC	Market Access Coalition Group
MAF	Million Acre Feet
MC	Marginal Cost
MCA	Marginal Cost Analysis
MCS	Model Conservation Standards
MIP	Minimum Irrigation Pool
MMBTU	Million British Thermal Units
MOA	Memorandum of Agreement
MOP	Minimum Operating Pool
MORC	Minimum Operating Reliability Criteria
MT	Market Transmission (rate)
MW	Megawatt (1 million watts)
MWh	Megawatthour
NCD	Non-coincidental Demand
NEPA	National Environmental Policy Act
NERC	North American Electric Reliability Council
NF	Nonfirm Energy (rate)
NFRAP	Nonfirm Revenue Analysis Program (model)

NLSL	New Large Single Load
NMFS	National Marine Fisheries Service
NOB	Nevada-Oregon Border
Northwest Power Act	Pacific Northwest Electric Power Planning and Conservation Act
NPV	Net Present Value
NR	New Resource Firm Power (rate)
NT	Network Transmission
NTP	Network Integration Transmission (rate)
NTSA	Non-Treaty Storage Agreement
NUG	Non-Utility Generation
NWPP	Northwest Power Pool
NWPPC C&R	Northwest Power Planning Council Cost and Revenues Analysis
NWPPC	Northwest Power Planning Council
O&M	Operation and Maintenance
OMB	Office of Management and Budget
OPUC	Oregon Public Utility Commission
OURCA	Oregon Utility Resource Coordination Association
OY	Operating Year (Aug-Jul)
PA	Public Agency
PATH	Plan for Analyzing and Testing Hypotheses
PBL	Power Business Line
PDP	Proportional Draft Points
PDR	Power Discharge Requirement
PF	Priority Firm Power (rate)
PFBC	Pressurized Fluidized Bed Combustion
PMA	Power Marketing Agencies
PNCA	Pacific Northwest Coordination Agreement
PNGC	Pacific Northwest Generating Cooperative
PNUCC	Pacific Northwest Utilities Conference Committee
PNW	Pacific Northwest
PPC	Public Power Council
PSW	Pacific Southwest
PUD	Public or People's Utility District
PURPA	Public Utilities Regulatory Policies Act
RAM	Rate Analysis Model (computer model)
RAS	Remedial Action Scheme
Reclamation	Bureau of Reclamation
REP	Residential Exchange Program
RFP	Request for Proposal
RL	Residential Load (rate)
RMS	Remote Metering System
ROD	Record of Decision
RTF	Regional Technical Forum
RTO	Regional Transmission Organization
SCCT	Single-Cycle Combustion Turbine
SS	Share-the-Savings Energy (rate)

STREAM	Short-Term Evaluation and Analysis Model
SUB	Springfield Utility Board
SWPA	Southwestern Power Administration
tcf	Trillion Cubic Feet
TRL	Total Retail Load
UAI charge	Unauthorized Increase Charge
UDC	Utility Distribution Company
URC	Upper Rule Curve
USFWS	U.S. Fish and Wildlife Service
VOR	Value of Reserves
WAPA	Western Area Power Administration
WEFA	WEFA Group (Wharton Econometric Forecasting Associates)
WPRDS	Wholesale Power Rate Development Study
WSCC	Western Systems Coordinating Council
WSPP	Western System Power Pool
WUTC	Washington Utilities and Transportation Commission
WY	Watt-Year

## 1.0 INTRODUCTION

This Final Administrator's Record of Decision (ROD) contains the decisions of the Bonneville Power Administration (BPA), based on the record compiled in this rate proceeding, with respect to the adoption of the adjusted unauthorized increase charge commencing early in 2001 through September 30, 2001. Chapters 2 and 3 present the issues raised by parties to this proceeding, the parties' positions, BPA's position on the issues, BPA's evaluation of the positions, and BPA's decisions.

The 1996 UAI charge was adopted in BPA's power rate case as part of the Administrator's Final Record of Decision, WP-96-A-02. BPA initiated this UAI-96R proceeding to adjust the level of the 1996 Unauthorized Increase (UAI) charge that is applied to a customer's power bill when the customer exceeds the amount of power the customer has a right to purchase and which BPA is obligated to supply under its contract. The UAI is a penalty charge designed to prevent a customer from taking more Federal power than it agreed to buy and BPA agreed to supply. Since 1974, BPA has had UAI penalty charges as part of its rates. WP-96-A-02 at 321-322; Metcalf, *et al*, WP-96-BPA-48, at 9. *See also* WP-02-A-02 at 10-37 *citing* WP-93-A-02 at 171.

### 1.1 Background

BPA proposes an adjustment to the level of the 1996 UAI charges for energy and demand. The UAI charge is a penalty intended to be a deterrent against customers taking energy and demand in excess of their right to buy power under contractual entitlements. The UAI is not a "put" or a "call" right to power but rather a penalty in the nature of liquidated damages for the customer's failure to supply its own firm resources to serve its load or to manage those resources in accordance with the terms of its BPA contract. The current level of the UAI charge for energy is a fixed 100 mills/kWh for energy, and the UAI charge for demand is equal to the demand charge from the applicable power rate schedule. The adjustment to the 1996 UAI charge for energy is proposed as a minimum charge of 100 mills/kWh, with the potential for a higher charge if prices for firm energy at the Dow Jones Mid Columbia Index (DJ Mid-C Index) or the California ISO Supplemental Energy exceed 100 mills/kWh at any time during the billing month. BPA is also proposing to adjust the UAI charge for demand to a multiple of the effective standard Demand Charge for the month, while allowing for some higher charge to be derived based on hourly prices for Spinning Reserve Capacity at the California ISO.

BPA believes this step is necessary. Since the approval of final 1996 UAI charge in 1997 by the Federal Energy Regulatory Commission (FERC), the wholesale power market has substantially changed. U.S. Dept of Energy – Bonneville Power Admin., 80 FERC ¶ 61,118 (1997). The price volatility being experienced in the wholesale power market has rendered the current level of the UAI charge inadequate to deter customers from taking demand and energy in excess of the amount of Federal power to which they are contractually entitled. This past summer the DJ Mid-C Index for firm power reached 475 mills/kWh and since then has gone much higher. UAI96R-E-BPA-02 p.21. Without this modification, the UAI charge can be an attractive alternative price to the market price for power for some BPA customers. Therefore, BPA may face power demands far in excess of its contract obligations and its planned system capability. Such

demands could result in a significant erosion of BPA's financial position and an inability to recover its costs and repay the U.S. Treasury.

## **1.2 Procedural History of This Rate Proceeding**

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

On October 2, 2000, BPA filed notice in the Federal Register that it was proposing to amend the UAI charge pursuant to §1010.10 of the Procedures. 65 Fed. Reg. 58758 (2000). BPA's initial proposal was published on October 6, 2000. Testimony, a study, and documentation, along with the proposed changes to the UAI-96 charge, supported the initial proposal.

BPA's UAI-96R proceeding began with a prehearing conference held on October 6, 2000. At the prehearing conference, the Hearing Officer issued orders concerning procedural matters in this proceeding. October 6, 2000, the Hearing Officer issued an Order establishing the schedule for this rate proceeding. The Hearing Officer also granted the petitions to intervene and adopted a service list for BPA's UAI-96R proceeding that was issued on October 13, 2000.

BPA's UAI-96R proposal, filed on October 6, 2000, was supported by prefiled written testimony and studies sponsored by 5 witnesses. Parties filed their direct testimony on October 27, 2000. On November 17, 2000, litigants to the proceeding filed testimony in rebuttal to the parties' direct cases. Written discovery of BPA's and the parties' direct and rebuttal cases was allowed pursuant to the procedural schedule. Parties did not file any data requests concerning BPA's initial UAI adjustment proposal and its rebuttal testimony.

Parties met on November 21, 2000, and elected to waive cross-examination of all pre-filed testimony. Prefiled testimony, including errata, was admitted by motion. The cross-examination scheduled for November 27, 2000 was canceled. The parties submitted initial briefs on December 5, 2000. BPA issued and distributed its Draft Record of Decision (DROD) to parties on December 15, 2000. Parties filed their Briefs on Exceptions to the DROD on December 22, 2000.

## **1.3 Waiver of Issues By Failure to Raise in Briefs**

While the parties have raised many issues in this proceeding in their briefs, there are a number of issues raised by the parties during the hearing that were not raised in the parties' initial briefs. Parties MAC, Springfield, and Clatskanie attempt to "reserve" issues in their Briefs on Exceptions by so stating. This is not consistent with the procedures for a BPA 7(i) proceeding. Pursuant to §1010.13(b) of the *Procedures Governing BPA Rate Hearings*, arguments not raised

in the parties' briefs are deemed to be waived. Such issues will be resolved and implemented based on BPA's stated position in the record.

#### **1.4 Legal Guidelines Governing Establishment of Rates**

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

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

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

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

## 1.5 Broad Ratemaking Discretion Vested in the Administrator

The Administrator has broad discretion to interpret and implement statutory standards applicable to ratemaking. These standards focus on cost recovery and do not restrict the Administrator to any particular rate design methodology or theory. See Pacific Power & Light v. Duncan, 499 F. Supp. 672 (D.C. Or. 1980); accord City of Santa Clara v. Andrus, 572 F.2d 660, 668 (9<sup>th</sup> Cir. 1978) (“widest possible use” standard is so broad as to permit “the exercise of the widest administrative discretion”); Electricities of North Carolina v. Southeastern Power Admin., 774 F.2d 1262, 1266 (4th Cir. 1985). In addition, section 7(e) of the Northwest Power Act provides that “[n]othing in this Act prohibits the Administrator from establishing, in rate schedules of general application, a uniform rate or rates for sale of peaking capacity or from establishing time-of-day, seasonal rates, or other rate forms.” 16 U.S.C. 839e(f).

The United States Court of Appeals for the Ninth Circuit has also recognized the Administrator's ratemaking discretion. Central Lincoln Peoples' Utility District v. Johnson, 735 F.2d 1101, 1120-29 (9th Cir. 1984) (“[b]ecause BPA helped draft and must administer the Northwest Power Act, we give substantial deference to BPA's statutory interpretation”); PacifiCorp v. F.E.R.C., 795 F.2d 816, 821 (9th Cir. 1986) (“BPA's interpretation is entitled to great deference and must be upheld unless it is unreasonable”); Atlantic Richfield Co. v. Bonneville Power Admin., 818 F.2d 701, 705 (9th Cir. 1987) (BPA's standby charge for power not taken was lawful and distinct from a curtailment charge upheld as a “reasonable decision in light of economic realities”); cf. Aluminum Company of America v. Central Lincoln Peoples' Utility District, 467 U.S. 380, 389 (1984) (“The Administrator's interpretation of the Regional Act is to be given great weight”); Dep't of Water and Power of the City of Los Angeles v. Bonneville Power Admin., 759 F.2d 684, 690 (9th Cir. 1985) (“Insofar as agency action is the result of its interpretation of its organic statutes, the agency's interpretation is to be given great weight”). BPA's rate making includes discretion to design rates or charges for specific purposes. City of Seattle v. Johnson, 813 F.2d 1364, 1367 (1987) (BPA statutes do not require BPA to impose any particular type of rate on its customers but do require BPA to use “sound business principles” in setting rates).

## 1.6 Confirmation and Approval of Rates

BPA's rates become effective upon confirmation and approval by FERC. 16 U.S.C. §839e(a)(2). FERC's review is appellate in nature, based on the record developed by the Administrator. United States Department of Energy (DOE)--Bonneville Power Admin., 13 F.E.R.C. ¶ 61,157, 61,339 (1980). The Commission may not modify rates proposed by the Administrator, but may only confirm, reject or remand them. DOE--Bonneville Power Admin., 23 F.E.R.C. ¶ 61,378, 61,801 (1983). The 1996 general rates and charges proposed by the Administrator were adopted and submitted to FERC on July 26, 1996. FERC granted final approval of BPA's 1996 rates on July 30, 1997. U.S. Dept of Energy – Bonneville Power Admin., 80 FERC ¶ 61,118 (1997).

## 1.7 Standard of Judicial Review

Section 9(e)(2) of the Northwest Power Act provides that “final determinations regarding rates under section 7 shall be supported by substantial evidence in the rulemaking record required by

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

## **2.0 SUBSTANTIVE ISSUES**

### **2.1 Introduction**

In this section, BPA will identify the key substantive issues, identify the parties and BPA’s positions on each issue, and identify the Administrator’s final decision on that issue.

### **2.2 Non-Cost Based Penalty Charges for Energy and Demand Unauthorized Overruns**

#### **Issue**

*Whether BPA properly defined the scope of this proceeding to exclude issues regarding BPA’s authority to impose UAI penalty charges that are non-cost based.*

#### **Parties’ Positions**

PPC argues that the proposed UAI charges are not cost based as required by BPA’s statutes. PPC Brief, UAI 96-R-B-PP-01, at 5-6; PPC Ex. Brief, UAI-96R-R-PP-01, at 2-5. PPC asserts that BPA should collect only the costs that it incurs in serving unauthorized increases. Furst *et al*, UAI-96-R-E-PP-01, at 6. In its Brief on Exceptions, MAC states that BPA has narrowly defined the cost issue in its DROD and “evades” the issue whether the UAI charge “should have a basis in BPA’s anticipated costs.” MAC Ex. Brief, UAI96R-R-MA-01, at 4. The Brief on Exceptions of the PPC, and Springfield reiterate their earlier arguments. UAI-96R-R-PP-01 at 4, 5; and UAI-96R-R-SP-01 at 2.

#### **BPA’s Position**

Since its inception, the UAI charge has been developed to be a penalty and not a cost based rate. Administrator’s 1996 Final Rates Proposal Record of Decision (1996 ROD), UAI-96R-E-BPA-05, A-2. The Administrator decided in the 1996 ROD that the UAI charge would be designed as a penalty rate for the purpose of deterring customers from taking more power than they had a right to purchase. WP-96-A-02 at 321-322. The Federal Register notice announcing the UAI-96R proceeding defined the scope of issues in this hearing to only those regarding the adjustment in the level of the 1996 UAI. 65 Fed. Reg. 58760 (2000).

## Evaluation of Positions

PPC opposes any effort by BPA to deviate from setting its rates to recover only its actual costs, PPC Brief, UAI-96R-B-PP-01, at 6, and asserts that BPA should develop “cost-based UAI charges consistent with statute.” PPC Ex. Brief, UAI-96R-R-PP-01, at 4-5. PPC disagrees with BPA’s assertion that “[m]aking the 1996 UAI charge a cost-based rate is not within the scope of this proceeding,” and contends that BPA cannot justify a violation of the Northwest Power Act by limiting the scope of an expedited 7(i) proceeding. PPC Brief, UAI-96R-B-PP-01, at 6. In its Brief on Exceptions the PPC goes further and argues that BPA has violated the Northwest Power Act by adopting a non-cost based UAI in spite of its execution of a settlement agreement on the 1996 rates. MAC refines its position to be that some logical relationship to anticipated costs is required and MAC ignores the decisions in the 1996 Final ROD and its own execution of a settlement which included this non-cost based, non-product penalty charge. In response to MAC’s contention that BPA is evading the issue whether the UAI charge should have a basis in BPA’s anticipated costs, BPA previously addressed that issue and similar arguments in BPA’s 1996 Final ROD on the UAI. The 1996 Final ROD states:

PGP/APC and WPAG argued that *the Unauthorized Increase charge should be cost based*. Leone-Woods, et al. WP-96-EPG/AP-02, at 30-34; Beck et al. WP-96-E-WA-13, at 49; APAC prehearing Brief, WP-96-P-PA-01, at 7. PGP has been making similar arguments regarding the Unauthorized Increase charge for many years. *See* 1983 Administrator’s Record of Decision, WP-83-A-02 at 187-188, and 1993 Final Rate Proposal Administrator’s Record of Decision, WP-93-A-02 at 166-171. *The current PGP proposal would turn unauthorized overruns into another energy product, one available at the purchaser’s discretion and at the spot market price for energy*. Leone-Woods, et al E-PG/AP-02, at 32. From BPA’s point of view, this is a much less efficient price signal than BPA’s proposed charge, in combination with the rest of BPA’s available products and prices. *The Unauthorized Increase Charge BPA has proposed is designed to encourage customer to choose the products they wish to purchase rather than using unauthorized overruns as an alternative “product.”* Metcalf et al E-BPA-48, at 6. *Since its inception, the Unauthorized Increase Charge has been developed to be a penalty and not a cost based rate.* 1993 Final Rate Proposal Administrator’s Record of Decision. WP-93-A-02 at 166-171. Encouraging customers to choose individual products rather than relying on unauthorized overruns is consistent with BPA’s efforts to be a competitive business partner and to unbundle its products. Metcalf *et al.*, E-BPA-48, at 6 Tr. 2041. WP-96-A-02,p. 321-322 (emphasis added).

