

**Residential Exchange Program Settlement  
Agreement Proceeding (REP-12)**

**ADMINISTRATOR'S FINAL  
RECORD OF DECISION**

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July 2011

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REP-12-A-02



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**APPENDICES:**

**APPENDIX A           2012 REP SETTLEMENT AGREEMENT**

**APPENDIX B           AMENDMENTS TO CONSUMER-OWNED UTILITY  
RESIDENTIAL PURCHASE AND SALE AGREEMENTS**

## COMMONLY USED ACRONYMS

AGC	Automatic Generation Control
ALF	Agency Load Forecast (computer model)
aMW	average megawatt(s)
AMNR	Accumulated Modified Net Revenues
ANR	Accumulated Net Revenues
ASC	Average System Cost
BiOp	Biological Opinion
BPA	Bonneville Power Administration
Btu	British thermal unit
CDD	cooling degree day(s)
CDQ	Contract Demand Quantity
CGS	Columbia Generating Station
CHWM	Contract High Water Mark
Commission	Federal Energy Regulatory Commission
Corps or USACE	U.S. Army Corps of Engineers
COSA	Cost of Service Analysis
COU	consumer-owned utility
Council	Northwest Power and Conservation Council
CRAC	Cost Recovery Adjustment Clause
CSP	Customer System Peak
CT	combustion turbine
CY	calendar year (January through December)
DDC	Dividend Distribution Clause
<i>dec</i>	decrease, decrement, or decremental
DERBS	Dispatchable Energy Resource Balancing Service
DFS	Diurnal Flattening Service
DOE	Department of Energy
DSI	direct-service industrial customer or direct-service industry
DSO	Dispatcher Standing Order
EIA	Energy Information Administration
EIS	Environmental Impact Statement
EN	Energy Northwest, Inc.
EPP	Environmentally Preferred Power
ESA	Endangered Species Act
e-Tag	electronic interchange transaction information
FBS	Federal base system
FCRPS	Federal Columbia River Power System
FCRTS	Federal Columbia River Transmission System
FELCC	firm energy load carrying capability
FORS	Forced Outage Reserve Service
FPS	Firm Power Products and Services (rate)
FY	fiscal year (October through September)
GARD	Generation and Reserves Dispatch (computer model)

GEP	Green Energy Premium
GRSPs	General Rate Schedule Provisions
GTA	General Transfer Agreement
GWh	gigawatthour
HDD	heating degree day(s)
HLH	Heavy Load Hour(s)
HOSS	Hourly Operating and Scheduling Simulator (computer model)
HYDSIM	Hydro Simulation (computer model)
ICE	Intercontinental Exchange
<i>inc</i>	increase, increment, or incremental
IOU	investor-owned utility
IP	Industrial Firm Power (rate)
IPR	Integrated Program Review
IRD	Irrigation Rate Discount
JOE	Joint Operating Entity
kW	kilowatt (1000 watts)
kWh	kilowatthour
LDD	Low Density Discount
LLH	Light Load Hour(s)
LRA	Load Reduction Agreement
Maf	million acre-feet
Mid-C	Mid-Columbia
MMBtu	million British thermal units
MNR	Modified Net Revenues
MRNR	Minimum Required Net Revenue
MW	megawatt (1 million watts)
MWh	megawatthour
NEPA	National Environmental Policy Act
NERC	North American Electric Reliability Corporation
NFB	National Marine Fisheries Service (NMFS) Federal Columbia River Power System (FCRPS) Biological Opinion (BiOp)
NLSL	New Large Single Load
NMFS	National Marine Fisheries Service
NOAA Fisheries	National Oceanographic and Atmospheric Administration Fisheries
NORM	Non-Operating Risk Model (computer model)
Northwest Power Act	Pacific Northwest Electric Power Planning and Conservation Act
NPV	net present value
NR	New Resource Firm Power (rate)
NT	Network Transmission
NTSA	Non-Treaty Storage Agreement
NUG	non-utility generation
NWPP	Northwest Power Pool
OATT	Open Access Transmission Tariff

O&M	operation and maintenance
OMB	Office of Management and Budget
OY	operating year (August through July)
PF	Priority Firm Power (rate)
PFp	Priority Firm Public (rate)
PFx	Priority Firm Exchange (rate)
PNCA	Pacific Northwest Coordination Agreement
PNRR	Planned Net Revenues for Risk
PNW	Pacific Northwest
POD	Point of Delivery
POI	Point of Integration or Point of Interconnection
POM	Point of Metering
POR	Point of Receipt
Project Act	Bonneville Project Act
PRS	Power Rates Study
PS	BPA Power Services
PSW	Pacific Southwest
PTP	Point to Point Transmission (rate)
PUD	public or people's utility district
RAM	Rate Analysis Model (computer model)
RAS	Remedial Action Scheme
RD	Regional Dialogue
REC	Renewable Energy Certificate
Reclamation or USBR	U.S. Bureau of Reclamation
REP	Residential Exchange Program
RevSim	Revenue Simulation Model (component of RiskMod)
RFA	Revenue Forecast Application (database)
RHWM	Rate Period High Water Mark
RiskMod	Risk Analysis Model (computer model)
RiskSim	Risk Simulation Model (component of RiskMod)
ROD	Record of Decision
RPSA	Residential Purchase and Sale Agreement
RR	Resource Replacement (rate)
RSS	Resource Support Services
RT1SC	RHWM Tier 1 System Capability
RTO	Regional Transmission Operator
SCADA	Supervisory Control and Data Acquisition
SCS	Secondary Crediting Service
Slice	Slice of the System (product)
T1SFCO	Tier 1 System Firm Critical Output
TCMS	Transmission Curtailment Management Service
TOCA	Tier 1 Cost Allocator
TPP	Treasury Payment Probability
Transmission System Act	Federal Columbia River Transmission System Act
TRL	Total Retail Load

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Commonly Used Acronyms

TRM	Tiered Rate Methodology
TS	BPA Transmission Services
TSS	Transmission Scheduling Service
UAI	Unauthorized Increase
ULS	Unanticipated Load Service
USACE or Corps	U.S. Army Corps of Engineers
USBR or Reclamation	U.S. Bureau of Reclamation
USFWS	U.S. Fish and Wildlife Service
VERBS	Variable Energy Resources Balancing Service (rate)
VOR	Value of Reserves
WECC	Western Electricity Coordinating Council (formerly WSCC)
WIT	Wind Integration Team
WSPP	Western Systems Power Pool

**PARTY ABBREVIATIONS  
AND JOINT PARTY DESIGNATION CODES**

Alcoa	Alcoa, Inc.
APAC	Association of Public Agency Customers
Avista	Avista Corporation
Benton	Benton County Public Utility District No. 1
Canby	Canby Utility Board
Cowlitz	Cowlitz County Public Utility District No. 1
EWEB	Eugene Water & Electric Board
Franklin	Franklin County Public Utility District No. 1
Grant	Grant County Public Utility District No. 1
IPC	Idaho Power Company
Idaho PUC or IPUC	Idaho Public Utilities Commission
MSR	M-S-R Public Power Agency
NRU	Northwest Requirements Utilities
PNGC	Pacific Northwest Generating Cooperative
PacifiCorp	PacifiCorp
Pend Oreille	Pend Oreille County Public Utility District No. 1
PGE	Portland General Electric
PPC	Public Power Council
OPUC	Public Utility Commission of Oregon
PSE	Puget Sound Energy
Seattle	City of Seattle – Seattle City Light
Snohomish	Snohomish County Public Utility District No. 1
Tacoma	City of Tacoma/Tacoma Power
WMG&T	Western Montana Electric Generating and Transmission Cooperative
WPAG	Western Public Agencies Group

**Joint Party 1 (JP01) comprises:**

Benton County PUD (BC)  
Cowlitz County PUD (CO)  
Eugene Water & Electricity Board (EW)  
Northwest Requirements Utilities (NR)  
Public Power Council (PP)  
City of Seattle — Seattle City Light (SE)  
Snohomish County PUD (SN)  
City of Tacoma — Tacoma Power (TA)

**Joint Party 2 (JP02) comprises:**

Benton County PUD (BC)  
Cowlitz County PUD (CO)  
Eugene Water & Electricity Board (EW)  
Northwest Requirements Utilities and Members (NR)  
Pacific Northwest Generating Cooperative and its Members (PN)  
Public Power Council (PP)  
City of Seattle — Seattle City Light (SE)  
Snohomish County PUD (SN)  
City of Tacoma — Tacoma Power (TA)

**Joint Party 3 (JP03) comprises:**

Joint Party 3 was inadvertently created. Parties have been disassociated and JP03 does not exist for this proceeding.