Moreover, the settlement entered into by the parties at the conclusion of the 1996 general rate proceeding states that the parties, “. . . will not contest that the rates and terms and conditions adopted in the Dockets comply with all contractual, regulatory, and statutory requirements applicable thereto with the exception of . . . (b) power rate design not specifically covered by this Power Settlement Agreement.” WP-96-A-02, A-2 at 2. The parties either agreed that the UAI charge was in full legal compliance or they had the opportunity to legally challenge the basis for the charge and failed to do so. In either case their present assertions are unpersuasive.

The Federal Register notice announcing the UAI-96R proceeding properly defined the scope of issues in this hearing to be only those regarding the adjustment in the level of the 1996 UAI. 65 Fed. Reg. 58760 (2000).

In the 1996 general rate proceeding, the PGP, APAC and PPC asserted the same arguments insisting that the UAI charge be cost based only. Such assertions were also previously made in the 1993 general rate case regarding the UAI charge. Both MAC and PPC in their briefs raise the same issues that a UAI charge which is not based on cost, or which is not based on the costs at the time of the overrun, or which is “excessive” in relation to costs is invalid and contrary to statute. BPA’s longstanding position on the unauthorized increase charge has been that it is a penalty and *not* a cost based rate for a product. In previous rate cases, in 1983, 1993, and 1996 for example, and continuing in this proceeding, BPA has consistently maintained and FERC has approved BPA’s authority to establish a non-cost based penalty charge. WP-96-A-02 at 321-322. BPA has consistently explained that the purpose for the UAI charge is deterrence and prevention of certain customer behaviors, not cost recovery. *Id.*

Since its inception in 1974, the UAI charge has been developed to be a penalty and not a cost-based rate. *See* 1993 ROD, WP-93-A-02, at 169. FERC has recognized the Administrator’s authority to impose a UAI charge that is not cost-based. U.S. Dept. of Energy-Bonneville Power Admin., 13 FERC ¶ 61,157, 61,340 (1980). FERC approved BPA’s UAI charge of 100 mills/kWh in the 1970s, when power costs were less than 5 mills/kWh. 1993 ROD, WP-93-A-02, at 171. FERC predicated its approval on the fact that the UAI charge was designed to modify customers’ behavior. *Id.* FERC took notice of the fact that the charge was developed to assure that BPA’s customers used their own resources first to meet their firm system load obligations. *Id.* As such, FERC noted that such a charge also ensures that the power BPA’s customers marketed to others was truly excess resource capability. *Id.*

The 1996 UAI charges were developed to modify customer behavior so that the customer will purchase a product and *not* use overruns charged to the UAI. The UAI is a penalty charge. *See* 1996 ROD, WP-96-A-02, at 321-322. *Keep et al*, UAI-96R-E-BPA-05, A-2. The UAI is a penalty charge that applies to any purchaser taking demand or energy in excess of its contractual entitlement. *Keep et al*, UAI-96R-E-BPA-03, at 2. The intent underlying the 1996 UAI charges was to deter customers who had their own generation or a contract obligation to supply nonFederal power to their load from exceeding their BPA contractual entitlements, *i.e.*, their purchase right to Federal power. *Id.* The purpose and scope of this proceeding is simply to correct and adjust the level of the charges so that they continue to act and have effect as a deterrent against customers taking demand and energy beyond their contractual right to Federal power. *Keep et al*, UAI-96R-E-BPA-05, at 4. Thus, issues regarding BPA’s authority to establish a non-cost based penalty charge have been resolved in previous rate cases, including the 1996 rate case; have been approved by FERC, and are not within the scope of this proceeding. *See* 65 Fed. Reg. 58758 (2000).

### Decision

*BPA properly defined the scope of this proceeding to exclude issues regarding BPA’s authority to impose UAI penalty charges that are non-cost based.*

## **2.3 Imbalance Service versus UAI charge**

### **Issue**

*Whether an unauthorized increase in energy or demand is an imbalance-type service for which BPA ought to adopt a “forgiveness bandwidth.”*

### **Parties’ Positions**

MAC argues that even if the UAI is a penalty, as a permissible exception to a cost-based rate, it must be reasonable and bear some relationship to cost and should not be “exorbitant or exploitive.” MAC Ex. Brief, UAI-96R-R-MA-01, at 2. MAC argues that the UAI charge “may be analogized” to FERC precedents regarding rates for imbalance service products under open access transmission tariffs. *Id.* at 4-6. MAC argues that FERC has held that “penalty charges for products similar to overrun services should never be ‘exorbitant or exploitive.’” *Id.* at 4. MAC continues to assert that BPA has not shown that customer “gaming” is a significant basis for modifying the UAI charge, *id.* at 2, and that inadvertent errors happen. MAC alleges that the UAI charge is a charge for a “capacity- and energy-imbalance-type service.” *Id.* at 3. MAC argues that BPA must create a penalty that effectively deters unauthorized increases at “both ends of the spectrum” *i.e.*, scheduling errors and gaming, *id.*, and thus proposes that BPA include a “dead-zone” or “bandwidth” to waive the UAI charges in those instances where a customer’s demand or energy take exceeds its contractual right by 5 percent or less. MAC Brief, UAI-96R-B-MA-01-at 3; MAC Ex. Brief, UAI-96R-R-MA-01, at 7. Finally, MAC argues that the “service” provided by the overruns is “part of a package of services provided by BPA under its contracts” and customer’s use of this “service” is not a breach but a right once they have paid the UAI charge. MAC Ex. Brief, UAI-96R-R-MA-01, at 3.

### **BPA’s Position**

Unauthorized increases do not constitute a capacity- and energy-imbalance-type service. BPA is not proposing to create new products in this rate proceeding. By adjusting the level of the UAI-96, BPA is assuring the deterrent effectiveness of the 1996 UAI charges to preclude customers from taking Federal power in excess of their contractual entitlement. Market changes have rendered the current level of the 1996 UAI for energy and demand inadequate to deter customers from taking demand and energy in excess of the amount of Federal power to which they are contractually entitled. *Keep et al.*, UAI-96R-E-BPA-03, at 3. BPA’s proposed adjustment to these charges would give BPA the ability to assess those charges as part of a monthly bill and at a level that reflects the volatility of the wholesale northwest power market in periods in which the market price for power exceeds the current UAI charge for energy and demand. *Id.*

### **Evaluation of Positions**

A UAI charge is triggered when a customer’s deliveries exceed the customer’s contractual entitlements for demand and/or energy. Unauthorized Increase Charges Study, UAI-96R-E-01, at 1. The charge for Unauthorized Increase in demand will be applied for any purchaser taking demand in excess of its contractual entitlement. *Id.* at 2. The UAI charge is “designed to

encourage customers to choose the products they wish to purchase rather than using the unauthorized overruns as an alternative product.” Keep, *et al.*, UAI-96R-E-03, at 3.

MAC wishes BPA to forgive amounts of Federal power taken, based on a purported inadvertence on the part of the customer, beyond what the customer is entitled to purchase, and to have that amount not charged to the customer. MAC justifies its support of its proposal of a “dead zone” or “bandwith” based on an assertion that service to unauthorized increases is, by its nature, provision of capacity and energy imbalance service. MAC Ex. Brief, UAI-96R-R-MA-01, at 8. MAC is incorrect in correlating an unauthorized increase in power taken to an energy and demand imbalance service.

FERC has defined Energy Imbalance as an ancillary service that is needed to correct the effects associated with undertaking a transmission transaction. *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Statutes and Regulations* ¶ 31,036 (1996), *order on reh’g*, Order No. 888-A, *FERC Statutes and Regulations* ¶ 31,048 (1997), Order No. 888-B, *order on reh’g*, 81 FERC ¶ 61,248 (1997), Order No. 888-C, 82 FERC ¶ 61,046 (1998); FERC Stats & Regs ¶ 31,036 at 31703 (1996). Energy Imbalance is one of the six FERC required ancillary services that a transmission provider must provide or offer to provide to transmission customers. *Id.* at 31,703. Energy Imbalance Service makes up for any net mismatch over an hour between the scheduled delivery of energy and the actual load that the energy serves in the control area. *Id.* at 31,708.

In Order No. 888, FERC listed several ways a transmission customer can reduce or eliminate the need for ancillary service of energy imbalance. A customer can avoid taking energy imbalance service if it controls generation with load-following capabilities located in the control area. The Final Rule pro forma tariff allows unlimited changes before the hour at no additional charge to a customer's hourly schedule of energy deliveries to the control area. By changing its schedule more frequently (based on updated load information, for example), a customer can reduce or avoid energy imbalance charges. Other customer options to reduce or avoid energy imbalance charges include (i) establishing the load as a separate control area island within the transmission provider's control area with its own generation and load; and (ii) removing the customer's load from the transmission provider's control area through dynamic scheduling.

In Order 888-A, FERC listed additional options for transmission customers to either reduce or eliminate their need for the ancillary service of energy imbalance. Energy Imbalance Service is provided when the transmission provider makes up for any difference that occurs over a single hour between the scheduled and the actual delivery of energy to a load located within its control area. For minor hourly differences between the scheduled and delivered energy, the transmission customer is allowed to make up the difference within 30 days (or other reasonable period generally accepted in the region) by adjusting its energy deliveries to eliminate the imbalance. A minor difference is one for which the actual energy delivery differs from the scheduled energy by less than 1.5 percent, except that any hourly difference less than one megawatt-hour is also considered minor.

FERC also established an hourly transmission deviation band of +/- 1.5 percent (with a minimum of 1 MW) for energy imbalance. The transmission customer must compensate the transmission provider for an imbalance that falls outside the hourly deviation band and for accumulated minor imbalances that are not made up within 30 days. FERC Stats & Regs. ¶ 31,048 at 30,229. FERC has been clear regarding Energy Imbalance Service, the appropriate bandwidth for load variations, and the price for exceeding the bandwidth that is appropriate for excessive load variations.

FERC has been equally clear that the ancillary service of Energy Imbalance is not to be used to address generation deviations. As FERC noted in Order 888-A:

A generator should be able to deliver its scheduled hourly energy with precision. If we were to allow the generator to deviate from its schedule by 1.5 percent without penalty, as long as it returned the energy in kind at another time, this would discourage good generator operating practice. A generation supplier could intentionally generate less power when its generating cost is high and make it up when its cost is lower if the second type of mismatch is included in our Energy Imbalance Service. Instead, a generator will have an interconnection agreement with its transmission provider or control area operator, and we expect that this agreement will specify the requirements for the generator to meet its schedule, and for any consequence for persistent failure to meet its schedule.

FERC Stats & Regs ¶ 31,048 at 30,230 (1997).

BPA rejects MAC's characterization that unauthorized increases in power taken are like capacity and energy imbalance-type services. Energy Imbalance Service is an ancillary service that is separate and distinct from unauthorized increases. In fact, Energy Imbalance service was made available to customers under BPA's ancillary products and services (APS-96) rate schedule. BPA's UAI charge is not a charge for a transmission product or ancillary service. It is a penalty charge for exceeding a contractual entitlement. Unlike traditional energy imbalance services where the customer is required to return the energy in kind at another time, the customer exceeding its power taken pays a penalty for the unauthorized take.

Finally, BPA is not persuaded by MAC's proposal that a dead-zone or bandwidth for demand and energy overruns is necessary. There are ways for the customer to significantly reduce if not eliminate the likelihood of the initial event that caused the unauthorized increase in demand: the customer properly manages and schedules its resources, or has reserves, or has a load following product, or has rights under the "Relief From Overrun" exhibit. Keep *et al*, UAI-96R-E-BPA-05, at 6-7. For customers under AA7 that purchase and schedule firm blocks of power to serve a portion of their consumer load, they must simply ensure that those purchases are scheduled so as to avoid incurring the UAI charge. *Id.* The UAI charge is a penalty rate for Federal power that was taken by a customer, but for which the customer has no right to purchase. MAC appears to labor under the misperception that the power for which it will pay this penalty is a product like any other power product of BPA. This is a misperception because the purpose of the UAI is to directly prevent such takes of Federal power by setting a penalty that is not attractive or economical. It would be wholly inconsistent with this purpose for BPA to adopt a "forgiveness"

bandwidth or not to charge the penalty for the amounts of power taken whether that be 1%, 5%, or 50%.

### **Decision**

*Unauthorized increases in demand and energy are not imbalance-type services and no “forgiveness bandwidth” on demand and energy overruns will be adopted.*

## **2.4 Emergency Service and the 96 Emergency Rate**

### **Issue**

*Whether an unauthorized increase is analogous to the provision of an “emergency service.”*

### **Parties’ Positions**

MAC asserts that an unauthorized increase can be “analogized” to “emergency service” since FERC issued Order 888. MAC Ex. Brief, UAI-96R-R-MA-01, at 9.

### **BPA’s Position**

BPA objects to MAC’s assertion because it nothing more than mere assertion and is neither developed nor supported by any evidence in the record.

### **Evaluation of Positions**

MAC asserts that an unauthorized increase is analogous to the provision of emergency service. MAC has similarly tried to liken an unauthorized increase to energy imbalance service, which BPA addresses in the previous section. Other than its bald assertion, MAC does not discuss further any distinction between those service vis-à-vis the unauthorized increase. BPA has evaluated the lack of similarity between unauthorized increases and the imbalance service. To the extent that emergency service is similar to imbalance service under Order 888 the above analysis applies and is adopted. MAC has failed to illustrate any difference between the two.

### **Decision**

*An unauthorized increase is not analogous to the provision of an “emergency service.”*

## **2.5 Basis For Calculating The Level of the UAI**

### **Issue**

*Whether the UAI charges for energy and demand take should be based upon market price indexes for the precise period when an unauthorized increase occurs.*

## **Parties' Position**

PPC argues that the unauthorized increase charge should be tied to the value of energy during the hour or the day when the unauthorized increase occurs. PPC Brief, UAI-96R-B-PP-01, at 6. SUB and MAC concur with PPC on this issue. SUB Brief, UAI-96R-B-SP-01, at 8; MAC Brief, WAI-96R-B-MA-01, at 8. In its direct testimony PPC argues that if BPA is going to rely upon the market for setting these charges, then, at a minimum, the charges should reflect the costs incurred at the time when the unauthorized take occurs, not the highest prices realized in the PNW and in the California market for the month. Furst *et al.*, UAI-96R-E-PP-01, at 2. This means that the charge should be tied to the value of energy during the hour or the day when the unauthorized increase occurs. *Id.* In its Brief on Exceptions, PPC reiterated its arguments that the UAI penalty be tied to the value of energy on the hour or day when the overrun occurs. PPC Ex. Brief, UAI-96R-R-PP-01, at 3. The PPC asserts that BPA will charge six times the penalty of BPA's actual opportunity costs for energy and 17,000 times the cost for Demand. *Id.* at 2. These rates, they say, are based upon BPA's speculation as to water conditions. *Id.* at 3. In its Brief on Exceptions MAC argues that BPA's proposal could lead to penalties that are many times the "amount" of any reasonable costs incurred and that BPA should have based its UAI charge on BPA's anticipated costs. MAC Ex. Brief, UAI-96R-R-MA-01, at 4.

## **BPA's Position**

BPA proposed that the UAI charge for energy for a given month be based on the greatest of: 100 mills/kWh; the highest DJ Mid-C price for the month; or the highest California ISO Supplemental Energy price at paths NW1 California-Oregon border (COB) and NW3 Nevada-Oregon Border (NOB) during the billing month. Keep *et al.*, UAI-96R-E-BPA-03, at 5.

BPA proposed that the UAI penalty for demand be the greater of (1) three times the applicable standard demand charge for the month; or (2) the sum of the hourly ISO Spinning Reserve Capacity prices for all HLH during the month. Keep *et al.*, UAI-96R-E-BPA-03, at 5. By definition, BPA's proposed penalty for demand overruns would not be specifically driven by the highest hourly ISO Spinning Reserve Capacity price index for a given billing month; rather, the penalty would convert this hourly price index to a monthly index-based charge by summing all HLH prices for the month. Proposed Revision to 1996 GRSPs, UAI-96R-E-BPA-04, at 1.