**Joint Party 4 (JP04) comprises:**

Avista Corporation (AC)  
Idaho Power Company (IP)  
PacifiCorp (PC)  
Portland General Electric Company (PG)  
Puget Sound Energy, Inc (PS)

**Joint Party 5 (JP05) comprises:**

Avista Corporation (AC)  
Benton County PUD (BC)  
Cowlitz County PUD (CO)  
Eugene Water & Electricity Board (EW)  
Idaho Public Utilities Commission (ID)  
Idaho Power Company (IP)  
Northwest Requirements Utilities and Members (NR)  
PacifiCorp (PC)  
Portland General Electric Company (PG)  
Pacific Northwest Generating Cooperative and its Members (PN)  
Public Power Council (PP)  
Puget Sound Energy, Inc (PS)

Public Utility Commission of Oregon (PU)  
City of Seattle – Seattle City of Light (SE)  
Snohomish County PUD (SN)  
City of Tacoma — Tacoma Power (TA)

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## STATEMENT OF THE ADMINISTRATOR

It has been over a decade since BPA last considered a settlement of the Residential Exchange Program (REP) established by section 5(c) of the Northwest Power Act. As most of those reading this Record of Decision will be aware, BPA's previous attempt at resolving the REP was not broadly supported in the region and resulted in the filing of numerous lawsuits with the United States Court of Appeals for the Ninth Circuit. The history of the ensuing litigation and the various proceedings and hearings that BPA conducted in response to the Court rulings will be described in greater detail in this Record of Decision. Suffice it to say, no other statutory provision of the Northwest Power Act has engendered more litigation and contentiousness than the REP, with 56 petitions for review now pending before the Court. As we have worked through these issues over the various proceedings, I can state with certainty that I have spent countless hours and have dedicated dozens of agency staff to considering the parties' respective and, often, completely divergent views on the proper implementation and rate treatment of the REP.

In 2008, as I was making my final findings in the most controversial of the REP records of decision, I took the unprecedented step of addressing the region in a personal statement. In that statement, I appealed to the litigating parties to find a path that would avoid embroiling the region in perpetual litigation and uncertainty over BPA's rates and the REP. At the end of my statement, I called on the parties to work together to find another lawful way:

This has been a very difficult undertaking, fraught with complexity and with large financial stakes. I believe we have done the best we could do to find a legally sustainable and politically equitable solution (in that order) to the challenge provided by the Ninth Circuit. Nevertheless, I would suggest there remains considerable uncertainty for the parties as to how REP issues may evolve in the future. For that reason I continue to urge the parties to work towards a lawful settlement that will provide greater long-term certainty and, because it will be defined by the parties, greater political equity than what any single Administrator, acting within the confines of the law, can provide.

*See* 2007 Supplemental Wholesale Power Rate Case, Administrator's Final Record of Decision (WP-07 Supplemental ROD), WP-07-A-05, at xx-xxi.

In response to this call, the parties have answered with the 2012 Residential Exchange Program Settlement. I will leave it to the balance of this Record of Decision to discuss my findings on the legal, factual, and policy merits of the Settlement. Here, however, I would like to express my gratitude to the parties for their dedication and collaboration in providing an alternative to the contentious legal challenges that have come to define the REP. The fact that the Settlement is supported by all six regional investor-owned utilities (IOUs), consumer-owned utilities (COUs) representing 88.1 percent of BPA's load, three state utility commissions, a number of COU representative groups, and a retail ratepayer advocacy group, who no more than a year and a half ago were locked in an epic legal battle before the Court over the REP, is a testament to the diligence, commitment, and excellent work of the negotiating parties. Together, this coalition of

interests represents entities that serve roughly 93 percent of the load in the Pacific Northwest region. I commend the negotiating parties for the enormous effort they put into the Settlement to achieve this level of support. I want to thank all of those involved for your hard work and perseverance through difficult and lengthy negotiations. The region is well-served due to your efforts.

## 1.0 INTRODUCTION

### 1.1 Summary Narrative

“It was the best of times, it was the worst of times ....” *See* Residential Exchange Program Settlement Agreement Evaluation and Analysis Study, REP-12-E-BPA-01, at 1 (Evaluation Study), *quoting in part* Charles Dickens, A TALE OF TWO CITIES, at 13 (Signet Classic 1997) (1859).

The past decade has not been, in many respects, the best of times for the Bonneville Power Administration (BPA) with regard to its implementation of the statutory exchange program established by section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act), known as the Residential Exchange Program (REP). 16 U.S.C. § 839c(c)(1). For the better part of the last decade, BPA, six regional investor-owned utilities (IOUs), over a hundred consumer-owned utilities (COUs), and many other regional parties have been locked in continuous litigation over BPA’s implementation of the REP. During this period, BPA has issued 15 records of decision (RODs) relating to the REP, many of which were challenged by parties in the U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit or Court). The legacy of these contentious legal battles is three published court decisions, five unpublished opinions, two remands, and 56 newly filed petitions with the Court. With the closing of the litigious 2000–2010 period, BPA and the region are now facing yet another decade of contentious litigation and uncertainty over the REP.

Better times, however, may yet lie ahead. In December of 2010, a number of regional parties presented BPA with a proposed settlement of the existing REP-related disputes that would replace BPA’s disputed implementation of the REP with a negotiated compromise. This settlement, the 2012 Residential Exchange Program Settlement (“2012 REP Settlement” or “Settlement”),<sup>1</sup> reflects the efforts of a broad coalition of regional parties to replace the cycle of instability and litigation over the REP with stability and certainty for the benefit of all regional ratepayers. These parties, which include six IOUs, three state utility commissions, a number of COU representative groups, a retail ratepayer advocacy group, and COUs representing 88.1 percent of BPA’s load, have asked BPA to join their efforts in ending the litigation and controversy over the REP by adopting the Settlement. In response to these parties’ request for BPA to accept the Settlement, BPA has conducted this proceeding.

The purpose of the Residential Exchange Program Settlement Proceeding (REP-12) is to provide a forum for BPA and regional parties to consider and evaluate the legal, factual, and policy merits of the 2012 REP Settlement. *See Proposed Residential Exchange Program Settlement Agreement Proceeding (REP-12); Public Hearing and Opportunities for Public Review and Comment*, 75 Fed. Reg. 78694, at 78702 (2010). Most importantly, before the Administrator may consider signing the proposed Settlement, he must find that the Settlement complies with the statutory restrictions and protections set forth in the Northwest Power Act. *Id.* To that end,

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<sup>1</sup> The Settlement is referred to as the “2012 REP Settlement” because REP benefits under the Settlement’s terms begin in FY 2012.