## **Evaluation of Positions**

PPC characterizes BPA's proposed UAI charges for demand and energy as excessive and unjustified and argues that the charge should be tied to the value of energy during the hour or the day when the unauthorized increase occurs. PPC Brief, UAI-96R-E-PP-01, at 6. In its direct testimony, PPC cites precedents in the gas industry and other power marketing administrations (*e.g.*, Southwestern and Western Area Power Administrations to support time-specific pass through cost bases for overrun penalties. Furst *et al.*, UAI-96R-E-PP-01, at 2.

Parties have previously argued in the 1996 rate case regarding the UAI charges that BPA's UAI charges should be based on cost and not set as a penalty rate. BPA considered those arguments in its Final ROD and rejected them. 1996 ROD, WP-96-A-02 at 321-322.

BPA believes limiting the UAI penalty charges to the market price of power, as measured by some specified price index, on the hour or date of an unauthorized increase would increase the likelihood that the customer responsible for the overrun would experience no economic cost as a result of the overrun. BPA's witnesses in the 1996 case stated:

If the price for unauthorized overruns is reduced to where it is equal to the spot market price, at that level the charge would encourage customers not to take certain products and instead rely on unauthorized overruns to receive the same product. For instance, if the unauthorized increase charge is reduced to the spot market price for power, customers could have an economic incentive to use unauthorized overruns to meet fluctuations in load from the amount forecasted instead of purchasing the load shaping product. BPA's customers are in the best position to know their own power needs, and the unauthorized overrun charge serves as an incentive to the customer to select the product it needs.

Metcalf *et al.*, WP-96-E-BPA-48, at 6.

Indeed, the DJ Mid-C index of average daily prices for firm HLH energy exceeded 100 mill/kWh on 59 days from May 1, 2000, to August 31, 2000 (2 days in May, 12 days in June, 14 days in July, and 31 days in August). Keep *et al.*, UAI-96R-E-BPA-03, at 3. BPA has recognized the developments in the open power markets in recent years and is designing the UAI charges to preclude any incentive for its customers to arbitrage unauthorized increases and achieve profits during periods when market prices are high, all at BPA's risk of supply. Keep *et al.*, UAI-96R-E-BPA-05, at 18. Also, since energy overruns often cannot be attributed to a specific hour, a charge for unauthorized increase energy based on the hour of the overrun does not cover all instances of energy overruns.

Finally, the UAI charges are intended to protect BPA from market cost exposure resulting from occurrences of unauthorized increases. *Id.* Basing the UAI charges for energy at the market value at the time of the overrun may under-recover BPA's cost of serving the overrun. Keep *et al.*, UAI-96R-E-BPA-03, at 8. There are cost impacts associated with unauthorized increases to BPA, even if BPA is not in the market. For example, BPA could be forced to run water to generate in order to serve unauthorized increases during a less expensive period, resulting in BPA without adequate water to generate at a later time when market prices are higher. *Id.* While BPA's primary intent underlying its UAI charges is to establish a penalty that provides a deterrent against demand and energy overruns, protection against such potential cost exposure is also an important component in the UAI charges.

For the index-driven penalty charges for demand, BPA proposed to sum the hourly California ISO Spinning Reserve Capacity prices for all HLH in a given billing month. BPA proposed that this index-based charge would be the effective charge if greater than three times the effective standard Demand Charge for the month. Keep *et al.*, UAI-96R-E-BPA-03, at 2; Keep *et al.*, UAI-96R-E-BPA-05, at 2. This construct for the penalty charges for demand merely converts an hourly index for Spinning Reserve Capacity prices to the same monthly basis as the standard demand charges. Without this conversion, the maximum index-based penalty charge for demand overruns, as defined by the California ISO's current price cap for hourly Spinning Reserve

Capacity, would be \$0.50/kW/hr under the former price cap and \$0.25/kW/hr under the current price cap (as of November 17, 2000). Keep *et al.*, UAI-96R-E-BPA-05, at 14. In comparison to BPA's monthly demand charge of \$0.87/kW/mo., this hourly charge is a price that is clearly too low to represent a deterrent against demand overruns. Further, while PPC argues that BPA's proposed design for UAI charges for demand is flawed because the charges are not based on the market prices at the time of the demand overrun, PPC fails to acknowledge that BPA's service to a demand overrun for one hour constitutes a monthly service. BPA witnesses testified that "BPA proposed a reasonable method for converting hourly index prices for capacity to a monthly penalty charge for demand overruns." *Id.* at 15. In fact, the appropriate underlying assumption is that any unauthorized increase power that BPA provides, *i.e.*, a demand overrun, is measured and billed monthly whether incurred one time or more than once during a month. Similarly, BPA's standard demand charges apply to monthly service and are billed on a \$/kW-month basis. Keep *et al.*, UAI-96R-E-BPA-05, at 2. Therefore, in order to provide a meaningful index-based penalty, it is appropriate to sum all the hourly ISO Spinning Reserve Capacity prices for all HLH of the month.

In sum, the recent market changes noted have rendered the current level of the 1996 UAI for energy and demand inadequate to deter customers from taking demand and energy in excess of the amount of Federal power to which they are contractually entitled. *Id.* UAI-96R-E-BPA-15. This market behavior shows that at the current level, the UAI charge is not functioning as a deterrent. BPA's proposed adjustment to these charges would give BPA the ability to assess charges that reflect the volatility of the market in periods in which the market price for power exceeds the current UAI charge for energy and demand. *Id.* This penalty rate would then continue to be effective as a deterrence. *Id.* Without this modification, the UAI charge can be an attractive alternative price to the market price for some BPA customers. *Id.* Therefore, BPA may face power demands far in excess of its planned system capability which could result in a significant erosion of BPA's financial position and an inability to recover its costs and repay the U.S. Treasury. *Id.*

### **Decision**

*The calculation of the UAI charges for energy and demand will be derived monthly as proposed by BPA and not upon market price indexes for the precise period within a month when an unauthorized increase occurs.*

## **2.6 California Market Indexes**

### **Issue**

*Whether the use of either the California market or California ISO price indexes is appropriate for the UAI charges.*

### **Parties' Positions**

PPC opposes BPA's use of the California ISO Spinning Capacity Reserve and Supplemental Energy indexes for the UAI charges for demand and energy, arguing that the ISO is

demonstrably unreliable. PPC Ex. Brief, UAI-96R-R-PP-01, at 5; PPC Brief, UAI-96R-B-PP-01, at 7; Furst *et al.*, UAI-96R-E-PP-01, at 3-5. PPC argues that the California ISO market suffers from serious deficiencies and is inappropriate for determining a cost-based unauthorized increase charge in the Pacific Northwest. *Id.* PPC favors the use of DJ Mid-C price indexes in the determination of the UAI charge for energy. PPC Ex. Brief, UAI-96R-R-PP-01, at 6; PPC Brief, UAI-96R-B-PP-01, at 7; Furst *et al.*, UAI-96R-E-PP-01, at 5-6.

SUB disagrees with BPA's proposed use of the California PX and ISO markets for the UAI charges. SUB Ex. Brief, UAI-96R-R-SP-01, at 4-5; SUB Brief, UAI-96R-B-SP-01, at 5-8. SUB notes its position is detailed in its direct testimony. *Id.* at 5; Nelson, UAI-96R-E-SP-01, at 6-8.

MAC also opposes adoption of an overrun penalty that subjects BPA's Northwest customers to the adverse effects of California market distortions. MAC Ex. Brief, UAI-96R-R-MA-01, at 6-7; MAC Brief, UAI-96R-B-MA-01, at 4.

### **BPA's Position**

BPA proposed incorporating the California ISO Spinning Capacity Reserve price indexes for the UAI charges for demand. Keep *et al.*, UAI-96R-E-BPA-03, at 4-5; Keep *et al.*, UAI-96R-E-BPA-05, at 2. BPA also proposed the use of California ISO Supplemental Energy price indexes, in conjunction with DJ Mid-C price indexes, in its determination of UAI charges for energy. Keep *et al.*, UAI-96R-E-BPA-03, at 4-5; Keep *et al.*, UAI-96R-E-BPA-05, at 2. BPA stated that omission of the California ISO indexes would, at times, create undue cost exposure to BPA and would not be a sufficient deterrent against such overruns. Keep *et al.*, UAI-96R-E-BPA-03, at 4-5; Keep *et al.*, UAI-96R-E-BPA-05, at 2.

While BPA acknowledges current market imperfections at the ISO, these imperfections do not undermine the California market's relevance to BPA's cost exposure. Keep *et al.*, UAI-96R-E-BPA-03, at 9; Keep *et al.*, UAI-96R-E-BPA-05, at 2. The price levels themselves, irrespective of their underlying determinants, define BPA's cost exposure to unauthorized increases in demand. The specific forces that drive ISO price levels during any specific period are less relevant than the price levels themselves. Keep *et al.*, UAI-96R-E-BPA-03, at 9. The inclusion of California ISO price indexes in BPA's UAI charge methodology is appropriate because, although the California ISO is not based in the Northwest, those price indexes are an indicator of BPA's cost exposure because of the very interconnected nature of the west coast markets. *Id.*

### **Evaluation of Positions**

In direct testimony, BPA stated two reasons for including the ISO Supplemental Energy price indexes in its proposed design of the UAI charge for energy. First, because ISO Supplemental Energy is traded on an hour-ahead basis, the ISO Supplemental Energy price index, among all indexes, most closely approximates the real-time circumstance that BPA faces when it must provide service to an unauthorized increase. Keep *et al.*, UAI-96R-E-BPA-03, at 8. Second, there is more certainty around the availability of this index than there is around the availability of the CalPX price indexes. *Id.* BPA proposed inclusion of the ISO Spinning Capacity Reserve

price index because, during certain high cost periods, the minimum UAI charges for demand would understate the true costs of serving demand overruns. The minimum charge would not provide a sufficient deterrent against a customer using unauthorized increases in demand when prices are higher than the minimum charge. *Keep et al.*, UAI-96R-E-BPA-03, at 9.

PPC cites the California ISO's *Report on Redesign of California Real-Time Energy And Ancillary Services Markets* in asserting that there are market imperfections in the California ISO markets. *Furst et al.*, UAI-96R-E-PP-01, at 4. PPC states that the California ISO markets are not considered robust enough to function without the use of price controls. *Id.* PPC concludes that the use of any California price as a market proxy for prevailing conditions in the Northwest will inevitably be flawed. *Id.*, at 5.

SUB argues that BPA should not use the California ISO ancillary services market indexes as a basis for UAI charges because power suppliers, including BPA, may have market power in the California ISO market. SUB Brief, UAI-96R-B-SP-01, at 5. SUB also states that BPA has overlooked findings on the presence of market power in the FERC Market Order Proposing Remedies for California Wholesale Electric's [sic], issued November 1, 2000, which BPA cited in its rebuttal testimony. *Id.*, at 5-6. Likewise, MAC opposes adoption of an overrun penalty that subjects BPA's Northwest customers to the adverse effects of California market distortions. MAC Brief, UAI-96R-B-MA-01, at 4. MAC Ex. Brief, UAI-96R-R-MA-01, at 6.

No perfect market exists for sales of electricity. FERC has jurisdiction to approve or disapprove that wholesale rate structure of IOUs used in California, including the use of market prices. The Market Order recognized potential problems and determined that certain changes to California's market structure would be needed. In the meantime, that market continues to operate and sell power products. The ISO has adopted pricing caps and FERC has approved those changes in pricing caps in Docket Nos. EL00-95-000, EL00-98-000, EL00-107-000, ER00-3461-000, and ER00-3673-000. *San Diego v. Sellers of Energy, et al.*, 93 FERC ¶ 61,121 (2000). Since FERC and the ISO have taken corrective actions, use of the pricing below the caps would not be unreasonable or unjust given the FERC approvals for the caps. The caps effectively limit the impact of price on purchasers. BPA believes FERC has taken action that establishes a reasonable limit.

PPC's argument concerning market imperfections in the California ISO is not persuasive since it fails to account for the interconnected nature of the west coast markets and does not account for any corrective actions discussed above. PPC offers no alternative index, nor does PPC establish an evidentiary basis upon which BPA could reject the use of the California ISO when BPA must obtain a supply. BPA direct testimony states that BPA is part of the larger west coast power system, that the index is currently capped at FERC approved levels, and that the California markets are relevant to BPA. *Keep et al.*, UAI-96R-E-BPA-03, at 9. The California markets are relevant to BPA's cost exposure when BPA must obtain supply and as a valuation for the power when a customer exceeds its right to take. To the extent the California market affects BPA, the magnitude of prices within that market is relevant to BPA even if at any point in time it may be due to some market imperfections. *Id.*

Furthermore, use of the California ISO is reasonable and appropriate because fixed charges are inadequate to serve as a deterrent against unauthorized increases in the current market. Experience with the recent power market has indicated that a single price is not as strong a disincentive as believed when it was set. This consideration supports the need, first of all, for an index-based component for the UAI charge for demand. Keep *et al.*, UAI-96R-E-BPA-05, at 11. The California ISO is the only west coast market for demand services and, among the California ISO ancillary services products, the hourly Spinning Capacity Reserve prices most closely approximate the kind of service BPA must provide to an unauthorized increase in demand. Also, California ISO Supplemental Energy price indexes provide an hourly measure of the value of energy at a market accessible to Northwest parties. Keep *et al.*, UAI-96R-E-BPA-05, at 4. An hourly index will provide the necessary comparability to the real-time circumstance confronting BPA when serving an unauthorized increase in energy. *Id.* Given the absence of a PNW hourly price index for energy, it is appropriate for the UAI charges for energy to incorporate an hourly index for energy at some market accessible by Northwest parties.

PPC's testimony and initial brief both indicate that, in fact, the California ISO is conducting a redesign of its markets to address the market imperfections. PPC Brief, UAI-96R-B-PP-01, at 7. Furst *et al.*, UAI-96R-E-PP-01, at 4-5. PPC also states that there is no evidence that the redesigned markets will function any better than the current California ISO markets. *Id.* However, no evidence was presented that the redesigned markets would not. The appropriateness of the California ISO indexes does not need to rest upon the success of the California ISO's efforts to resolve the market imperfections. Ultimately, the price levels themselves are more relevant than their underlying determinants in defining BPA's cost exposure since BPA will be paying those prices if it buys power. Keep *et al.*, UAI-96R-E-BPA-03, at 9. Periods of high prices in California would potentially expose BPA to high opportunity costs or, under some scenarios, high purchase costs associated with providing service to an unauthorized increase, irrespective of the underlying reasons. It is also the case that such a period of high prices, whether driven by market flaws or not, would also feature the greatest opportunities for customers to profit by arbitraging unauthorized increases if the design of UAI charges does not incorporate these indexes. Keep *et al.*, UAI-96R-E-BPA-05, at 18.

PPC argues that the Mid-C market hub is the most reflective of costs and market values in the PNW because BPA uses the Mid-C hub for cost classification between demand and energy charges and seasonal differentiation and diurnal differentiation, and the fact BPA does more transactions at Mid-C than through the California ISO. Therefore, PPC argues that Mid-C market, should be used in establishing the costs to BPA when imposing UAI charges. Furst *et al.*, UAI-96R-E-PP-01, at 5-6. PPC argues for reliance only on DJ Mid-C indexes by citing statements in a data response by BPA staff sponsoring the marginal cost analysis in the 2002 BPA rate case. This BPA data response states that "the Mid-C trading hub was selected because of the available hubs in this analysis, Mid-C is the most representative of the relevant power prices in the Pacific Northwest." Furst *et al.*, UAI-96R-E-PP-01, at 5-6, citing Response to Data Request PP-BPA:082. In accordance with §1010.13(a), Procedures Governing BPA Rate Hearings, materials not admitted into evidence shall not be attached to any brief. PPC references a data response that has not been admitted into evidence in this proceeding. No party had an opportunity to review or rebut this information. Therefore, BPA will not address or comment on any arguments posited by PPC that reference or rely on the cited data response.

SUB claims that BPA overlooked findings in the Market Order; SUB states the Order has “numerous references that market power may exist in the California ISO.” SUB Brief, UAI-96R-B-SP-01, at 6. SUB states that it is not asserting that BPA has exercised market power but rather asserts that FERC has found the California ISO pricing unjust and unreasonable. *Id.* at 7. SUB concludes that BPA should not adopt the California ISO prices on the basis that FERC could reject the proposed UAI as inconsistent with BPA’s statutory requirements that rates be established using sound business principles. *Id.* at 8. MAC argues similarly that the Market Order identifies the most extreme market prices produced in California as “unjust and unreasonable.” MAC Brief, UAI-96R-B-MA-01, at 12.

The Order states “[t]he Commission finds in this order that the electric market structure and market rules for wholesale electric energy in California are seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy (Day-Ahead, Day-of, Ancillary Services and real-time energy sales) under certain conditions.” Attachment B, Market Order Proposing Remedies for California Wholesale Electric’s (sic), issued November 1, 2000, at 3. While SUB and MAC focus on the flaws of the market they ignore the fact that “the UAI issue is not one of the price at which BPA sells into the California market, but the price at which BPA may be forced to pay for energy or demand when a customer exceeds its contract right to demand or energy.” Keep *et al.*, UAI-96R-E-BPA-05, at 10. Notwithstanding the Market Order and the remedies issued therein, the market in California continues to operate and sell power products. SUB correctly states that BPA must establish rates using sound business principles. SUB Brief, UAI-96R-B-SP-01, at 8. SUB is incorrect, however, in stating that BPA’s use of the ISO is inconsistent with those principles. *Id.* BPA’s use of the ISO is consistent with sound business principles because there is a risk and cost exposure the ISO imposes on BPA. While BPA acknowledges there are current market imperfections at the ISO, these imperfections do not undermine the California market’s relevance to BPA’s risk or cost exposure in supplying energy or demand as an unauthorized increase. *Id.* at 9.

The California ISO Supplemental Energy and Spinning Reserve Capacity price indexes reflect hour-ahead transactions that most closely approximate the real-time nature of service to unauthorized increases among the available indexes and are indices for the common commodities, specifically energy and capacity, for which BPA is developing the UAI charges. Including California ISO prices in the UAI charge methodology is both reasonable and necessary in light of BPA’s cost exposure. Keep *et al.*, UAI-96R-E-BPA-05, at 9. BPA needs a deterrent against demand and energy overruns placed on BPA’s system. *Id.* at 16.

### **Decision**

*It is appropriate for BPA to use California market and California ISO price indexes for the UAI charges.*

## 2.7 Level of Adjusted UAI

### Issue

*Whether the level of the penalties under the proposed UAI charges is appropriate.*

### Parties' Positions

PPC asserts that the proposed UAI charges would establish “a rate” that is excessive. Ex. Brief, UAI-96R-R-PP-01, at 2. PPC Brief, UAI-96R-B-PP-01, at 4-6. PPC argues that the UAI charges should be reflective of market values at the time of the unauthorized increase. *Id.* at 5-6; Furst *et al.*, UAI-96R-E-PP-01, at 2.

SUB opposes the use of California ISO price indexes for the UAI charges. SUB Brief, UAI-96R-B-SP-01, at 5; Nelson, UAI-96R-E-SP-01, at 7-8. SUB proposes that the UAI charge for demand be based on three times the standard demand charge plus an additional charge for the associated energy tied to the DJ Mid-C indexes. SUB Brief, UAI-96R-B-SP-01, at 10-11; Nelson, UAI-96R-E-SP-01, at 8. SUB further proposes an energy penalty that would be the greater of \$100 per MWh or 125% of the average DJ Mid-C index price for HLH energy for the month. SUB Brief, UAI-96R-B-SP-01, at 10-11; Nelson, UAI-96R-E-SP-01, at 8.

MAC asserts that BPA’s proposed UAI charges is “overkill and extremely unfair to most customers.” MAC Brief, UAI-96R-B-MA-01, at 2; MAC Ex. Brief, UAI-96R-R-MA-01, at 4; Parrish, UAI-96R-E-MA-01, at 1.

### BPA’s Position

BPA is modifying the UAI charges for demand and energy in response to recent market volatility and developments that have rendered the charges inadequate as a deterrent against unauthorized increases and created significant cost exposure to BPA. Recent market prices are as great as four and a half times the 100 mills/kWh rate of the UAI charge for energy. Keep *et al.*, UAI-96R-E-BPA-03, at 2-3; Keep *et al.*, UAI-96R-E-BPA-05, at 17-18. The proposals by PPC, SUB, and MAC ignore the basic behavior deterrent purpose of the UAI charges as a penalty for taking power that the customer has no right to take. Keep *et al.*, UAI-96R-E-BPA-05, at 17.

### Evaluation of Positions

MAC characterizes BPA’s proposed UAI charges as “overkill” and unfair to most customers, MAC Brief, UAI 96R-B-MA-01, at 2, and argues that the penalty charges must be reasonable and bear some relationship to BPA’s costs. MAC Ex. Brief, UAI-96R-R-MA-01, at 2. MAC asserts that the penalties for demand and energy overruns should be tempered to match the offense. *Id.* at 7. MAC claims that “[a]fter all, inadvertent scheduling mistakes remain the most prevalent reason for overruns.” MAC Brief, UAI 96R-B-MA-01, at 11; MAC Ex. Brief, UAI-96R-R-MA-01, at 2. MAC also alleges that “BPA believes that its ratemaking discretion is unbounded when it comes to penalties. *Id.* at 3. PPC concurs with MAC’s opposition to BPA’s proposed demand penalty and MAC’s views that the UAI charges for energy should be tied to

the value of energy on the date or hour in which the overrun occurs. PPC Ex. Brief, UAI-96R-R-PP-01, at 2-3. PPC argues that BPA should only collect the costs that it incurs and that BPA should not realize a “windfall” as a result of a customer placing an unauthorized increase on BPA’s system during low priced market periods. Furst *et al*, UAI-96R-E-PP-01, at 6. PPC further argues that, given BPA’s reliance on market indexes “for determining the extent to which it is harmed, then a floor is unnecessary.” *Id.*

MAC asserts in its Brief on Exceptions that the UAI charge must have some basis in BPA’s anticipated costs and that BPA is not imposing a reasonable penalty. MAC Ex. Brief, UAI96R-R-MA-01 at 2, 4-6. MAC argues that BPA is setting a price level unrelated to any cost it may face and that this is contrary to FERC precedent. *Id.* MAC uses arguments from FERC review of open access transmission tariffs on “imbalance service products.” *Id.* The issue of imbalance charges has been previously addressed. However, MAC ignores the FERC precedent approving the level of the non-cost based UAI charge. For example, in the 1970s BPA’s cost of power was 3.5 mils/kWh and the UAI was 100 mils/kWh. At that time there was no open wholesale market to create the incentive for customers to use overruns. MAC has not refuted the fact of the Northwest market volatility nor the fact that BPA customers have “gamed” the UAI charge to create overruns in high market months.

BPA’s use of the indexes and pricing based on the higher of the pricing during the month sets a limit on what the monthly deterrent will be. Because the overruns are unplanned and unknown to BPA until they occur, BPA cannot anticipate a cost for overruns as it might for a planned purchased power service. Because they could occur at any time during the month, the UAI charge level is now being revised as a flexible deterrent intended to follow the higher cost periods of the month and to track the price level changes in the markets from month to month. It is based on the fact that a deterrent which is less than the cost of the alternative supply, is no deterrent to overruns at all. As FERC itself has noted in addressing revenue credit from penalty charges, if a penalty is operating effectively as a deterrent then it is set at such a level as will effectively discourage its use and little or no revenue results from the charge. “Penalties are intended to deter conduct. Hence, if the penalties are properly designed, there will be no revenue to credit.” Trunkline Gas Co., 45 FERC ¶63,013, 63,029 (1988), citing El Natural Paso Gas Co. 35 FERC ¶61,440, 62,070 (1987).

MAC further asserts that BPA in applying the UAI charge should distinguish between whether the overrun was intentional or not. MAC Ex. Brief, UAI-96R-R-MA-01, at 4. As addressed previously, MAC attempts to characterize the unauthorized increase as an energy imbalance-type service for which BPA should be cognizant of FERC precedent regarding the level of penalty charges associated with such products and services within the gas industry and for the provision of transmission by transmission providers. *Id.* at 4-5. MAC cites Consumer Energy Company, 86 FERC ¶ 63,004 (1999) in which FERC rejected an energy imbalance penalty that was 16 times higher than cost of responding to an imbalance. *Id.* at 5. Again, BPA’s unauthorized increase is not an energy imbalance-type service. Under BPA’s published APS-96 rate customers can obtain energy imbalance service; they may not do so through an unauthorized increase. Were the UAI charge designed to be a “call” right to power for our customers, then the similarity to an energy imbalance charge might be considered.

As MAC readily acknowledges, the distinctions between the legal and factual considerations in Consumers Energy and BPA's UAI charge are overwhelming. MAC Ex. Brief, UAI-96R-R-MA-01, at 5-6. First, the statutory standard for FERC review under the Northwest Power Act is entirely different than it is under the provisions of the Federal Power Act. FERC has a duty to review BPA rates for recovery of costs and the UAI is to prevent advertent or inadvertent costs occurring during the rate period and threatening BPA revenues. Second, the FERC review of the imbalance charge is occurring as a part of the approval of a transmission open access tariff not a power sale tariff. The imbalance service is a planned service provided by the transmission function. In contrast, an unauthorized increase may occur at any time. As such it is simply not a planned service whose timing, extent, or impact can be known in advance. Third, in Consumers Energy FERC rejected the charge because *no threshold* showing of severe conditions, operational behavior or threat had been made. 86 FERC ¶ 63,004 (1999). BPA witnesses have established that the recent market changes have rendered the current level of the 1996 UAI for energy and demand inadequate to deter customers from taking demand and energy in excess of the amount of Federal power to which they are contractually entitled. *Keep et al.*, UAI-96R-E-BPA-03, at 3. This market behavior shows that at the current level, the UAI charge is not functioning as a deterrent. BPA's proposed adjustment to these charges would give BPA the ability to assess charges that reflect the volatility of the market in periods in which the market price for power exceeds the current UAI charge for energy and demand. *Id.* Fourth, MAC ignores the fact that the UAI charge has been approved by FERC as a deterrent. BPA must ensure that UAI charge remains an effective deterrent to prevent the UAI charge from becoming an alternative product in this price volatile market that could then threaten BPA revenues. *Id.* FERC has approved and confirmed this penalty as a deterrent against such behavior. Finally, MAC failed to note that the proposed penalty in the Central Energy case was found to be "not well thought through" and "uncertain to achieve the desired effect of influencing proper scheduling behavior." 86 FERC ¶ 63,004. In contrast, BPA's proposed adjustment in the level of the UAI charge is well founded and in keeping with its historical purpose as an effective deterrent to overruns as previously approved and confirmed by FERC.

MAC's and PPC's arguments ignore the penalty intent underlying the UAI charges and are without merit. The UAI is designed to prevent a customer from taking more power than it has a right to take, and is not to encourage such behaviors. *Keep et al.*, UAI-96R-E-BPA-03, at 2. The UAI charges are not intended to be cost-based; rather, they are intended to deter customers placing demand and energy overruns on BPA's system. *Keep et al.*, UAI-96R-E-BPA-05, at 4. Minimum UAI charges are necessary to ensure that there is always an incentive for customers to avoid placing unauthorized demand or energy increases on BPA's system when index-driven charges may not constitute the necessary deterrent. *Keep et al.*, UAI-96R-E-BPA-03, at 7; *Keep et al.*, UAI-96R-E-BPA-05, at 10.

The proposed adjustment to the UAI charge will not result in BPA realizing a "windfall" as asserted by PPC. By adjusting the level of the UAI charges, BPA is confident that customers will not incur unauthorized increases. "BPA's customers are in the best position to meet their own obligations and know their own power needs, and the unauthorized overrun charge serves as an incentive to the customer to select the product it needs." Metcalf, *et al.*, WP-96-E-BPA-48, at 6. BPA's ability to plan its service obligations as specified in the power sales contracts, and to control its costs depends on customers accurately specifying the obligations that BPA must

serve. Keep *et al*, UAI-96R-E-BPA-03, at 7. There are ways for the customer to significantly reduce if not eliminate the likelihood of the initial event that caused the unauthorized increase in demand: the customer properly manages and schedules its resources, or has reserves, or has a load following product, or has rights under the “Relief From Overrun” exhibit. Keep *et al*, UAI-96R-E-BPA-05, at 6-7. For customers under AA7 that purchase and schedule firm blocks of power to serve a portion of their consumer load, they must simply ensure that those purchases are scheduled so as to avoid incurring the UAI charge. *Id.* Similarly, MAC provides no evidence to support its assertion that the “most prevalent reason for overruns” is due to “inadvertent scheduling mistakes.” Regardless, there are various tools available to customers to manage both their obligations to efficiently operate and schedule their resources so as to avoid inadvertent scheduling mistakes, as alleged by MAC. BPA will not ignore the fact that even a customer’s “inadvertent” scheduling mistake represents a cost exposure to BPA. *See* UAI-96R-E-BPA-06. Whether inadvertent or intentional, customers must be responsible for their own scheduling mistakes and for meeting their contract obligations to supply non-Federal power. BPA believes that imposition of the proposed adjustment to the 1996 UAI charges will reduce, if not eliminate, scheduling mistakes by customers in the future.

PPC argues that if BPA is going to rely upon market indexes for the UAI charges for energy, then the charges should “reflect the costs incurred at the time when the unauthorized take occurs, not the highest prices realized...for the month. This means that the charge should be tied to the value of energy during the hour or the day when the unauthorized increase occurs.” PPC Brief, UAI-96R-B-PP-01, at 6; Furst *et al*, UAI-96R-E-PP-01, at 2. BPA is not persuaded by PPC’s suggestion and will not change its proposal. First, the UAI charge is a non-cost-based penalty imposed to deter customers from taking unauthorized increases in the first instance. Making the UAI charge a simple pass through of the cost incurred creates no deterrent and will encourage customers to use the UAI charge as a product. Second, PPC’s proposal is administratively infeasible because energy overruns are determined on a monthly basis, rather than on a date-specific or hour-specific basis. Keep *et al*, UAI-96R-E-BPA-05, at 16. Even SUB acknowledges that “unauthorized energy amounts are based on monthly energy entitlements.” Nelson, UAI-96R-E-SP-01, at 8. Not only would implementing PPC’s proposal require attributing overruns of monthly energy entitlements to individual dates and hours of the day, it is also impractical under the terms of the current utility power sales contracts.