BPA Staff and regional parties have spent the past seven months in the formal REP-12 hearing exploring the statutory and technical merits of the proposed Settlement. The resulting record developed in this case reflects the positions of a wide group of parties and contains the full panoply of issues and viewpoints on the statutory questions presented by the Settlement.

The evidentiary record is now complete. The Administrator has reviewed the evidence and the arguments of the parties in their briefs. As will be explained throughout this Record of Decision (ROD), the Administrator’s decision is that the Settlement complies with BPA’s statutory directives and should be adopted. The basis for this decision, and the Administrator’s findings and conclusions on the legal, factual, and policy issues raised by the parties in this proceeding, are addressed in this ROD.

## **1.2 Background of the Residential Exchange Program**

### **1.2.1 Section 5(c) of the Northwest Power Act**

The Residential Exchange Program (REP) was established in section 5(c) of the Northwest Power Act to provide residential and small farm customers of Pacific Northwest (PNW or regional) utilities a form of access to low-cost Federal power. Both investor-owned utilities (IOUs) and consumer-owned utilities (COUs) can participate in the REP, when meeting qualification standards. Section 5(c) requires that:

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

16 U.S.C. § 839c(c)(1). Under the REP, a Pacific Northwest electric utility has a right to offer to sell power to BPA at the utility’s average system cost of providing power (ASC). *Id.* If such an offer is made, then BPA is required to purchase such power at the utility’s ASC<sup>2</sup> and, in exchange, sell an equivalent amount of power to the utility at BPA’s PF Exchange rate. *Id.* This “exchange” transfers no actual power to or from BPA; rather, it is implemented as an accounting transaction to eliminate real power losses and for administrative ease. The amount of the power exchanged equals the exchanging utility’s residential and small farm loads. The net effect of this arrangement is that BPA provides monetary benefits to an exchanging utility based on the difference between the utility’s ASC and the applicable PF Exchange rate, multiplied by the utility’s residential load. These monetary “REP benefits” must be passed through directly to the utility’s residential and small farm consumers. 16 U.S.C. § 839c(c)(3).

In implementing the REP, BPA must determine an exchanging utility’s ASC. Section 5(c)(7) of the Northwest Power Act provides that BPA will determine utilities’ ASCs on the basis of a

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<sup>2</sup> In lieu of such purchase, BPA may under certain circumstances acquire an equivalent amount of electric power from other sources (“*in lieu* transaction”). 16 U.S.C. § 839c(c)(5). Under such circumstances, the Residential Purchase and Sale Agreement (RPSA) would provide for a sale and actual delivery of power by BPA to the utility.

methodology developed by BPA in consultation with the Pacific Northwest region. The ASC Methodology is subject to review and approval by the Federal Energy Regulatory Commission (Commission or FERC). 16 U.S.C. § 839c(c)(7). BPA’s most current ASC Methodology was developed in 2008 (2008 ASC Methodology) and approved by FERC in September of 2009. *See Sales of Electric Power to the Bonneville Power Administration; Revisions to Average System Cost Methodology*, 128 FERC ¶ 61,222 (Sept. 4, 2009).

### **1.2.2 Section 7(b)(2) of the Northwest Power Act and the PF Exchange Rate**

Although utilities’ sales to BPA are made at their ASCs, BPA’s sales to exchanging utilities are made at BPA’s PF Exchange rate. The PF Exchange rate is equal to BPA’s PF Public rate (for power sales to BPA’s preference customers), which is established pursuant to section 7(b)(1) of the Northwest Power Act, 16 U.S.C. § 839e(b)(1), except as the PF Public rate may be adjusted under section 7(b)(2) of the Act, 16 U.S.C. § 839e(b)(2). Section 7(b)(2) creates a “rate test” that compares the PF Public rate established under the Northwest Power Act with a PF Public rate established using five assumptions specified in section 7(b)(2). These five assumptions are:

- (A) the [COUs’] general requirements had included during such five-year period the direct service industrial customer loads which are (i) served by the Administrator, and (ii) located within or adjacent to the geographic service boundaries of such public bodies and cooperatives;
- (B) [the COUs] were served, during such five-year period, with Federal base system resources not obligated to other entities under contracts existing as of December 5, 1980 (during the remaining term of such contracts) excluding obligations to direct service industrial customer loads included in subparagraph (A) of this paragraph;
- (C) no purchases or sales by the Administrator as provided in [section 5(c)] of this section were made during such five-year period;
- (D) all resources that would have been required, during such five-year period, to meet remaining general requirements of the public body, cooperative and Federal agency customers (other than requirements met by the available Federal base system resources determined under subparagraph (B) of this paragraph) were (i) purchased from such customers by the Administrator pursuant to section 839d of this title, or (ii) not committed to load pursuant to section 839c(b) of this section and were the least expensive resources owned or purchased by public bodies or cooperatives; and any additional needed resources were obtained at the average cost of all other new resources acquired by the Administrator; and
- (E) the quantifiable monetary savings, during such five-year period, to public body, cooperative and Federal agency customers resulting from (i) reduced public body and cooperative financing costs as applied to the total amount of resources, other than Federal base system resources, identified under subparagraph (D) of this paragraph, and (ii) reserve benefits as a result of the Administrator’s actions under this chapter were not achieved.

16 U.S.C. § 839e(b)(2)(A)-(E).

The effective comparison made under the section 7(b)(2) rate test is between the PF Public rate established under the Act (the Program Case rate) with a rate that removes certain requirements of the Act (the 7(b)(2) Case rate). The intent of section 7(b)(2) is to protect BPA's preference customers from excessive costs incurred under certain provisions of the Northwest Power Act, most notably the REP. 16 U.S.C. § 839e(b)(2)(C). If the Program Case rate, minus certain adjustments, exceeds the 7(b)(2) Case rate, the rate test "triggers." If the rate test triggers, the PF Public rate is adjusted downward by the amount of the trigger; section 7(b)(3) of the Act requires that the PF Public rate cost reduction be recovered from all other (non-PF Public) rates for power, including the PF Exchange rate. 16 U.S.C. § 839e(b)(3). Assessing the 7(b)(3) surcharge to the PF Exchange rate has the effect of increasing the level of the PF Exchange rate and reducing the amount of REP benefits paid by COUs in their PF Public rates.

Pursuant to section 7(b)(2), BPA was required to implement the rate test for the first time in BPA's 1985 rate case. On May 31, 1984, after a notice and comment proceeding, BPA published a "*Legal Interpretation of Section 7(b)(2) of the PNW Electric Power Planning and Conservation Act*" (*Legal Interpretation*), 49 Fed. Reg. 2911 (1984). The *Legal Interpretation* was intended to resolve the basic legal questions involved in the implementation of section 7(b)(2). Because of the importance and complexity of the 7(b)(2) rate test, and in order to provide customers certainty as to how section 7(b)(2) would be applied, BPA conducted a special evidentiary hearing in 1984 to establish a *Section 7(b)(2) Implementation Methodology* (*Implementation Methodology*). The *Implementation Methodology* was adopted on August 17, 1984. The *Legal Interpretation* and *Implementation Methodology* were modified in BPA's WP-07 Supplemental Rate Proceeding.

### **1.2.3 Calculation of REP Benefits and the Implementation of the REP Through Residential Purchase and Sale Agreements**

Once a utility's ASC has been calculated and the PF Exchange rate has been established, two of the three necessary elements for calculating REP benefits have been determined. The third element, exchange loads, is based upon qualifying residential and small farm loads as measured by each utility participating in the REP. Subsequent to each calendar month, each exchanging utility invoices BPA with its exchange load for the month, and BPA computes the cost of purchase at the utility's ASC and the revenue from the sale at the PF Exchange rate by multiplying relevant rates by the kilowatthours of invoiced exchange load. The net payment is the utility's REP benefit for the month.