SUB opposes the use of California ISO indexes in the UAI charge for energy, SUB Brief, UAI-96R-B-SP-01, at 10; Nelson, UAI-96R-E-SP-01, at 7-8. SUB asserts that BPA’s proposal to use California ISO (and California PX) price indexes would result in “extremely high and unreasonable UAI costs to customers.” SUB Brief, UAI-96R-B-SP-01, at 5. SUB proposes that the UAI charge for demand be based on three times the standard demand charge, plus an additional charge for the associated energy priced at the higher of \$100 per MWh or 125% of the average DJ Mid-C index price for HLH energy for the date of the overrun. SUB Brief, UAI-96R-B-SP-01, at 10-11; Nelson, UAI-96R-E-SP-01, at 8. SUB proposes UAI charges based on a fixed component and a variable component, “the combination of which results in a variable demand charge which is much higher than the current UAI charge for demand.” SUB Brief, UAI-96R-B-SP-01, at 11. Under SUB’s proposal, the fixed component, at three times the standard PF demand charge, would be \$2.61 per kW/mo. *Id.* SUB’s proposed “variable

component,” *i.e.*, the added charge for the associated energy, would be added to this fixed charge, which SUB states “would be a reasonable and effective deterrent”. *Id.*

After review of SUB’s proposal, BPA is not persuaded that it should replace its proposal with SUB’s proposal for several reasons. First, BPA finds that SUB incorrectly asserts that this composite penalty charge for demand overruns “would be a reasonable and effective deterrent.” While moving to a variable index, SUB’s proposal does not capture the volatility of market prices BPA is exposed to when it provides power for unauthorized increases. For instance, the maximum DJ Mid-C index price for energy during the twelve-month period from September 1999 through August 2000 was 672.88 mills per kilowatt hour, the DJ Mid-C HLH price for June 28, 2000. *See* Proposed Unauthorized Increase Charges (UAI-96R) Rate Adjustment Documentation, UAI-96R-E-BPA-02, at 30. Under SUB’s proposal, as clarified in its Brief on Exceptions, SUB Ex. Brief, UAI-96R-R-SP01, at 6, the penalty for a single kW of demand overrun would be \$2.61/kW/mo. The added penalty for one kWh of associated energy for June 2000, based on the historical data on the record, would have been a maximum of \$1.558 per kW/mo. (*i.e.*, plus  $1.25 \times 672.88$  mills per kilowatthour/ 1000, adjusted for the percentage of total hours of the month represented by HLHs). SUB Ex. Brief, UAI-96R-R-SP-01, at 6. This equates to a composite penalty of \$4.368/kw/mo. SUB further argues that its proposal is progressive in that energy associated with UAIs in demand would be cumulative throughout the month, and offers an example in which a customer places a demand overrun on BPA of 10 MW for one hour on one day and 1 MW of demand overrun for 16 hours on a subsequent day. *Id.* Thus, a customer would levied a penalty for 10 MW of demand, plus a penalty for 26 MWh’s of associated energy. However, when historical prices on the record for June 2000 are employed in SUB’s example, the results illustrate that SUB’s proposal for the demand penalty is not sufficiently “progressive.” The total UAI charges for demand would be \$26,100 (*i.e.*, \$2.61/kW/mo. X 10 MW x 1000). The penalty charges for the associated energy, even if one assumes the maximum June 2000 DJ Mid-C price of 672.88 mills per kWh for both dates, would total \$40,508 (*i.e.*, \$1.558/kWh x 1000 x 26 MWh’s). Therefore, the total UAI charges under SUB’s example would be a total of \$66,608, or \$6.66/kW/mo of demand overrun. However, that same kilowatt of demand during all HLH’s in June was worth \$24.20 per kW/mo. at the California ISO. *See* Proposed Unauthorized Increase Charges (UAI-96R) Rate Adjustment Documentation, UAI-96R-E-BPA-02,at 4. Therefore, SUB’s proposal for demand, while incorporating a variable, index-based component, would still yield charges that at times would not capture the market volatility that defines the current market. Additionally, SUB proposes to exclude any energy assessed under the demand penalty from the calculation of UAI charges for energy, Nelson, UAI-96R-E-SP-01, at 9, and further undermines the viability of its proposal. SUB’s proposal, in essence, has the same inherent shortcomings as a purely fixed demand penalty in deterring customer behavior and protecting BPA against demand overruns cost exposure.

Second, SUB’s methodology supporting its proposal is incoherent and flawed. SUB proposes that the penalty charge for energy be tied to the *average* HLH price at the DJ Mid-C index, rather than employing the highest DJ Mid-C price index for a given month. SUB Brief, UAI-96R-B-SP-01, at 11. Specifically, SUB proposes a penalty charge for energy that would be the greater of \$100 per MWh or 125% of the average DJ Mid-C index price for HLH energy for the month. SUB Brief, UAI-96R-B-SP-01, at 10-11; Nelson, UAI-96R-E-SP-01, at 8-9. SUB’s brief states:

“BPA states that this is unacceptable as a deterrent, that it would mask high prices during extreme periods (UAI-96R-E-BPA-05, at 12 at 1).” SUB Brief, UAI-96R-B-SP-01, at 10. SUB reasons that “because UAI charges for demand would be applied to energy during HLHs, unauthorized increase amounts for energy would occur in LLHs.” *Id.*, SUB Ex. Brief, UAI-96R-R-SP-01, at 6. SUB then states “[w]hile the unauthorized increase amounts would be in LLHs, SUB proposes to use the HLH Mid-C index price as the basis for pricing the unauthorized energy charges.” SUB Brief, UAI-96R-B-SP-01, at 10. SUB claims its proposal will constitute an effective deterrent because HLH pricing is higher than LLH pricing during a monthly period. *Id.*

This proposal inappropriately assumes that the only HLH energy overruns are those that occur in conjunction with UAIs in demand, attributing any residual energy overruns to LLHs. UAIs in energy are often determined based on monthly energy entitlements and, other than for flat block purchases, there is no basis for assuming that these residual energy overruns occur during LLHs. SUB’s proposal also does not recognize that, irrespective of when unauthorized increases occur, there can be substantial cost impacts to BPA. For instance, when BPA must run water to generate in order to serve unauthorized increases during a lower cost period, this could result in BPA not having adequate water to generate at a later time when market prices are higher. Keep *et al*, UAI-96R-E-BPA-03, at 8; Keep *et al*, UAI-96R-E-BPA-05, at 16. SUB’s proposal to base the UAI charge for energy on an average of HLH prices at the DJ Mid-C index would, in fact, mask high prices during periods of extremely high prices as BPA witnesses testified in rebuttal. Keep *et al*, UAI-96R-E-BPA-05, at 12. For example, SUB’s own testimony demonstrates that the average HLH price at the DJ Mid-C index for May 2000 was \$59.42 per MWh, while the maximum DJ Mid-C index for that same price was \$177.46. Nelson, UAI-96R-E-SP-01, at 5. Under SUB’s proposal, the effective UAI charge for would have been set by the minimum charge of \$100 per MWh. Thus, BPA’s actual cost exposure during the most extremely high priced period, as measured by the maximum DJ Mid-C Index, would have been a full \$77 per MWh greater than the charge yielded by SUB’s proposal.

SUB adds that using the average price over a month also addresses “the fact that unauthorized increases occur due to load forecast error and the complex management of loads and resources over the course of a month.” SUB, Brief, UAI-96R-B-SP-01, at 11-12. BPA assumes that what is implied by SUB is that its proposal will mitigate the impact of UAI charges on customers resulting from load forecast error and inefficient resource management. BPA does not intend for its UAI charges to address load forecasting errors and resource management problems since BPA provides products that perform those functions. As BPA has stated, there are ways for customers to significantly reduce if not eliminate the likelihood of the initial event that caused the unauthorized increase. Keep *et al*, UAI-96R-E-BPA-05, at 7. For customers under AA7, such as SUB, that purchase and schedule firm blocks of power to serve a portion of their consumer load, they must simply ensure that those purchases are scheduled so as to avoid incurring the UAI charge. *Id.*

It is at the very times when market prices are highest and the regional electrical system is most strained when the likelihood of unauthorized increases occurring is highest. Keep *et al*, UAI-96R-E-BPA-05, at 17; Keep *et al*, UAI-96R-E-BPA-03, at 4. Further, it is during such periods of scarce power and high market prices that the economic incentive for arbitrage is greatest.

Keep *et al*, UAI-96R-E-BPA-05, at 17; Keep *et al*, UAI-96R-E-BPA-03, at 4. There are cost impacts to BPA associated with unauthorized increases, irrespective of market prices at any point in time and irrespective of whether BPA is active in the market at any given time. BPA could be forced to use water to generate power in order to supply an unauthorized increase during a less expensive period, resulting in less available water to generate power for a load at a later time when market prices for power are higher. Keep *et al*, UAI-96R-E-BPA-03, at 8; Keep *et al*, UAI-96R-E-BPA-05, at 17. Finally, and most importantly, BPA's cost exposure is only one consideration in setting the UAI charges; the UAI charges are intended as a deterrent against energy overruns, as well as demand overruns. Keep *et al*, UAI-96R-E-BPA-03, at 3; Keep *et al*, UAI-96R-E-BPA-05, at 16. SUB's proposed UAI charge for energy is inadequate in its protection against BPA's cost exposure and as a deterrent against unauthorized increases in energy.

MAC asserts that BPA's proposed UAI charges are excessively punitive, MAC Brief, UAI-96R-B-MA-01, at 5. MAC cites BPA's correction of California ISO Spinning Reserve Capacity data (as corrected by BPA, Keep *et al*, UAI-96R-E-BPA-05, at 12-13). *Id.*; Parrish, UAI-96R-E-MA-01, at 2-3. Specifically, MAC cites the hourly California ISO Spinning Reserve Capacity price of \$1.50 per MW (which equates to an hourly charge of \$0.0015 per kW) for hour 7 on August 11, 2000, and contrasts that with BPA's derived demand penalty charge under its proposal of \$26,550 per MW-mo (equivalent to \$26.55 per kW/mo) for the historical period August 2000. MAC Brief, UAI-96R-B-MA-01, at 5. MAC asserts that this charge is "extremely punitive and unfair." *Id.* In testimony, MAC relied on its original numerical comparison to assert that BPA's proposed charge would only be justified on a cost basis if a "customer's demand level was exceeded by one MW in *every* heavy load hour of the month" (emphasis in original). Parrish, UAI-96R-E-MA-01, at 3. MAC further argues that BPA's proposed demand penalty could lead to an unintended consequence for BPA, *i.e.*, once a customer exceeds its authorized demand level and incurs a penalty the customer will actually have an incentive to continue using that overrun in demand for the remainder of the billing cycle since there is no additional penalty to the customer for doing so. MAC proposes that the UAI charge for demand for a given month be set at the highest, single Spinning Capacity Reserve price at the ISO. Parrish, UAI-96R-E-MA-01, at 3-4. This demand penalty would be assessed for each hour and each amount by which a customer exceeded its demand entitlement. *Id.* MAC asserts that service to demand overruns for one hour do not necessarily constitute a monthly service by BPA and that, since spinning reserve capacity is now traded on an hourly basis, BPA could determine charges for individual hours and tally those charges on monthly customer bills. MAC Ex. Brief, UAI-96R-R-MA-01, at 6. MAC argues that even though demand overruns are billed on a monthly basis, the associated penalties do not need to be calculated on a monthly basis. *Id.* MAC also proposes a cap on the accumulated charges equal to the greater of the sum of all HLH prices for ISO Spinning Reserve Capacity or 1.5 times BPA's published demand charge. *Id.* MAC again cites the August 2000 example to show that the demand penalty charges under its proposal would greatly exceed BPA's opportunity costs, by a factor of 333 times assuming a demand overrun during an hour in which the ISO Spinning Capacity Reserve price was at \$1.50 per MW. MAC Brief, UAI-96R-B-MA-01, at 7.

MAC's arguments are not persuasive, and would lead to UAI charges for demand that are inadequate as a deterrent. First, MAC's argument that BPA's proposed penalty charge for

demand is only justified when a customer exceeds its demand entitlement for each HLH of the month is flawed. MAC ignores the fact that BPA's meeting any overrun in demand, as in standard service, is measured on a monthly basis and needs to be charged accordingly. Keep *et al.*, UAI-96R-E-BPA-05, at 14. MAC takes issue with this fact and contends it is not valid. MAC Brief, UAI-96R-B-MA-01, at 8. MAC contends "[t]hese are hourly, not, monthly products." *Id.* MAC is fundamentally mistaken; the UAI charges are not recovering costs for a product but obtaining a penalty charge against the overruns on the month. Unauthorized overruns are not products that any customer has a right to select and purchase. Keep *et al.*, UAI-96R-E-BPA-05, at 5. Parties have previously argued that BPA's UAI charges should be based on cost and be a product, and BPA has rejected those arguments. The Administrator's ROD for the 1996 UAI addressed this issue. 1996 ROD, WP-96-A-02, at 321-322. Further, the current UAI charge for demand is stated in monthly terms, i.e., a fixed charge of \$0.87/kW/mo. Keep *et al.*, UAI-96R-E-BPA-03, at 4. BPA does not propose a change in the use of the monthly period in which demand overruns are measured and billed. Second, the resulting magnitude of UAI charges yielded by MAC's proposal would be wholly inadequate to act as a deterrent against demand overruns. In fact, BPA has shown that under the price caps that existed at the ISO in August 2000, the penalty charge for demand under MAC's proposal would have been less than the standard PF demand charge. Keep *et al.*, UAI-96R-E-BPA-05, at 14. Third, MAC's assertion that BPA's proposed demand penalty would encourage a customer to continue exceeding its demand limit for the remainder of the billing period after the initial demand overrun is without merit. The primary objective of the UAI charge for demand is to deter customers from placing even the first hourly demand overrun on BPA's system. *Id.* at 15. BPA's proposed UAI charge for demand would create this deterrent, while MAC's proposal, in contrast, would not. *Id.*

MAC's proposed cap on the demand penalty charges also is without merit. First, in order to deter demand overruns at all times, the UAI charges for demand should recognize that supplying service to even one hour of demand overruns constitutes an increase in demand service for the month. *Id.* Therefore, BPA proposed a reasonable method for converting hourly indexed prices for capacity to a monthly penalty charge for demand overruns. *Id.* In contrast, a determinant of a "cap," as proposed by MAC, on accumulated penalty charges that could be as low as 1.5 times the standard demand charge would not constitute a sufficiently strong price signal to deter demand overruns, especially in light of a standard demand charge equal to \$0.87 per kW/mo. *Id.*

MAC asserts that BPA's UAI charges for energy are "unreasonably punitive in its application." Parrish, UAI-96R-E-MA-01, at 5. MAC argues that BPA's proposed penalty charge for energy is "unreasonable because it is not related to actual costs potentially incurred by BPA when a customer exceeds its contractual right to energy." *Id.* MAC cites numerical examples from historical data for May and June, 2000, to demonstrate that BPA would, under BPA's proposed UAI charges for energy, "collect over six times its actual damages" over the two month period. *Id.* at 6. MAC's numerical example is based on historical ISO Supplemental Energy prices for the two month period and an assumption that a customer exceeds its contractual right to energy by 1 MW in all of the HLH's of both months. *Id.* MAC proposed that BPA set the UAI charge for energy "at a level sufficient to meet or exceed costs in 90% of the hours, rather than 100% of the hours as proposed by BPA." *Id.*; MAC Brief, UAI-96R-B-MA-01, at 3. MAC also supports PPC's proposal, Furst *et al.*, UAI-96R-E-PP-01, at 2, that the penalty charges for energy be tied to the hour that the overrun occurred. MAC Brief, UAI-96R-B-MA-01, at 8.

This aspect of MAC's proposal is unreasonable because it is not related to actual costs and ignores the penalty intent of this charge. Keep *et al.*, UAI-96R-E-BPA-05, at 16. MAC's suggestion that the penalty charges be tied to the hour of an energy overrun ignores the fact that energy overruns are determined on a monthly basis, rather than on an hour-specific basis. *Id.* Third, there are cost impacts to BPA associated with unauthorized increases in energy, irrespective of market prices at any point in time or irrespective of whether BPA is in the market. *Id.* BPA could be forced to run water to serve an unauthorized increase during a lower cost period, resulting in BPA being without adequate water to serve load at a later time when market prices are higher. *Id.* As BPA witnesses stated in rebuttal, the UAI charges are intended as a deterrent so that it modifies customer behavior. *Id.*

MAC's contention that BPA's proposed UAI charges are excessively punitive and bear no relationship to BPA's costs is erroneous. The central intent of the UAI charges is to provide a deterrent against demand and energy overruns at all times. Keep *et al.*, UAI-96R-E-BPA-03, at 10; Keep *et al.*, UAI-96R-E-BPA-05, at 16. However, the proposed design of the UAI charges expressly recognizes the varying levels of market cost exposure to BPA over time, and the effective level of the penalty charges for any given month will recognize the prevailing market prices during that month. . Keep *et al.*, UAI-96R-E-BPA-03, at 4-5; Keep *et al.*, UAI-96R-E-BPA-05, at 2. During those months when prevailing market prices for power, as measured by the DJ Mid-C price indexes and prices at the California ISO, are extremely high, the UAI charges for demand and energy will be set commensurately to reflect BPA's potential cost exposure and to create a sufficient deterrent against overruns. Conversely, when market prices for power are low enough, the UAI charges for demand and energy will revert to the minimum charges which BPA believes are still sufficient to deter customers from placing demand and energy overruns on BPA's system. Keep *et al.*, UAI-96R-E-BPA-03, at 7. Contrary to MAC's arguments, BPA's proposed design does "bear some relationship to costs", by allowing the penalty charges to vary and drop to the proposed minimum UAI charges for demand and energy as BPA's own market cost exposure diminishes during lower cost months. BPA's proposed penalty design is not punitive nor unreasonable; rather, it simply incorporates a flexible measure of BPA's market cost exposure sufficient to provide a reasonable and appropriate incentive against demand and energy overruns and cost protection to BPA at all times. The very design of the proposed UAI charges refutes MAC's contention that BPA views its discretion in designing the UAI charges as "unbounded." BPA could have proposed an even more austere UAI charge design, e.g., with extraordinarily high minimum charges that would have been less sensitive to lower prevailing market prices while typically yielding much higher penalty charges.

Regarding PPC's and SUB's briefs on exceptions, their arguments for the level at which the UAI should be set do not differ or add to those arguments presented earlier in their initial briefs and originally in the 1996 power rate proceeding. BPA's analysis of these arguments remains the same. First, this UAI charge is not designed to sell a product at all and particularly not at cost. BPA offers power products for the customer to purchase which provide that service. The UAI charge is not such a service but is a penalty designed to induce a specific behavior by customers. The UAI is to prevent takes of energy or capacity and must not encourage customers' behavior to take overruns. WP-96-A-02 at 321-322. Second, the UAI charge is not cost based and never has been, and it has previously been set at a level many times the price of cost based power. Since the 1970's BPA has had a UAI charge which was set at 100 mills when BPA's priority firm

power rate was 3.5 mills per/kWh. Third, the reason for adjusting the level is the result of changes in the short term power market. Customers, and BPA's data shows more than one, are not supplying a large portion of their contract obligation from third party power from that market and some customers this past summer used the UAI charge as a heavy load hour product. This behavior demonstrates that the UAI charge's deterrent effect under the current market conditions is nil.

### **Decision**

*The level of the penalties inherent in the proposed UAI charges is appropriate.*

## **2.8 Use of "Cost" and "Opportunity Costs"**

### **Issue**

*Whether BPA appropriately uses the concept of opportunity cost exposure in its UAI charge design.*

### **Parties' Positions**

MAC asserts that BPA utilizes "cost" and "opportunity cost" interchangeably in its support of its UAI charge design. MAC Brief, UAI-96R-B-MA-01, at 2. MAC asserts that "opportunity cost" is relevant only to the consideration of the penalty necessary to discourage customers from gaming the market by taking capacity and energy beyond their contractual entitlement. *Id.* at 3.

### **BPA's Position**

At certain times during the year, the minimum UAI charge would leave BPA exposed to higher costs as defined by the market. Keep *et al.*, UAI-96R-E-BPA-03, at 6. During those periods, the market indexes provide a reasonable measure of the cost exposure associated with an Unauthorized Increase for either energy or demand, either as a representation of BPA's power purchase costs or its opportunity costs. *Id.*

### **Evaluation of Positions**

MAC asserts that BPA utilizes "cost" and "opportunity cost" interchangeably to support its proposed UAI charges. MAC Ex. Brief, UAI-96R-RB-MA-01, at 2; MAC Brief, UAI-96R-B-MA-01, at 2. This assertion is incorrect. Review of the record demonstrates that BPA does not interchange the two terms in any way that treats them synonymously.

BPA cites its cost exposure associated with unauthorized increases placed on its system as one consideration in developing its UAI charges. Keep *et al.*, UAI-96R-E-BPA-03, at 7 and 10; Keep *et al.*, UAI-96R-E-BPA-05, at 16-18. At the same time, BPA takes care to clearly differentiate between those instances when such market cost exposure is best defined by the opportunity costs associated with serving unauthorized increases (*see* Keep *et al.*, UAI-96R-E-BPA-03, at 6, 8, and 9; Keep *et al.*, UAI-96R-E-BPA-05, at 4, 8, and 12) and those situations

when BPA would be forced to incur costs via purchases on the open market to serve demand and energy overruns (*see Keep et al.*, UAI-96R-E-BPA-03, at 6, 8, and 9; *Keep et al.*, UAI-96R-E-BPA-05, at 4, 8, 12, and 16).

MAC argues that “opportunity cost” is only relevant to the consideration of the amount of the penalty necessary to deter customers from gaming the market by taking more capacity and energy from BPA and that, even if gaming existed, BPA would not need to recover its full opportunity cost to be made whole. MAC Brief, UAI-96-R-B-MA-01, at 3. MAC’s argument is flawed. First, BPA’s rebuttal testimony references one example of “gaming” the UAI charge. Regardless of the number of such instances, BPA has reasonable grounds to believe such behavior will continue. *Keep et al.*, UAI-96R-E-BPA-03, at 4. Second, as stated in BPA’s rebuttal, there may be times when an unauthorized increase placed on BPA’s system prevents or reduces BPA sales into the ISO markets. *Keep et al.*, UAI-96R-E-BPA-05, at 4. Such a sale would have generated surplus revenue that BPA would have used to maintain the lowest rates for all customers. Thus, if an unauthorized increase on BPA’s system precludes a sale on the open market at some given price, then BPA is certainly not made whole at anything less than that price and, arguably, all of BPA’s customers are financially harmed. Further, opportunity cost pricing is a standard pricing method, and BPA has employed the use of opportunity costs in prior rate proceedings. BPA relied on opportunity cost pricing in the 1996 rate proceeding. The 1996 Load Shaping charge was based, in part, on the sales in the nonfirm market, i.e. the opportunity cost of providing load shaping services. 1996 ROD, WP-96-A-02, at 290. Also, in the 1985 rate case, BPA priced the first quartile of the DSI loads based on the opportunity cost of serving the first quartile with nonfirm energy. 1985 ROD, WP-85-A-02, at 150-155. Contrary to MAC’s characterization of opportunity costs in this proceeding as “speculative,” MAC Ex. Brief., UAI-96R-R-MA-01, at 2, opportunity costs represent real economic costs and should be considered in the design of the UAI charges.

MAC also argues that “cost” is the only relevant criterion, and that if “BPA recovers its forecasted cost, it will make its Treasury payments.” MAC Brief, UAI-96-R-B-MA-01, at 2. It is unclear what MAC means. However, it appears that MAC may be asserting that BPA’s cost exposure is the only relevant criterion for developing the UAI charges. That would be an incorrect assertion and contrary to BPA’s decision in the 1996 rate case on the purpose of the UAI charge. The UAI charges are intended as a penalty. *Keep et al.*, UAI-96R-E-BPA-03, at 2. Further, MAC’s statement that BPA will make its Treasury payment if BPA recovers its forecasted cost is also not relevant, given the penalty nature of the UAI charges. MAC also asserts that BPA is using its treatment of “costs” and “opportunity costs” to “lessen the likelihood that it will fail to make its Treasury payments.” MAC Brief, UAI-96-R-B-MA-01, at 2. MAC has taken out of context BPA’s valid concern that BPA may face power demands far in excess of its planned system capability. *Keep et al.*, UAI-96R-E-BPA-03, at 3. A small number of overruns of hundreds of megawatthours in a 500 mill plus market would have an impact on BPA revenues. BPA objects to MAC’s mischaracterization.

Contrary to MAC’s assertion, BPA’s proposed revised UAI charges are intended to *preserve* its ability to make its Treasury payments in the face of new developments in the power markets. BPA submitted into evidence load data demonstrating BPA’s potential exposure for the balance of the current rate period (1,044 aMW) from customers that diversified, which is in addition to

customers with resources within BPA's control area. BPA Data Response PP-BPA:003, UAI-96R-E-BPA-14. BPA is concerned that customers will take unauthorized overruns as an alternative product if the UAI charge is an attractive alternative price to the market price. *Id.* Therefore, BPA may face power demands far in excess of its planned system capability which could result in a significant erosion of BPA's financial position and an inability to recover its costs and repay the U.S. Treasury. *Id.*

### **Decision**

*BPA's recognition of opportunity cost exposure in the development of the UAI charges is appropriate.*

## **2.9 Retroactive Rate Making**

### **Issue**

*Whether application of the UAI charges constitutes retroactive ratemaking.*

### **Parties' Positions**

SUB contends that the use of the highest hourly index price for energy in a month as a penalty charge for unauthorized energy use is retroactive rate making if the highest hourly price occurs later in the billing month than the time when the unauthorized energy use occurred. SUB Brief, UAI-96R-B-SP-01, at 8. SUB makes a similar argument concerning the penalty charge for unauthorized demand, stating that the charge is retroactive because it sums all heavy load hour prices during the month. *Id.* at 9. SUB recommends that BPA should not base UAI charges on the highest Dow Jones Mid-Columbia (Mid-C) Index price for firm energy for actual purchases during a month, the highest hourly ISO supplemental energy prices for actual purchases during a month, or the sum of the hourly ISO Spinning Reserve Capacity prices during all heavy load hours of a month. *Id.* SUB reiterates its arguments and maintains that BPA's approach would result in a higher probability that FERC would remand the rates. SUB Ex. Brief, UAI-96R-R-SP-01, at 4.

In its Brief on Exceptions, SUB reasserts its argument that the UAI was retroactive ratemaking and adds, "SUB was not seeking to invoke any doctrine [of retroactive ratemaking] in its Initial Brief. As stated in its Initial Brief, SUB is concerned that FERC would view BPA's proposed rate methodology as retroactive in nature even though BPA would apply the new rate methodology prospectively. SUB Ex. Brief, UAI-96R-R-SP-01 at 4. SUB is concerned that the rate distinction between prospective and retroactive rate making may become blurred. *Id.*

### **BPA's Position**

The unauthorized increase charges are penalty charges adopted by the Administrator and approved by FERC. U.S. Dept of Energy – Bonneville Power Admin., 80 FERC ¶ 61,118 (1997). They are not a rate which applies to any product or service that a customer has the contractual right to buy. *Keep et al.*, UAI-96R-E-BPA-05, at 5. The rule against retroactive

ratemaking applies when there is an attempt to impose surcharges representing costs for which there is no rate then filed and in effect. *See Towns of Concord, Norwood, & Wellesley v. FERC*, 955 F.2d 67, 75 (D.C.Cir. 1992). In this proceeding BPA seeks to prospectively adjust the level of the 1996 UAI charges. BPA will apply the proposed level of the UAI charges to customer bills as part of its standard billing procedure once the new level receives interim approval from FERC, not before. Regarding SUB's statements in its Brief on Exceptions, BPA fails to see any merit to the concern expressed since the UAI charge, if approved by FERC as proposed, will only apply prospectively in accordance with BPA billing procedures.

### **Evaluation of Positions**

SUB's argument shows that it is viewing the unauthorized increase charges as if they were rates for a product that it has a right to choose and purchase. SUB cites language from a D.C. Circuit decision regarding retroactive rate making, where the Court states that its guiding concern is "providing the necessary predictability," allowing purchasers of gas to know in advance the consequences of the purchasing decisions they make." UAI-96R-B-SP-01, at 9. First, on this point SUB has a fundamental misunderstanding of the nature of the UAI charges and their application to unauthorized increases. No customer has the contractual right to make a purchase decision to incur an unauthorized increase. The UAI charge is not a rate that applies to any product or service that a customer has the contractual right to buy. *Keep et al.*, UAI-96R-E-BPA-05, at 5. Indeed, the UAI charge applies as a penalty only when a customer causes BPA to supply power in excess of those products and services that a customer agreed to purchase and was entitled to take. *Id.* *See Metcalf, et al.*, WP-96-E-BPA-48, at 5.

Second, whether or not SUB seeks to invoke the doctrine of retroactive ratemaking it is inapplicable. The rule against retroactive ratemaking applies when there is an attempt to impose surcharges representing costs for which there is no rate then filed and in effect. *See Towns of Concord, Norwood, & Wellesley v. FERC*, 955 F.2d 67, 75 (D.C.Cir. 1992). The doctrine requires that rate changes be made prospectively only. *Id.* In this proceeding BPA seeks to prospectively adjust the level of the 1996 UAI charges. BPA intends to apply the proposed level of the UAI charges to customer bills as part of its standard billing procedure once the adjustment receives interim approval from FERC, not before.

The indexes that will be used to establish the charge for unauthorized increases are defined in this proposal; those indexes will not be established after the customer has taken unauthorized energy or demand. UAI-96R-E-BPA-04, at 1. The manner in which BPA will use the index to determine the level of the unauthorized increase charges is defined in this proposal; it will not be established after the customer has already taken unauthorized energy or demand. *Id.* The values from which the unauthorized increase energy is taken all occur within the billing month when the unauthorized increase occurs. *Id.* Finally, it appears that SUB objects to the design proposed by BPA to calculate the adjusted level of the UAI charges. Such objections are valid in this rate proceeding; however, SUB is mistaken in its assertion that the proposed design of the UAI charges constitutes retroactive ratemaking.

## Decision

*Application of the UAI charges does not constitute retroactive ratemaking.*

### **2.10 Credit for Negative PF**

#### Issue

*Whether BPA should pay for Negative PF as part of its UAI proposal.*

#### Parties' Position

SUB proposes that UAI energy charges be reduced by a credit for any Negative PF incurred during the course of a month. SUB Brief, UAI-96R-B-SP-01, at 10, 12. SUB Ex. Brief, UAI-96R-R-SP-01, at 7. SUB claims that BPA's UAI demand charge would cause customers to incur HLH negative PF. SUB Brief, UAI-96R-B-SP-01, at 12. SUB claims that since Negative PF is more likely to occur in HLHs, then pricing Negative PF based on 100% load factor power discounts the value for Negative PF. *Id.*

#### BPA's Position

The 1996 rate case did not contain any BPA proposal in its rates to purchase purported "negative PF" from customers, or to offer any credit for such a customer "product," nor any proposal as to how to recover from customers the cost of such a credit or "product." Keep, *et al.*, UAI-96R-E-BPA-05, at 8. SUB's suggestion is beyond the scope of the general rates already adopted and approved by FERC for this rate period and goes beyond the issue of the pricing level of a penalty charge for taking Federal power which a customer has no right to take. *Id.* at 8. BPA is not proposing to create new products in this rate proceeding. BPA is assuring that the deterrent nature of the Unauthorized Increase charges will prevent customers from over-taking Federal power. Market changes have rendered the current level of the 1996 UAI for energy and demand inadequate to deter customers from taking demand and energy in excess of the amount of Federal power to which they are contractually entitled. Keep, *et al.*, UAI-96R-E-BPA-03, at 3. BPA's proposed adjustment to these charges gives BPA the ability to assess those charges as part of a monthly bill and at a level that reflects the volatility of the market in periods in which the market price for power exceeds the current UAI charge for energy and demand. *Id.*

#### Evaluation of Positions

SUB's contention that most negative PF will occur in HLH is purely conjectural. The very nature of SUB's proposal, *i.e.*, giving a "credit" for any negative PF as if it occurs flat across the entire month, would make it very attractive for a utility to "create" negative PF during inexpensive LLHs of the month in order to offset UAI energy charges for the customer's failure to schedule expensive HLH resources. Such a proposal could impose additional costs on the Federal system if a credit were to be given for such actions. Reducing Unauthorized Increase charges with negative PF credits is inconsistent with a penalty charge and runs contrary to the intention of re-establishing the effectiveness of the Unauthorized Increase charges as a deterrent.

It would be both counterproductive and unreasonable for BPA to provide a credit on a penalty charge when the customer takes demand and/or energy that it has no right to take.

### **Decision**

*BPA will not give credit for negative PF as an offset to Unauthorized Increase charges.*

### **Issue**

*Whether BPA's use of California ISO price indexes in its proposed UAI charge will adversely affect Northwest markets.*

### **Parties' Position**

MAC asserts that by tying the UAI charges to the highest monthly California prices, BPA will be utilizing the very prices that are "most likely to be overly excessive due to under-scheduling or other market manipulation." MAC Brief, UAI-96R-B-MA-01, at 4. MAC states that BPA should not exacerbate the problems that FERC is currently attempting to correct. *Id.* MAC further states that the California market is distorted and alleges that "BPA's use of California market prices in fashioning its penalty carries the risk of adversely affecting" the market in the Northwest. MAC Ex. Brief, UAI-96R-R-MA-01, at 7.

### **BPA's Position**

In testimony BPA did not specifically address the potential effect, or absence of any effect, of the proposed UAI charges, based on the California ISO, on the Northwest market. BPA does support its use of the highest monthly prices in the UAI charge for energy by stating that it is at the very times that market prices are highest and the regional electrical system is most strained that the likelihood of unauthorized increases occurring is greatest. *Keep et al.*, UAI-96R-E-BPA-05, at 17. BPA adds that it is during such periods of scarce power and high market prices that the economic incentives to arbitrage unauthorized increases is greatest. *Id.* BPA also states that specific forces that drive ISO price levels during any specific period are not as relevant as the price levels themselves; it is the level of market prices, irrespective of their underlying determinants, that define BPA's market cost exposure. *Keep et al.*, UAI-96R-E-BPA-05, at 9.