The REP has traditionally been implemented through Residential Purchase and Sale Agreements (RPSAs), the first of which were executed in 1981 for a 20-year term.

### **1.3 History of REP Litigation**

#### **1.3.1 Early Litigation Over the REP**

The history of BPA's implementation of the REP is marked by controversy and litigation. Shortly after the passage of the Northwest Power Act in 1980, BPA and regional parties negotiated the terms of BPA's first ASC Methodology (1981 ASC Methodology) and the provisions of 20-year RPSAs that would be used to implement the REP. For the better part of the next decade, BPA and regional IOUs were locked in almost continuous litigation over these components of the REP.

Litigation over the 20-year RPSAs ensued immediately after the passage of the Northwest Power Act. Certain California parties challenged multiple aspects of the RPSAs that BPA and regional IOUs had negotiated. These issues were litigated before the Court and, after six years, were finally resolved in 1986. *See Cal. Energy Res. Cons. & Dev. Comm'n v. Johnson*, 807 F.2d 1456 (9th Cir. 1986).

No party challenged BPA's 1981 ASC Methodology. However, after three years of experience under the 1981 ASC Methodology, BPA revised the 1981 ASC Methodology in order to exclude certain controversial costs from utilities' ASCs. The IOUs and state utility commissions vigorously opposed these changes and attempted multiple times to prevent BPA from finalizing its changes to the 1981 ASC Methodology. *See Pub. Util. Comm'n of Or. v. Bonneville Power Admin.*, 767 F.2d 622 (9th Cir. 1985); *Pac. Power & Light v. Bonneville Power Admin.*, 795 F.2d 810 (9th Cir. 1986). Ultimately, BPA was able to complete its revision of the ASC Methodology in 1984 (1984 ASC Methodology). After FERC approved the 1984 ASC Methodology, regional IOUs and state public utility commissions (PUC) challenged it in Court. The Court affirmed the 1984 ASC Methodology with certain qualifications (*see PacifiCorp v. FERC*, 795 F.2d 816 (9th Cir. 1986)), and the IOUs and PUCs continued to dispute BPA's implementation of the REP. Dozens of BPA's ASC determinations were contested before FERC, several of which were ultimately resolved by the Court. *See Wash. Util. & Transp. Comm'n v. FERC*, 26 F.3d 935 (9th Cir. 1994); *CP Nat. Corp. v. Bonneville Power Admin.*, 928 F.2d 905 (9th Cir. 1991).

#### **1.3.2 BPA's REP Settlement Agreements in the 1980s and 1990s**

The complexity and controversy over the REP drove many utilities to settle their participation in the REP. During the 1980s and 1990s, BPA entered into numerous REP settlement agreements with its preference and IOU customers, referred to at that time as REP Termination Agreements. BPA and its utility customers entered into these long-term REP settlement agreements for many reasons, including the complexity of administering the REP, the avoidance of protracted and contentious REP disputes, and the desire of BPA and many customers for greater convenience and certainty as to their benefits from the program. BPA negotiated settlement agreements and paid benefits under such agreements to 33 exchanging utilities, including all of BPA's exchanging preference customers, for terms up to 15 years. BPA's preference customers made up the vast majority of the utilities that took advantage of this opportunity to settle their REP disputes, with BPA executing REP settlement agreements with 29 preference customers between

1987 and 1996.<sup>3</sup> BPA also entered into settlement agreements with three IOUs between 1994 and 1998. Most of these REP settlement agreements were set to expire in 2001, the end of the term of the 1981 RPSAs.

There is no indication from any of the many REP settlement agreements entered into by the IOUs and preference customers that any such customers took the position that BPA was not authorized to enter into such agreements, that the agreements constituted BPA's abandonment of the REP or adoption of a substitute program for the REP, or that the agreements were improper for any other reason. To the contrary, the REP settlement agreements with IOU and preference customers necessarily reflected the understanding of the parties that such agreements were within BPA's authority. BPA's long history of REP settlement agreements with its IOU and COU customers provided part of the background for a subsequent attempt to settle REP issues.

### **1.3.3 BPA's 2000 REP Settlement Agreements**

#### **1.3.3.1 Background of the 2000 REP Settlements**

As the REP settlements from the 1980s and 1990s neared their expiration, BPA and regional parties commenced a series of meetings to explore the future implementation of the REP, particularly with the region's IOUs, for the FY 2002–2011 period. These regional discussions began in 1996 with the convening of the Comprehensive Review of the Northwest Energy System, a Steering Committee led by the governors of Idaho, Montana, Oregon, and Washington. *See generally* Power Subscription Strategy ROD, December 1998. The Steering Committee's Final Report proposed a "subscription" system for purchasing specified amounts of power from BPA at cost with incentives for customers to take longer-term subscriptions. In connection with its Subscription proposal, the Steering Committee encouraged BPA and other parties in the region to explore a settlement of the REP with the region's IOUs.

The Comprehensive Review led to the Federal Power Subscription Work Group process and the resulting Subscription Strategy ROD and contracts. The Subscription Strategy was a comprehensive BPA business plan that planned many details regarding service for all of BPA's customer classes: preference customers, IOUs, and DSIs. For the IOUs, the Subscription Strategy proposed that BPA would offer the ability to (1) continue participation in the REP through RPSAs or (2) enter into negotiated settlement agreements of the REP for the FY 2002–

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<sup>3</sup> BPA executed REP settlement agreements with the following preference customers between 1987 and 1996: PUD No. 1 of Clallam County, WA; Glacier Electric Cooperative; PUD No. 1 of Klickitat County, WA; Prairie Power Cooperative, Inc.; Vigilante Electric Power Cooperative, Inc.; Flathead Electric Cooperative, Inc.; PUD No. 1 of Grays Harbor County, WA; Orcas Power & Light Co.; Salmon River Electric Cooperative, Inc.; Blachly-Lane Electric Cooperative Association; Central Electric Cooperative, Inc.; Consumers Power, Inc.; Coos-Curry Electric Cooperative, Inc.; Douglas Electric Cooperative, Inc.; Lost River Electric Cooperative, Inc.; Oregon Trail Electric Cooperative; Raft River Electric Cooperative, Inc.; Umatilla Electric Cooperative Association; PUD of Clark County; City of Idaho Falls; Oregon Trail Electric Consumers Cooperative; Lewis County PUD; Inland Power & Light Company; the Pacific Northwest Generating Cooperative; Fall River Rural Electric Cooperative; Lower Valley Power & Light, Inc.; Benton Rural Electric Association; Clearwater Power Company; and Harney Electric Cooperative, Inc. BPA also entered into REP Settlement Agreements with IOUs between 1994 and 1998: PacifiCorp; Puget Sound Power & Light Company; and Portland General Electric Company.

2011 period. The proposed settlement of the REP would provide benefits in settlement of, and in return for, a waiver of claims under the REP. Under the Subscription Strategy, and the subsequent 2000 REP Settlements, benefits were to be in the form of monetary payments or the sale of power, or both. The IOUs' residential and small farm loads would, under the proposed settlement, be assured access to the equivalent of 1,900 aMW of BPA power benefits for the FY 2002–2006 period and 2200 aMW of BPA power benefits for the FY 2007–2011 period. At least 1,000 aMW during the first five years, FY 2002–2006, were to be met with actual BPA power deliveries. Any monetary payment would reflect the difference between the market price of power forecast in BPA's rate case and an amount expected to be approximately equal to the PF Preference rate (currently known as the PF Public rate). After completion of an administrative review proceeding and based upon the record compiled in that proceeding, the Administrator decided to offer the 2000 REP Settlements. The IOUs chose to execute the 2000 REP Settlements.

### **1.3.3.2 Collecting the Costs of the 2000 REP Settlements in Rates**

In 1999, BPA commenced its 2002 Wholesale Power Rate Adjustment Proceeding (WP-02 rate proceeding) to establish rates for the five-year period beginning in FY 2002 (FY 2002–2006). In the WP-02 rate proceeding, BPA proposed to recover the cost of the 2000 REP Settlements in rates charged to BPA's customers. The costs of the 2000 REP Settlements to be collected in rates came in two forms. First, the 2000 REP Settlements provided monetary benefits to the IOUs. These payments were expected to reach approximately \$66 million per year for the five-year rate period. In addition to the monetary benefits, a power sale at a rate equivalent to the PF Preference rate was included in the 2000 REP Settlement package of benefits. The cost of providing these power sales to the IOUs under the 2000 REP Settlement was expected to be approximately \$73 million per year for the five-year rate period. Together, the combination of payments and the below-market power sale was expected to result in a total cost in rates of about \$140 million per year for FY 2002–2006.

In setting the WP-02 rates, BPA characterized the costs of the 2000 REP Settlements as “settlement” costs rather than benefit payments provided under the REP. This characterization was significant because, for ratemaking purposes, the costs of the settlements were treated as normal business expenses that were allocable to all power rates (including the PF Preference rate) under section 7(g) of the Northwest Power Act rather than REP benefit payments that would be subject to the limitations set forth in section 7(b)(2). As viewed by BPA at the time, allocating the costs of the 2000 REP Settlement to the PF Preference rate without regard for section 7(b)(2) was permissible because the 2000 REP Settlements involved generic “settlement” payments, not payments of REP benefits under the exchange program established by section 5(c). BPA ultimately decided that the costs of the 2000 REP Settlement could be allocated to the PF Preference rate as a normal business cost under the general “equitably allocate” ratemaking principles established in section 7(g). 16 U.S.C. § 839e(g).

After BPA executed the 2000 REP Settlements, the West Coast experienced an unprecedented spike in energy prices. A combination of low stream flows, high market prices, and an increase in demand for BPA power created a “perfect storm” for BPA. The West Coast energy crisis of

2000–2001 caused BPA to revise its rates and the 2000 REP Settlement benefits. The payments to the IOUs were increased because the 2000 REP Settlements set REP benefits as the difference between the market price of energy and BPA’s then-PF Preference rate; thus, as the West Coast energy crisis drove market prices upward, REP benefits increased. Also, BPA entered into Load Reduction Agreements (LRAs) during the energy crisis with two IOUs that allowed BPA to monetize the expected power sales to these utilities. In all, the modifications increased the 2000 REP Settlement benefits by more than \$160 million per year, resulting in over \$300 million in total benefits paid each year during FY 2002–2006. Most of these costs fell on BPA’s preference customers and their consumers.

#### **1.3.4 Challenges to the 2000 REP Settlements and the WP-02 Rates**

In January of 2001, certain parties filed petitions with the Ninth Circuit challenging BPA’s statutory authority to implement the REP through the 2000 REP Settlements. In September 2003, following final FERC confirmation and approval of BPA’s WP-02 rates, parties also filed challenges to BPA’s decision to recover the costs of the 2000 REP Settlements from the PF Preference rate without performing the 7(b)(2) rate test.

In 2003, BPA proposed a settlement of all legal challenges to the 2000 REP Settlements and other litigation. This “global” settlement was never adopted. Nevertheless, based on the proposed global settlement and on BPA’s posting of the PacifiCorp and Puget Sound Energy LRAs on its Web site, two parties challenged a provision of the LRAs (referred to as the “Reduction in Risk” provision) under which the cost of the two LRAs decreased if all parties settled the 2000 REP Settlement litigation.

After the global settlement efforts failed, BPA and the IOUs executed a number of amendments to the 2000 REP Settlements in 2004 that placed caps and floors on the amount of payments the IOUs would receive during FY 2007–2011. These amendments are referred to as the 2004 Amendments. Among other changes effectuated by the 2004 Amendments was an amendment to the Reduction in Risk provision that deferred the payment of \$100 million under the LRAs until the FY 2007–2011 period. The 2004 Amendments were timely challenged.

In 2006, while all of the foregoing challenges were still pending before the Court, the WP-02 rates expired and were replaced by rates established in BPA’s 2007 Wholesale Power Rate Proceeding (WP-07 rates) for the FY 2007–2009 period. In setting the WP-07 rates, BPA again allocated a significant portion of the costs of the 2000 REP Settlements to the PF rate without performing the 7(b)(2) rate test. The WP-07 rates were filed with FERC on July 28, 2006, and received interim approval from the Commission on September 21, 2006.

#### **1.3.5 The Court’s Decisions: PGE, Golden NW, and Snohomish**

On May 3, 2007, before FERC approved BPA’s WP-07 rates, the Court issued two decisions in the pending challenges to the 2000 REP Settlements and the then-expired WP-02 rates. In *Portland General Electric v. Bonneville Power Admin.*, 501 F.3d 1009 (9th Cir. 2007) (*PGE*), the Court granted petitions challenging BPA’s decision to adopt the 2000 REP Settlements. Significantly, the Court concluded that the 2000 REP Settlements were an improper exercise of

BPA's settlement authority because they were inconsistent with sections 5(c) and 7(b) of the Northwest Power Act.

In a companion case issued the same day, *Golden Northwest Aluminum v. Bonneville Power Admin.*, 501 F.3d 1037 (9th Cir. 2007) (*Golden NW*), the Court held that BPA had improperly allocated the cost of the 2000 REP Settlements to the then-PF Preference rate in violation of section 7(b)(2). 501 F.3d at 1048. The Court concluded it was not proper for BPA to allocate to the PF Preference rate costs of the 2000 REP Settlements in excess of the section 7(b)(2) rate test trigger amount based on BPA's theory that such costs were incurred pursuant to the Administrator's section 2(f) contracting authority and could therefore be "equitably allocated" pursuant to section 7(g) of the Northwest Power Act. The Court remanded the WP-02 rates to BPA with instructions to set rates "in accordance with this opinion." *Id.* at 1053.

After issuing the *PGE* and *Golden NW* decisions, the Court also reviewed challenges to certain amendments to the 2000 REP Settlements signed in 2004. *See Pub. Util. No. 1 of Snohomish County, Wash. v. Bonneville Power Admin.*, 506 F.3d 1145 (9th Cir. 2007) (*Snohomish*). In *Snohomish*, the Court held that the validity of the 2004 Amendments depended on how BPA treated the underlying 2000 REP Settlements in light of *PGE*. *Id.* at 1154. The Court then remanded to BPA the 2004 Amendments and the Reduction of Risk portion of the LRAs (as amended by the 2004 Amendments). *Id.* The Court dismissed all other challenges to the LRAs. *See Pub. Util. Dist. No. 1 of Grays Harbor County, Wash.*, 250 Fed. Appx. 820; *Pub. Util. Dist. No. 1 of Snohomish County, Wash.*, 250 Fed. Appx. 817; *Pub. Util. Dist. No. 1 of Snohomish County, Wash.*, 250 Fed. Appx. 821.

### **1.3.6 BPA's Response to PGE, Golden NW, and Snohomish: the WP-07 Supplemental Rate Hearing (FY 2002–2009) and the 2008 RPSAs**

#### **1.3.6.1 Overview of the WP-07 Supplemental Rate Hearing**

Following the issuance of the *PGE*, *Golden NW*, and *Snohomish* decisions, BPA ceased making payments to the IOUs under the 2000 REP Settlements and commenced a section 7(i) process to determine whether and to what extent the 2000 REP Settlements caused illegal costs to be included in rates charged to the COUs. This proceeding, referred to as the WP-07 Supplemental Rate Hearing, began in February of 2008. The WP-07 Supplemental proceeding had three central components.