### **Evaluation of Positions**

MAC alleges that BPA's proposed use of California ISO indexes in the UAI charges "would unnecessarily extend the influence of unjust rates from California to the Pacific Northwest," at the same time that Federal officials and state officials in the Northwest are "seeking to do just the opposite." MAC Ex. Brief, UAI-96R-R-MA-01, at 6. MAC's premise for this assertion is wrong. The extension of the California market's influence to the Northwest is not dependent on BPA's design of its UAI charges; clearly, as recent events have demonstrated, the California market's effect on the Northwest is already evident. BPA and the Northwest are part of the larger west coast market, *Keep et al.*, UAI-96R-E-BPA-03, at 9, and BPA is not insulated from the effects of developments in California. By including the use of Northwest and California

market price indexes in its proposed UAI charges, BPA is deterring customers from placing unauthorized increases on BPA's system that exacerbate BPA's market cost exposure and to preclude any incentives for customers to profitably arbitrage unauthorized increases during periods when market prices are high. *Id.* at 10; Keep *et al*, UAI-96R-E-BPA-05, at 18. Simply put, BPA and the Northwest already face any adverse impacts of the California markets; with its proposed revisions to its UAI charges, BPA is only ensuring that its customers do not exacerbate its market cost exposure by placing energy and demand overruns on BPA's system.

Further, it is difficult to see how BPA's proposed UAI design could adversely affect the Northwest markets since the design is intended, in part, to avoid or minimize unauthorized increases during high cost periods when power is likely to be most scarce. If anything, the proposed UAI design should encourage customers to shape their resources in a fashion that avoids unauthorized increases on BPA's system during the very highest priced periods, reducing net demand in the west coast markets during those times. BPA rejects MAC's assertion as unsupported by the record.

### **Decision**

*There is no basis for concluding that BPA's used of the California ISO price indexes in its proposed UAI charges will adversely affect the Northwest markets.*

### **Issue**

*Whether BPA should exclude the highest 10 percent of hourly prices in its derivation of the UAI charges for energy.*

### **Parties' Position**

MAC proposes that derivation of the UAI charges for energy exclude the ten percent of hours each month during which prices, as reflected in the price indexes, are the highest. MAC Br., UAI-96R-B-MA-01, at 3; Parrish, UAI-96R-E-MA-01, at 6-7.

### **BPA's Position**

BPA is proposing that the UAI charge for energy for any given month be set at the highest of either 100 mills per kWh (the minimum charge), the highest DJ Mid-C price for the month, or the highest California ISO Supplemental Energy price for the month. Keep *et al*, UAI-96R-E-BPA-03, at 2; Keep *et al*, UAI-96R-E-BPA-05, at 2.

### **Evaluation of Positions**

MAC proposes that the derivation of UAI charges for energy exclude the highest ten percent of the California ISO Supplemental Energy prices for the month. MAC Brief, UAI-96R-B-MA-01, at 3; Parrish, UAI-96R-E-MA-01, at 6. MAC argues that the resulting penalty charges would act as a strong disincentive for customers not to exceed their authorized energy amounts while still giving BPA a high level of confidence that its costs in any hour would be collected. *Id.* MAC's

proposal is ill founded. MAC's proposal would not provide an effective deterrent to energy overruns, nor would it protect BPA against cost exposure associated with energy overruns during the highest cost hours in each month. *Keep et al*, UAI-96-R-E-BPA-05, at 17. On the contrary, it is during the highest cost hours, the very hours which MAC would propose to exclude, that BPA's system is most strained and energy is most scarce. *Id.* It is during these conditions when BPA is most vulnerable to additional costs and customers would be most likely to place unauthorized increases on BPA's system. *Id.* Also, it is during such periods of scarce power and high market prices that the economic incentive for customers to arbitrage unauthorized increases is the greatest. *Id.* Therefore, BPA rejects MAC's proposal.

### **Decision**

*BPA will not exclude the highest 10 percent of indexed prices in the monthly derivation of its UAI charges for energy.*

## **3.0 CONTRACT ISSUES**

### **Issue**

*Whether amendatory agreements numbers 7 and 8 to the 1981 power sales contract preclude BPA from adjusting the level of the UAI charge such that adoption of a change would be a breach of contract.*

### **Parties' Position**

CPUD, SUB, and PPC contend that as part of the load commitment customers made to BPA under amendatory agreements numbers 7 and 8 to the 1981 power sales contract, BPA guaranteed 5-year rate stability without the risk of adjustment. CPUD Brief, UAI-96R-B-CP-01, at 2; SUB Brief, UAI-96R-B-SP-01, at 4; PPC Brief, UAI-96R-B-PP-01, at 8. CPUD argues "BPA expressly waived its right to adjust any rate prior to the expiration of the rate term on September 30, 2001 for those customers that agreed to a minimum load commitment." CPUD, UAI-96R-B-CP-01, at 3. SUB contends "BPA inappropriately attempts to assign the costs of the risk its stated it would assume in the PF-96 Rate Case Record of Decision to AA#7 holders." SUB, UAI-96R-B-SP-01, at 4. In its brief on exceptions MAC contends that "BPA promised not to change *any* of its rates in Amendatory Agreements No. 7 and No. 8 and there is no plausible argument for excluding modifications of the UAI charge from this guarantee." MAC Ex. Brief, UAI-96R-R-MA-01, at 10. PPC claims "[a]ny change to the Unauthorized Increase Charge prior to September 30, 2001, for these utilities eviscerates the very meaning of 'price stability' and is a violation of both Amendatory Agreements." PPC, UAI-96R-B-PP-01, at 9.

### **BPA's Position**

AA7 provides a commitment to rate stability for those products and services which *are purchased* by the customers under the contract and for which they have the right to purchase under the contract. *Keep, et al.*, UAI-96R-E-BPA-05, at 5. It does not apply to charges for supplying energy and demand for which a customer absolutely lacks any right to take under its

contract. *Id.* The parties mistakenly assert that the UAI is a product or service which they can take at any time and is thus subject to the purported “rate commitment.” However, the 1996 Record of Decision rejected the argument that the UAI is a product. The Administrator’s ROD for the 1996 UAI addressed this issue. WP-96-A-02 at 321-322. The UAI charge is not a rate that applies to any product or service that a customer has the contractual right to buy under section 2(a) of AA7 to its contract. *Id.* Whether BPA’s adjustment of the level of this penalty charge constitutes a breach of contract is not within the scope of this rate proceeding.

### **Evaluation of Positions**

In BPA’s direct testimony, BPA stated the intent of the UAI charge is “designed to encourage customers to choose the products they wish to purchase rather than using the unauthorized overruns as an alternative product.” Keep, *et al.*, UAI-96R-E-BPA-03, at 2, *quoting* the 1996 Final Rate Record of Decision at 322. The 1996 UAI charges were set at a level intended to deter customers who had their own generation or a contract obligation to supply power to their load from exceeding their BPA contractual entitlements to power. *Id.* In 1996 many metered customers executed Amendatory Agreement No. 7 to their 1981 power sales contracts and added non-Federal power purchases from the market or other suppliers as firm resources to serve a portion of these customers’ loads. *Id.* Some customers failed to schedule power from their suppliers when the market price was high and thus have taken power beyond their right to buy BPA power, thereby incurring the UAI charge. *Id.* These contracts provide that the UAI charge will apply for any failure to supply their firm power purchases for loads. *Id.*

CPUD, SUB, and PPC raise several arguments regarding the proposed adjustment of the 1996 UAI charge as a violation of the contracts under which they, or customers they represent, purchase power from BPA. CPUD, Brief, UAI-96R-B-CP-01, at 2; SUB Brief, UAI-96R-B-SP-01, at 4; PPC Brief, UAI-96R-B-PP-01, at 8. SUB, CPUD, PPC, and MAC all argue that under the “rate pledge” in AA7 the customer has the right to pay only the current UAI charge and that any change in the charge is inconsistent with the terms of the “rate lock.” SUB Ex. Brief, UAI-96R-R-SP-01 at 2-3; CPUD Ex. Brief, UAI-96R-CP-01 at 3-5; PPC Ex. Brief, UAI-96R-R-PP-01 at 6-8; MAC Ex. Brief, UAI-96R-R-MA-01 at 8-9. As SUB correctly states, contractual disputes lie outside the scope of this rate proceeding. SUB Brief, UAI-96R-B-SP-01, at 2. CPUD contends that BPA’s direct testimony opened the door to the AA7 contract issue and that BPA is now attempting to close that door. CPUD Ex. Brief, UAI-96R-R-CP-01, at 2. CPUD claims that BPA’s position is “fatally flawed” for the following reasons: the UAI charge applies to a product or service purchased by the customer, no provision of AA7 prohibits a customer from taking an unauthorized increase, and the “rate-lock” guarantee in AA7 applies “without restriction.” *Id.* at 3. MAC contends that “BPA promised not to change *any* of its rates in Amendatory Agreements No. 7 and No. 8 and there is no plausible argument for excluding modifications of the UAI charge from this guarantee.” MAC Ex. Brief, UAI-96R-R-MA-01, at 10. Both MAC and CPUD argue that the decision in City of Seattle v. Johnson, 813 F.2d 1364 (9<sup>th</sup> Cir. 1987) on the “availability charge” supports their assertions the UAI charge is a rate covered by the “rate lock.” CPUD Ex. Brief, UAI-96R-R-CP-01, at 8; MAC Ex. Brief, UAI-96R-R-MA-01, at 9.

BPA disagrees with the assertions made by the parties regarding inconsistency or breach of a term of the contract for the following reasons. First, no breach has occurred because the UAI is a

penalty not covered by the “rate lock” language of the contract. Second, BPA has provided to each customer all the federal power to which the customer has a right to purchase. Customers using the UAI charge to “buy” power are taking more than they are contractually or statutorily allowed. Customers cannot, as the parties here have, ignore their own obligations to supply power and then assert that they have a right to service based on the UAI penalty charge. Parties to the 1981 contracts and AA7 knew and understood that the UAI penalty charge was not adopted as a price for a product or service but as a deterrent to any overrun. BPA made this explicit in its 1996 ROD. WP-96-A-02 at 321-322. The parties executed a settlement agreement and agreed to that construct or did not challenge it.

FERC has no jurisdiction to review claims for breach of contract, as opposed to claims the true nature of which is to challenge a final rate of BPA subject to FERC review. *See U.S. Dept of Energy – Bonneville Power Admin.*, 39 FERC ¶ 61,078, 61,213 n. 10) (1987). On this point the Ninth Circuit has held that breach of contract claims when in excess of \$10,000 lie within the jurisdiction of the U. S. Court of Federal Claims under the Tucker Act, 28 U.S.C. §§ 1346(a)(1), 1491. *Public Utility District No. 1 of Clark County v. Johnson*, 855 F.2d 647, 650 (9<sup>th</sup> Cir. 1988). In this proceeding BPA is not asserting that the UAI charge is not subject to FERC review, otherwise BPA would not have conducted a 7(i) proceeding. Rather, the issue of breach of contract does not lie before FERC and the parties’ arguments cannot confer jurisdiction for review by FERC of BPA contracts where none exists under statute. BPA’s position is that subject to FERC review, the change in the level of the UAI is a valid charge which will be applied to overruns when customers fail to meet their obligations to supply power under their contracts.

Under section 7(a) of the Northwest Power Act grants BPA broad authority to “establish, and periodically review and revise” rates in accordance with “sound business principles.” 16 U.S.C. §839e(a)(1). With respect to the posted WP-1996 rates which apply to the products and services customers have chosen to purchase under their contracts, BPA is not proposing any adjustment in those rates. Separate and apart from those rates, BPA has a reasonable concern, grounded in fact, that the current 1996 UAI charge is no longer an effective deterrent to guard against customers choosing to incur the UAI charge. *Keep, et al.*, WP-96R-E-BPA-05, at 6. It is consistent with sound business principles to adjust the level of the UAI charge to maintain its deterrent nature and to preclude customers from using the UAI charge as an alternative product to the customer itself supplying its own services. *Id.* at 5. Therefore, BPA is exercising its authority to propose the adjustment to the 1996 UAI charge because it is a rate that does not attach to any product or service that any customer has a right to; the UAI charge only applies as a penalty when a customer takes Federal power it does not have the right to take. *Id.*

CPUD, SUB, and PPC contend that the power sales contract, particularly AA7 and AA8, preclude BPA from adjusting the 1996 UAI charge. In its brief on exceptions SUB argues that “the rate for the UAI charge is established in section 4(a) and the customer has a right to pay only that rate.” SUB Ex. Brief, UAI-96R-R-SP-01, at 3. CPUD claims that section 4(b) of AA7 expressly waives BPA’s right to adjust the 1996 UAI charge. CPUD Brief, UAI-96R-B-CP-01, at 5. CPUD argues that AA7 grants “the customer the right to take an unauthorized increase” and that AA7 “assigns a rate” for such service. *Id.* at 6. CPUD quotes the following language from section 2(d) of AA7:

Any power that cannot be assigned to a class of power supplied by Bonneville and that is delivered by Bonneville to the Purchaser's loads due to a failure of the Purchaser's supplier to deliver power to Bonneville or the Purchaser's system for the Purchaser's account to meet its delivery obligation shall be treated as an Unauthorized Increase.

*Id.*

The above language does not grant a customer the right, explicitly or implicitly, to buy and take an unauthorized increase nor does it assign to it a rate. CPUD fails to note that section 2(d) explicitly states that BPA has no obligation to serve that portion of the customer's Actual Firm Load that is served by the customer's dedicated resources:

for the portion of its load Actual Firm Load served by such dedicated Firm Resources added under section 2(b)(4), above, Bonneville shall not be obligated to serve such load under this Amendatory Agreement . . . .

When a customer experiences an unauthorized increase due to the operations or scheduling of its dedicated generation or contract resources, or because of customer load forecast error, it causes BPA to supply more power beyond what BPA is obligated to serve under the contract. The customer takes more power than it has a right to take. However, such a taking does not arise as a matter of right to a product or service offered to customers by BPA. The language in section 2(d) quoted by CPUD plainly states that BPA will treat power that is measured but which cannot be assigned to another class of power as an unauthorized increase so that it can be billed to the customer. This provision does not make the UAI an adjustment to the PF rate, but rather it is a separate charge.

In addition, such power is not sold pursuant to the terms of the contract which provide for the sale of amounts of Firm Power and other products to meet the customer's Actual Firm Load under section 2(a) of AA7. And, contrary to SUB's position that section 4(a) of the AA7 established the rate for the UAI charge, the rate for the UAI charge was established in accordance with section 7(i) of the Northwest Power Act, 16 U.S.C. § 839e(i), not the contract.

BPA has not proposed any change to any purchased power rate that is applicable to a customer's contract to purchase power. AA7 [and AA8] provides a commitment to rate stability for those products and services which the customers choose to purchase and for which they have the right to purchase under the contract. Keep, *et al.*, UAI-96R-E-BPA-05, at 5. The rate stability commitment in section 4(b) of the agreement references that "wholesale power, . . . products and services rates . . . for the products and services being purchased under section 2(a) of this Amendatory Agreement or under the Agreement." Section 2(a) provides for the sale of Firm Power, and other products, to meet the customer's Actual Firm Load. However, the UAI charge is not a rate which applies to any product or service that a customer has the right purchase under the contract. It applies to the opposite, power for which there is not purchase right. Keep, *et al.*, UAI-96R-E-BPA-05, at 5. As BPA witnesses testified in 1996,

[t]he purpose of the unauthorized overrun charge is not to set a price for power that BPA markets; BPA has rate schedules for that purpose. Nor is the purpose of the unauthorized overrun charge to meet the market, to be a competitive price for power. Rather, as stated in our direct testimony, the unauthorized increase is designed to discourage customers from taking more power from BPA than they are contractually entitled to take.

Metcalf, *et al.*, WP-96-E-BPA-48, at 5. BPA's testimony in 1996 clearly established that in order to be an effective deterrent, the level of the UAI charge must be set accordingly.

If the price for unauthorized overruns is reduced to where it is equal to the spot market price, at that level the charge would encourage customers not to take certain products and instead rely on unauthorized overruns to receive the same product. For instance, if the unauthorized increase charge is reduced to the spot market price for power, customers could have an economic incentive to use unauthorized overruns to meet fluctuations in load from the amount forecasted instead of purchasing the load shaping product. BPA's customers are in the best position to know their own power needs, and the unauthorized overrun charge serves as an incentive to the customer to select the product it needs.