First, BPA established rates for FY 2009 that complied with the Court's order by removing the costs of the 2000 REP Settlements and replacing them with the costs of REP benefits that complied with sections 5(c) and 7(b)(2) of the Northwest Power Act. As part of BPA's prospective implementation of the section 7(b)(2) rate test, BPA revised its Section 7(b)(2) Legal Interpretation and Section 7(b)(2) Implementation Methodology.

Second, BPA performed an analysis, referred to as the "Lookback," to determine whether BPA had overcharged the COUs' rates for the WP-02 period (FY 2002–2006) and the first two years of the WP-07 rate period (*i.e.*, FY 2007–2008) (collectively, the "Lookback period"). To do this,

BPA compared the payments the IOUs received under the 2000 REP Settlements with the amount of REP benefits the IOUs would have received under a traditional implementation of the REP pursuant to sections 5(c) and 7(b) of the Act. To calculate the amount of REP costs for the Lookback period, BPA reviewed how ASCs would have been established during the Lookback period under the 1984 ASC Methodology, how BPA would have included REP costs in the WP-02 and WP-07 rates, and any adjustments that would have been necessary to more closely track the amount of REP benefits that would have been incurred during that period through implementation of the REP in the absence of the 2000 REP Settlements. Accordingly, BPA made a number of adjustments to its calculation of the section 7(b)(2) rate test, adjustments that would have been incorporated into the WP-02 and WP-07 rates in the absence of the 2000 REP Settlements using information available when establishing the final WP-02 and WP-07 rates.

Third, BPA proposed a method for collecting the overcharges from the IOUs and returning these funds to the COUs as refunds. IOUs that received more in REP benefits under the 2000 REP Settlements than allowed by sections 5(c) and 7(b)(2) of the Northwest Power Act would be assessed a refund obligation known as a “Lookback Amount.” BPA proposed to collect the Lookback Amounts from the IOUs by withholding future benefits owed to the IOUs under the REP. The withheld REP benefits would then be used to fund refunds to the injured COUs that were originally overcharged in rates as a result of the 2000 REP Settlements.

#### **1.3.6.2 Conclusions Reached in the WP-07 Supplemental Rate Hearing: the WP-07 Supplemental Record of Decision (WP-07 Supplemental ROD)**

The WP-07 Supplemental Rate Hearing proved to be one of the most complex administrative hearings conducted in BPA’s history. By the close of the eight-month WP-07 Supplemental Rate Hearing, BPA had compiled an administrative record that exceeded 117,000 pages. The parties raised hundreds of issues regarding BPA’s Lookback Analysis and implementation of the section 7(b)(2) rate test. BPA responded to the parties’ arguments in a 709-page ROD, the 2007 Supplemental Wholesale Power Rate Case Administrator’s Final Record of Decision (WP-07 Supplemental ROD), issued on September 22, 2008. WP-07 Supplemental ROD, WP-07-A-05.

In the WP-07 Supplemental ROD, BPA concluded that the COUs had been overcharged in rates as a result of the 2000 REP Settlements by approximately \$1 billion during the FY 2002–2008 period. *Id.* at 166-251. BPA proposed to return these overcharges to the injured COUs with an initial lump-sum cash payment in 2008 and then through future reductions in REP benefit payments to the applicable IOUs. *Id.* at 256-297.

In addition to determining the refunds and overcharges caused by the 2000 REP Settlements, the WP-07 Supplemental ROD also addressed BPA’s final decisions on the appropriate amount of REP benefits to pay the IOUs and include in rates for FY 2009. To make this determination, BPA had to address a host of controversial issues related to the section 7(b)(2) rate test. More than 270 pages of the WP-07 Supplemental ROD were dedicated to addressing the issues and arguments presented by the parties on the section 7(b)(2) rate test alone. *Id.* at 398-676.

The extraordinary complexity of the issues in the WP-07 Supplemental Rate Hearing led BPA’s Administrator, Stephen Wright, to take the unprecedented step of issuing a statement as a preface to the WP-07 Supplemental ROD. In this statement, Administrator Wright candidly acknowledged that “[o]f the three BPA power rate cases I have had the responsibility for deciding, all have been contentious, but this has been by far the most difficult.” WP-07 Supplemental ROD, WP-07-A-05, at xv. While including the “usual array of complex issues associated with projected revenues, rate design, and rate levels,” this case also involved the “unprecedented challenge of responding to a remand from the Ninth Circuit Court of Appeals.” *Id.* The complexity present in this proceeding was compounded by the substantial debate over BPA’s implementation of section 7(b)(2) of the Northwest Power Act, a provision that Administrator Wright described as a “[b]yzantine sentence that nearly fills a page and that is, in my view, the most complicated section in the Act.” *Id.*

### **1.3.6.3 Development of the 2008 RPSAs**

Because the traditional REP was being implemented for FY 2009, BPA also needed to negotiate and execute new RPSAs with the IOUs intending to participate in the REP. Thus, concurrent with the WP-07 Supplemental Rate Hearing, BPA engaged in a public process to develop new RPSAs. After taking public comments on a prototype RPSA, BPA published a final RPSA in September of 2008. Among other terms included in the RPSA, BPA adopted a provision that would allow BPA to recover the Lookback Amounts from the IOUs by reducing future REP benefit payments. BPA’s justification for including this and other provisions in the RPSA was explained in the 2008 RPSA Record of Decision (2008 RPSA ROD).

### **1.3.7 Challenges to the WP-07 Supplemental ROD and the 2008 RPSA ROD: APAC, IPUC, and Avista**

BPA’s decisions in the WP-07 Supplemental ROD and the 2008 RPSA ROD were vigorously opposed by both COUs and IOUs, state utility commissions from Oregon (OPUC) and Idaho (IPUC), and the Citizens’ Utility Board of Oregon (CUB). Although the parties’ claims are numerous and multifaceted, they can generally be summarized as follows: the COUs claim that BPA has grossly underestimated the IOUs’ refund obligation and that the actual overcharge to COUs for the FY 2002–2008 period is at least \$2 billion and growing. The IOUs, in contrast, argue that no refunds are owed at all because the Court did not direct BPA to provide refunds and because the terms of their 2000 REP Settlements specifically prohibit BPA from recouping REP benefits paid under those agreements.

The IOUs and the COUs also oppose BPA’s interpretation and implementation of the section 7(b)(2) rate test. These disputes, if resolved in the manner advocated by the IOUs, would eliminate the triggering of the section 7(b)(2) rate test, thereby reducing the PF Exchange rate, and as a result substantially increasing the IOUs’ REP benefits. Conversely, if resolved in the manner advocated by the non-exchanging COUs, these issues would result in a larger triggering of the section 7(b)(2) rate test, thereby increasing the PF Exchange rate, and as a result substantially decreasing the IOUs’ REP benefits.

In the months following BPA's issuance of the WP-07 Supplemental ROD and the 2008 RPSA ROD, the parties filed multiple petitions for review with the Ninth Circuit. These petitions were subsequently consolidated into the following three cases.

**1.3.7.1 *Ass'n of Public Agency Customers et al. v. Bonneville Power Admin., Nos. 08-74725 et al. (APAC)***

Following the WP-07 Supplemental proceeding, BPA issued its WP-07 Supplemental ROD on September 22, 2008. In the WP-07 Supplemental ROD, as noted above, BPA conducted its comprehensive "Lookback" analysis wherein BPA calculated the refunds owed to the COUs and the refund liability of each of the IOUs. Beginning November 14, 2008, various BPA customers and constituents filed 14 petitions for review with the Ninth Circuit challenging BPA's Lookback analysis and the refund-related findings BPA reached in the WP-07 Supplemental ROD. On January 20, 2009, the Court issued an order consolidating all the petitions for review into *APAC* and granting interventions. Briefing on the issues in these cases concluded in March 2010.

**1.3.7.2 *Idaho Public Utilities Comm'n et al. v. Bonneville Power Admin., Nos. 08-74927 et al. (IPUC)***

Beginning December 3, 2008, certain BPA customers and state public utility commissions filed seven petitions for review with the Ninth Circuit challenging the 2008 RPSAs, which were offered to customers eligible for the REP on September 12, 2008. Shortly thereafter, six other petitions for review were filed by various BPA customers and constituents seeking review of the same or substantially the same actions. These parties challenge various provisions of the RPSA. In particular, the petitioners object to a provision of the RPSA that permits BPA to withhold REP benefits payable to the IOUs in order to recover Lookback Amounts determined in the WP-07 Supplemental ROD. On January 16, 2009, the Court issued an order consolidating all the petitions for review into *IPUC* and granting interventions. Briefing on the issues in these cases concluded in March 2010.

**1.3.7.3 *Avista Corp. et al. v. Bonneville Power Admin., Nos. 09-73160 et al. (Avista)***

On July 16, 2009, FERC granted final approval to BPA's WP-07 Wholesale Power Rates. Within the next 90 days, a number of parties filed petitions for review with the Ninth Circuit challenging BPA's WP-07 rates, BPA's 2008 Section 7(b)(2) Legal Interpretation, and BPA's Section 7(b)(2) Implementation Methodology. These consolidated petitions involve challenges to BPA's WP-07 ratemaking issues and in particular the 7(b)(2) rate test decisions BPA reached in the WP-07 Supplemental ROD. Briefing on these issues will commence in September 2011.

**1.3.8 *The Second Generation of Challenges—The WP-10 Record of Decision: PGE II and PacifiCorp***

While the *APAC* and *IPUC* cases were being briefed, BPA commenced a rate proceeding to establish rates for the FY 2010–2011 period (WP-10 rate proceeding). In the WP-10 rate proceeding, BPA proposed to continue to implement the Lookback remedy by reducing the

IOUs' prospective REP benefit payments and paying refunds to the COUs based on the determinations made in the WP-07 Supplemental ROD. BPA also proposed to implement the section 7(b)(2) rate test in the same manner as in the WP-07 Supplemental ROD. In order to minimize the need for BPA and the parties to file duplicative arguments addressed in the WP-07 Supplemental ROD, all of the parties' arguments and evidence submitted in the WP-07 Supplemental Rate Hearing related to the Lookback and BPA's implementation of sections 7(b)(2) and (3) were incorporated by reference into the WP-10 administrative record.

On July 21, 2009, BPA issued its final Record of Decision in the WP-10 rate proceeding (WP-10 ROD). Subsequently, parties filed petitions challenging BPA's decisions in the WP-10 ROD. These challenges were consolidated by the Court as described below.

#### **1.3.8.1 *Portland General Electric Co. et al. v. Bonneville Power Admin., Nos. 09-73288 et al. (PGE II)***

On July 21, 2009, BPA issued its final decision in the WP-10 rate proceeding. As noted above, the WP-10 rate proceeding incorporated certain decisions from BPA's WP-07 Supplemental ROD that are under review in APAC. In October and November of 2009, five investor-owned utilities filed petitions for review of such decisions to the extent the decisions involved non-ratemaking issues that might be subject to the Ninth Circuit's jurisdiction prior to FERC's final approval of BPA's WP-10 power rates. It is BPA's understanding that these challenges are primarily directed at BPA's decision to withhold REP benefits from the IOUs in order to repay the disputed Lookback Amounts. The IOU petitioners in *PGE II* acknowledge that the ratemaking issues in the WP-10 rate case (such as the implementation of sections 7(b)(2) and (3)) would not be timely until FERC granted final confirmation and approval to such rates. Briefing on these issues is scheduled to commence in December of 2011.

#### **1.3.8.2 *PacifiCorp et al. v. Bonneville Power Admin., Nos. 10-73348 et al.***

On August 6, 2010, FERC granted final confirmation and approval of the WP-10 power and transmission rates. Certain investor-owned utilities, consumer-owned utilities, and a group of industrial consumers served by consumer-owned utilities filed petitions for review of the Lookback and ratemaking decisions underlying the WP-10 rates. These consolidated petitions for review were in turn consolidated with the petitions for review in *PGE II*, Nos. 09-73288 *et al.*

### **1.4 The Need for Settlement of the REP Litigation**

As summarized above, there is extensive litigation pending in the Ninth Circuit on issues related to BPA's establishment of its power rates and BPA's implementation of the REP from FY 2002 to the present. By the release date of this ROD, there are 56 petitions before the Ninth Circuit challenging virtually every aspect of BPA's Lookback and section 7(b)(2) decisions. *Stiffler et al.*, REP-12-E-BPA-13, at 4; *see also* Murphy and Kallstrom, REP-12-E-JP02-02, at 3. This litigation creates significant uncertainty for BPA and its customers regarding both retrospective and prospective wholesale power rate levels and REP benefits. Furthermore, the scope of these challenges spans a decade of BPA ratemaking, from FY 2002–2011. *Stiffler et al.*, REP-12-E-

BPA-13, at 4. A remand by the Court of a substantive issue in any of the pending Ninth Circuit cases could result in BPA having to once again revise rates from prior periods to conform to the Court's opinion. *Id.*

The disruption that the pending litigation poses to BPA and the region is substantial. As things stand now, not a single COU or IOU ratepayer of BPA knows whether or not the rates it has paid, the REP benefits it has distributed to its consumers, or the refunds it has received over the past 10 years are lawful. *Id.* To put this in perspective, by the end of FY 2011, BPA will have paid \$587 million in refund payments to the COUs and \$637 million in REP benefits to the IOUs during FY 2007–2011. FY 2012–2013 Lookback Recovery and Return Study, REP-12-E-BPA-03, at 6, 16, line 76 (sum of columns D, E, and F plus \$110.4 million paid to IOUs pursuant to the 2008 Residential Exchange Interim Relief and Standstill Agreements). *Every single one of these dollars is potentially subject to being reclaimed by BPA as a result of the pending REP litigation.* Furthermore, as noted by Staff, “the problem only grows with time.” Stiffler *et al.*, REP-12-E-BPA-13, at 4. To date, the IOUs, OPUC, IPUC, CUB, and the Washington Utilities and Transportation Commission (WUTC) contend that all of the \$587 million in withheld REP benefits must be paid to their regional consumers. Conversely, the COU-aligned parties claim the unpaid refund amounts still owed by the IOUs have ballooned to “\$4.028 billion, and [are] increasing.” Wolverton, REP-12-E-AP-01, at 14. With each new attempt by BPA to “fix” the latest set of problems with its implementation of the REP, a new wave of litigation will likely be filed. Stiffler *et al.*, REP-12-E-BPA-13, at 4. The end result is that, until the Court finally rules on almost every issue in contention among the many parties, the region will face continuing uncertainty in both the level of the PF rate and the amount of REP benefits payable to the IOUs. *Id.* at 5. As Staff ominously noted: “We are already in the second generation of litigation; how many more generations need to occur before matters are finally consummated? We fear that this generation would not be the last.” *Id.*

This fear of never-ending litigation over the REP was echoed by other parties and served as one of the primary motivations behind the movement among COUs and IOUs to seek an alternative to litigation. In considering their reasons for moving away from litigation, a large group of COUs responded as follows:

The prospect for never-ending, inconclusive litigation caused most of [the Settling COUs to] recognize the unlikelihood of achieving any certainty through litigation and remand in a time frame they considered reasonable. And, increasingly, parties have realized that a small minority of the parties affected by the costs or benefits of the REP could embroil everyone else through a seemingly endless cycle of conflict and related expense.