*Id.* at 6.

Second, although the 1996 UAI charge is contained within the general rate schedules it is included so that BPA can measure the amount taken, calculate the charge and include it as part of a customer's bill. Both PPC and CPUD contend that BPA should have clearly excluded the UAI charge from the rate stability provisions. PPC Ex. Brief, UAI-96R-R-PP-01, at 7; CPUD Ex. Brief, UAI-96R-R-CP-01, at 4. SUB argues that there is "no language in the AA#7 that differentiates rate protection for specific products while excluding rates or charges for other specific products. SUB Ex. Brief, UAI-96R-R-SP-01 at 2-3. BPA is not persuaded by these arguments. Rate stability is provided to those cost based power products and services customers have chosen to purchase under AA7 and AA8. In stark contrast, the UAI charge is not a charge applicable to any cost-based product which a customer has a right to buy, i.e., customers are not entitled to choose to purchase an unauthorized increase.

Contrary to the parties' assertions, BPA believes that the rate lock covers only those rates and charges for products and services which the customer could, and did actually agree to, purchase under its contract. This coverage does not include penalty charges for what the customer itself promised to provide for service to its load. The rate commitment language of Section 4(a) of AA7 states:

Purchaser shall have no obligation to pay Bonneville wholesale power, transmission or products or services rates which differ from the rates specified in section 4(a) above, *for the products and services being purchased under section 2(a) of this Amendatory Agreement or under the [1981] Agreement.*

The parties gloss over the fact that section 2(a) defines the products and services they are "purchasing under the Amendatory Agreement and the [1981] Agreement" which do not include a product or service for unauthorized increases. Mr. Metcalf's testimony referred to in the 1996

ROD set out that the UAI charge was neither a product or service and that it was incorporated into the GRSPs as a penalty for deterrence.

The rate pledge did explicitly except out of its ambit any rate or charge for federal power provided that was not a planned purchase of a product or a service the customer designated. This was the distinction Mr. Metcalf made when he stated the UAI-96 is not a product or a service providing overruns. The rate pledge covers only those rates and charges for the planned purchases of products and services to which the customer pre-agreed under its contract, and does not cover penalty charges for failing to provide power that the customer itself promised to provide for its load.

In the 1996 case, BPA's witnesses testified that the rate components covered by the 5-year rate commitment included an annual demand charge, seasonally and differentiated energy charges, a Load Regulation charge, and a Load Shaping charge. Metcalf, *et al.*, WP-96-E-BPA-18, at 4. In contrast, the UAI charge is a non-cost based penalty charge and thus not one of the cost-based rate components covered by the 5-year rate commitment. Unlike the cost-based products, the 1996 UAI charge does not share coverage of any of the risk of cost-based products. SUB alleges that the proposed adjustment to the UAI would "unilaterally assign the risk" that "BPA assumed . . . associated with 5 year rate commitments in the 1996 rate case." SUB Brief, UAI-96R-B-SP-01, at 4. SUB's position is illogical and unsupportable. As previously stated, the UAI charge is designed as a non-cost based penalty charge. It is unrelated to the risk BPA assumed regarding the losses of its customer load in 1996 and by providing competitive cost-based products and services. *See* Administrator's 1996 Final Rates ROD, WP-96-A-02, at 17. Because it is a penalty charge, it is important that the UAI charge work appropriately. In periods of scarcity of power the 100 mills/kWh UAI charge will look attractive to some customers as an alternative to paying higher market prices. Keep, *et al.*, UAI-96R-E-BPA-03, at 4. In its rebuttal testimony, BPA witnesses provided a clear example of one such incident:

In Data Response No. PP-BPA:004 BPA provided an example of a customer taking action from August 2-9, 2000, not to schedule in power it was obligated to use in load, choosing instead to incur the UAI charge. Use of the UAI charge in this manner is inappropriate and demonstrates a need to adjust the level of the charge so that it operates as a penalty charge to deter similar behavior in the future.

Keep, *et al.*, UAI-96R-E-BPA-05, at 6. Also, it is during such periods when market prices are at their highest when a fixed 100 mills/kWh UAI charge would present the greatest economic incentive to arbitrage Unauthorized Increases into the market. Keep, *et al.*, UAI-96R-E-BPA-03, at 4.

BPA adopted the 1996 UAI charge to act as a deterrent and a penalty and not as a cost-based rate. *See* Keep, *et al.*, UAI-96R-E-BPA-05, at 4-5. It is not a component of any "product" pricing model. The parties are disingenuous when they argue that the adjustment of the level of the UAI charge affects the pricing of a "product." It is not a product. "The Unauthorized Increase Charge BPA has proposed is designed to encourage customers to choose the products they wish to purchase rather than using unauthorized overruns as an alternative 'product.'"

Administrator's 1996 Final Rates ROD, WP-96-A-02, at 322, Attachment A, UAI-96R-E-BPA-05, at A-1.

BPA does not dispute the court's discussion in the City of Seattle case regarding the "availability charge." In dismissing petitions claiming breach of contract for want of jurisdiction, the U.S. Court of Appeals for the Ninth Circuit stated that "[r]ates are simply charges BPA imposes on its customers . . . ." *Id* at 1367. The court further explained that "the statute [the Regional Act] does not require BPA to impose any particular type of rate on its customers." *Id*. In this current section 7(i) proceeding BPA is proposing to adjust the level of the UAI penalty charge. CPUD and MAC are, however, mistaken to assume that if the UAI charge is a rate that it is therefore subject to the rate lock. CPUD Ex. Brief, UAI-96R-R-CP-01, at 4; CPUD Brief, UAI-96R-B-CP-01, at 8; MAC Ex. Brief, UAI-96R-R-MA-01, at 9. For the reasons discussed above, the rate lock does not apply to the UAI charge. Specifically, the UAI charge is not applied in conjunction with any product or service a customer has the contractual right to purchase under section 2(d) of AA7. Rather, it is a non-cost based penalty that is applied when BPA has supplied energy or demand beyond BPA's contract obligation.

MAC further argues that like the availability charge discussed in the City of Seattle case the UAI charge could be characterized as a "volumetric component" of the PF just as the availability charge is for power-overruns. MAC Ex. Brief, UAI-96R-R-MA-01, at 9. BPA rejects this characterization because this was not the approach or the decision that the Administrator made in the 1996 ROD. There is nothing in the ROD which suggests that BPA was adopting the UAI as anything other than a measure of liquidated damages for a customer's failure to perform its half of the bargain, or as a fine to provide an effective deterrent.

SUB and CPUD state that adoption of the adjusted level of the UAI charge may subject BPA to arbitration proceedings for breach of contract. SUB Brief, UAI-96R-B-SP-01, at 5; CPUD Brief, UAI-96R-B-CP-01, at 9. SUB asserts that such challenges could increase BPA's costs rather than stabilize them. SUB Brief, UAI-96R-B-SP-01, at 5. BPA has established that given the wholesale market, it has a penalty charge whose level will result in losses to BPA. *See Keep, et al.*, UAI-96R-E-BPA-03, at 3. BPA does not find that threats of contract challenges or arbitration are any basis to accept such losses and not adjust the level of the penalty so that it remains a deterrence to such losses.

### **Decision**

*Amendatory Agreements 7 and 8 do not preclude BPA from adopting the adjusted level of the 1996 UAI charge as proposed. Adoption of this adjustment is not a breach of contract and is beyond the scope of this rate proceeding.*

## **4.0 PROCEDURAL ISSUES**

### **4.1 The Stipulations by Parties**

Following a notice to the parties dated October 6, 2000, regarding a meeting to discuss schedule and a possible stipulation regarding this proceeding, the parties met on October 11, 2000 and on

October 20, 2000. The parties and BPA agreed that BPA would attempt to address some issues in the UAI-96R case by way of a stipulation. BPA would circulate a stipulation to be executed in counterpart by the parties. Initially, the proposed stipulation was intended to address the admission of direct testimony by BPA and the parties. However, parties were unwilling to stipulate to the admission of testimony in advance of seeing it and to waive cross-examination at that time. Therefore, BPA prepared a form of stipulation whose purpose was to clarify certain questions regarding BPA's proposal to adjust the level of the UAI-96 charge.

On October 11, 2000, BPA circulated a form of stipulation to all parties. BPA has received countersigned forms of this stipulation by all parties to this case with the exception of Alcoa, Inc., Industrial Customers of Northwest Utilities, and PacifiCorp. Given that the overwhelming majority of parties have agreed to this stipulation, and that the parties who have not executed the stipulation presented neither testimony nor briefs in this proceeding, and that no objection was raised by them to the stipulation, BPA will incorporate into its final GRSPs the clarifications and revisions agreed to in the stipulation.

#### **4.2 The Incorporation by Reference of the 1996 Rate Case**

On November 27, 2000, BPA submitted a motion and affidavit of Byron G. Keep to the Hearings Officer for the purpose of moving into evidence the following:

BPA's Exhibit numbers UAI-96R-E-BPA-01 through 05 (with the exception of two sentences on page 06 lines 3-5 of UAI-96R-E-BPA-05 which were stricken) and all attachments and tables.

All BPA Data Responses to Data Requests by the Parties, PG-BPA:001; PGBPA:002; PG-BPA:003; PG-BPA:004; PG-BPA:005; DS-BP:001; PP-BPA:001; PP-BPA:002; PP-BPA:003; PP-BPA:004; PP-BPA:005; PP-BPA:006; PP-BPA:007; PP-BPA:008, constituting clarification of BPA's prefiled testimony.

Parties prefiled direct testimony was also moved into evidence. BPA's motion also requested the Hearing Officer to take official notice, under rule 1010.11(4) of BPA's Procedures Governing Bonneville Power Administration Rate Hearings, of those portions of the 1996 Final Rate Proposal Administrator's Record of Decision, WP-96-A-02, regarding BPA's adoption of the 1996 UAI charge, and those portions of testimony by BPA and the parties in the ROD regarding the UAI charge at 321-322.

On December 12, 2000, the Hearings Officer granted BPA's motion to admit into evidence the testimony and exhibits noted above and stated that official notice was taken of the portion of the 1996 Record of Decision in Docket No. WP-96-A-02 and those portions of testimony referred to regarding the Unauthorized Increase Charge on pages 321-322.

### **4.3 The Waiver of Cross-Examination**

On November 21, 2000, BPA met with the parties to address the question of cross-examination. Only three parties had filed direct and rebuttal testimony to BPA's case. The parties filing testimony stated they did not wish to cross-examine BPA or other witness, and BPA stated that it did not have cross examination for those parties. Subsequent to that meeting, BPA contacted all parties and confirmed that none of them desired to conduct cross examination of any witnesses. On November 27, 2000, in its Motion to Admit Testimony into Evidence, BPA informed the Hearings Officer that all parties were waiving cross examination of all witnesses in this proceeding. No party opposed this motion, and on December 12, 2000, the Hearings Officer entered an order acknowledging and affirming the parties' agreement to waive cross examination in this proceeding.

### **4.4 Environmental Compliance**

BPA's final 1996 rate proposal was found to be consistent with BPA's Business Plan Final Environmental Impact Statement (BPEIS) (DOE/EIS-0183, June 1995) and the Business Plan Record of Decision (ROD) (August 15, 1995), as documented in the tiered 1996 Final Rate Proposal Administrator's ROD (WP-96-A-02, pages 526-528). The proposed adjustment to the 1996 Unauthorized Increase Charge is consistent with that tiered decision.

### **4.5 Participant Comments**

In BPA's Federal Register Notice of this rate proceeding, BPA set November 15, 2000, as the closing date for participant comments concerning the UAI-96R rate filing. 65 Fed. Reg. 58758 (2000). No public participant submitted comments to BPA concerning this proceeding.

## **5.0 CONCLUSION**

As required by law, the adjustment to the 1996 Unauthorized Increase Charge (UAI-96R) established and adopted in this ROD has been set to recover the costs associated with the acquisition, conservation, and marketing of electric power, including the amortization of the Federal investment in the FCRPS (including irrigation costs required to be repaid out of power revenues) over a reasonable period of years and all other power-related costs and expenses incurred by the Administrator in carrying out the requirements of the Northwest Power Act and other provisions of law. In addition, this adjustment has been designed to be as low as possible consistent with sound business principles, to encourage the widest possible use of BPA's power, and to satisfy BPA's other ratemaking obligations, including those contained in the Energy Policy Act of 1992. The Hearing Officer has assured that all interested parties and participants were afforded the opportunity for a full and fair evidentiary hearing, as required by law.

BPA must evaluate its proposed rate provisions in a section 7(i) proceeding pursuant to the Northwest Power Act. BPA must also evaluate the potential environmental impacts of the proposed rates and alternatives thereto as required by National Environmental Policy Act. In this instance, the environmental analysis provided by the Business Plan Final EIS details the

environmental impacts of BPA's final UAI-96R proposal. The environmental analysis contained in the Business Plan Final EIS has been considered in making the decisions in this ROD.

Based upon the record compiled in this proceeding, the decisions expressed herein, and all requirements of law, I hereby adopt the attached Unauthorized Increase Charges (UAI-96R) as final. In accordance with Federal Energy Regulatory Commission Requirements, 18 C.F.R. section 300.10(g), the Administrator hereby certifies that the UAI-96R charges adopted herein are consistent with applicable laws and are the lowest possible rates consistent with sound business principles.

Issued at Portland, Oregon, this 4 day of January, 2001.

/s/ Steven G. Hickok  
Acting Administrator and Chief Executive Officer

**REVISION TO 1996 GRSPs  
UNAUTHORIZED INCREASE CHARGES  
FINAL PROPOSAL**

Delete Section II.R.1 of the GRSPs in the 1996 Wholesale Power and Transmission Rate Schedules, and replace with the following:

**1. Charge for Unauthorized Increase in Demand**

The amount of Measured Demand during a billing hour that exceeds the amount of demand the purchaser is contractually entitled to take during that hour shall be billed at the greater of:

- a. Three (3) times the applicable monthly demand charge;
- b. The sum of hourly California ISO Spinning Reserve Capacity prices for all HLHs in the month, at path NW1 (COB); or
- c. The sum of hourly California ISO Spinning Reserve Capacity prices for all HLHs in the month, at path NW3 Nevada-Oregon Border (NOB).

If the interval pricing for either “b.” or “c.” above is changed to reflect an interval length less than one hour, BPA will calculate an hourly equivalent price for each hour using all of the interval prices at which an “actual transaction took place” within that hour.

**2. Charge for Unauthorized Increase in Energy**

The amount of Measured Energy during a diurnal period of a billing month, day, or hour that exceeds the amount of energy the purchaser is contractually entitled to take during that period shall be billed the greater of:

- a. One hundred (100) mills/kWh; or
- b. for the month in question, the greater of:
  - (1) the highest diurnal DJ Mid-C Index price for firm power; or
  - (2) the highest hourly ISO California Supplemental Energy price (NP15).

If the interval pricing for (2) above is changed to reflect an interval length less than one hour, BPA will calculate an hourly equivalent price for each hour using all of the interval prices at which an “actual transaction took place” within that hour.

The DJ Mid-C Index definitions for HLH's (or peak) and LLH's (or off-peak) will be adjusted, as necessary, to be consistent with (comport with) BPA's definitions for HLH and LLH periods.

In the event that either the ISO California Supplemental Energy price index or the DJ Mid-C Index expires, the index will be replaced for purposes of the Unauthorized Increase Charge for energy by:

- (1) the highest price at which an actual transaction took place, was experienced for the month at the CalPX, NW1 (COB);
- (2) the highest price at which an actual transaction took place, was experienced for the month at the CalPX, NW3 (NOB).

Add the following to Section II.A.6.1, Section II.B.6.1, Section II.C.3.1, and Section II.E.7.1 of the 1996 Priority Firm Rate Schedule; Section II.A.5.1, Section II.B.6.1, and Section II.D.7.1 of the 1996 New Resource Firm Power Rate Schedule; and Section II.B.6.1 and Section II.C.7.1 of the 1996 Industrial Firm Power Rate Schedule; Section II.D.1 of the 1996 Industrial Power Spot Gas Rate Schedule; Section II.C.1 of the 1996 Variable Industrial Power Rate Schedule; Section III.A of the 1996 Reserve Power Rate Schedule; and Section IV. of the 1996 Power Shortage Rate Schedule.

<b>Rate Adjustment</b>	<b>Section</b>
Unauthorized Increase Charge	II.R.1