Murphy and Kallstrom, REP-12-E-JP02-02, at 18-19.

Resolution of past disputes was not the only reason parties so diligently sought an alternative to continued litigation over the REP. With the regional IOUs and COUs at loggerheads over BPA's implementation of the REP, the long-term needs of the region also suffered. As described by one set of customers:

The uncertainty over the costs of the REP complicates any long-term planning by COUs, including resource planning. The uncertainty also affects the COUs' long-term management of rates, because one major cost component of their most significant power source is unpredictable. The time-lags created by fighting the issues out in rate cases before BPA and then challenging BPA's determinations in court also create potential inequities because of the practical inability to get any relief into the hands of whichever retail consumers may have been harmed. These numerous and significant uncertainties are among the major factors that have encouraged the COUs to attempt to develop a settlement with BPA and the IOUs that addresses both the pending litigation and the future REP costs.

*Id.* at 14. Whereas continuing to litigate the REP could, at best, result in “additional litigation, forcing the parties to repeat the cycle,” a settlement offered the litigating parties a “reliable route to known, acceptable results within a reasonable time frame.” *Id.* at 13, 20.

The time for settlement of the REP was also particularly ripe because of new developments in BPA ratemaking. The FY 2012–2013 rate period is the inaugural rate period under BPA's Tiered Rate Methodology (TRM), which serves as the rate methodology BPA will use to set rates for BPA's COU customers under their 17-year Regional Dialogue Contracts. Carrasco *et al.*, REP-12-E-JP02-01, at 4. As described by one group of COU representatives, “[t]he TRM and the ‘Regional Dialogue’ contracts related to the TRM represent a fundamentally new, more stable model for BPA to conduct its power marketing business.” *Id.* In the context of a new set of long-term power contracts and a new rate methodology, these COUs contend that it “makes sense for BPA, the IOUs, and the COUs to concurrently develop an agreed-upon long-term, stable model for implementing the REP.” *Id.*

It is against this factual backdrop that regional parties turned their attention from litigation to settlement discussions. These discussions took place over a number of years in various forums and venues. A brief description of these efforts is provided in the next section.

## **1.5 Background of the 2012 REP Settlement**

### **1.5.1 Pre-WP-07 Supplemental ROD Efforts at Settlement—the November 2007 Recommendations**

The 2012 REP Settlement reflects the efforts of a broad group of BPA customers and other interested parties that, for the better part of four years, has attempted to reach a global settlement of disputes over BPA's past and future implementation of the REP. Evaluation Study, REP-12-FS-BPA-01, section 4.1. These efforts began in mid-2007, shortly after the Court issued its decisions in *PGE* and *Golden NW*. *Id.* At that time, BPA commenced a series of meetings with interested parties to discuss BPA's response to the Court's opinions. *Id.* During these meetings, BPA encouraged representatives of the COUs and IOUs to reach a settlement over the REP to avoid protracted and complicated litigation. *Id.* Thereafter, a group of IOU and COU representatives, representing the vast majority of regional utilities, engaged in an intensive negotiation effort to find common ground. *Id.* Ultimately, in November 2007, the represented

parties were able to reach agreement on a non-binding value structure and framework that, in the parties' view, would equitably resolve both past and future disputes over BPA's implementation of the REP. *Id.* These recommendations, referred to as the November 2007 Recommendations (Recommendations), asked BPA, among other items, to reinstate the REP with the expectation of providing the IOUs between \$200 million and \$220 million annually (in nominal dollars) from FY 2007 through FY 2028. *Id.*; *see also* Bliven *et al.*, WP-07-E-BPA-52, at 26-27. The parties requested that BPA implement the Recommendations in its WP-07 Supplemental rate proposal. *Id.*

The parties submitted the Recommendations to BPA just prior to the scheduled initiation of BPA's WP-07 Supplemental rate proceeding. *Id.* In response, BPA delayed the commencement of the WP-07 Supplemental rate proceeding and met with IOU and COU groups throughout November and December 2007 in an attempt to determine whether the concepts in the Recommendations could feasibly be implemented. *Id.* Although progress was being made on developing a construct that would permit Staff to propose an implementation of the Recommendations in rates, time constraints ultimately precluded the parties and Staff from finalizing a resolution that could be proposed in the WP-07 Supplemental rate proceeding. *Id.* at 27-28. Staff subsequently withdrew from the settlement discussions to focus on completing the initial proposal for the WP-07 Supplemental proceeding. *Id.* at 28. Although some aspects of the Recommendations were considered in developing the initial proposal, Staff was unable to implement in the WP-07 Supplemental initial proposal the Recommendations as intended by the parties. *Id.*

### **1.5.2 Post-WP-07 Supplemental ROD Settlement Efforts**

Following the publication of the WP-07 Supplemental ROD in 2008, BPA and principals from various IOU and COU groups continued to explore the possibility of settlement. Evaluation Study, REP-12-FS-BPA-01, section 4.1. Settlement discussions continued through the fall and winter of 2008 and moved into 2009. *Id.* While these discussions were ongoing, as noted above, petitions challenging BPA's implementation of the REP were filed with the Ninth Circuit. *Id.* The first challenge was to BPA's Lookback decisions in the WP-07 Supplemental proceeding. *Assoc. of Pub. Agency Customers v. Bonneville Power Admin.*, Nos. 08-74725 *et al.* (APAC). The second challenge was to the 2008 Residential Purchase and Sale Agreements offered to BPA's utility customers participating in the REP. *Idaho Pub. Utilities Comm'n v. Bonneville Power Admin.*, Nos. 08-74927 *et al.* (IPUC). As the briefing in these cases moved forward, BPA and representatives for the COUs and IOUs met to discuss the possibility of involving a mediator in the REP settlement discussions. In November 2009, the parties tentatively agreed to engage a mediator following the completion of the briefing in APAC and IPUC. Evaluation Study, REP-12-FS-BPA-01, section 4.1. Mediation sessions were scheduled to begin in mid-April 2010 and continue until late May 2010. *Id.*

### **1.5.3 The 2010 REP Litigation Mediation and the 2010 Agreement in Principle**

Mediation on the REP litigation commenced on April 15, 2010, in Portland, Oregon. *Id.* Leading the mediation sessions was former Federal District Court Judge Layn Phillips, a nationally renowned mediator. Assisting Judge Phillips was Bernard Schneider. *Id.* The parties

also provided the mediator with a technical panel made up of three experts on the operation and implementation of the REP and BPA ratemaking. Because many of the issues in the mediation would affect the prospective implementation of the REP, the litigants invited regional parties not directly involved in the litigation to participate in the mediation. *Id.* In total, more than 50 litigants and other parties participated in the mediation. *Id.* The mediation was scheduled to end in May, but discussions between the parties and the mediator continued through the end of June 2010. *Id.* Although by the conclusion of these sessions the litigants and parties had not achieved a global settlement, significant progress had been made toward reaching a compromise on all existing claims and the future implementation of the REP. Principals for most of the litigants agreed to continue to work toward a settlement. *Id.*

In early September 2010, with assistance from the mediator, representatives for a substantial majority of the litigants and other regional parties agreed to a non-binding Agreement in Principle (AIP). *Id.* The AIP committed the negotiating parties to work in good faith on a final settlement of the REP that adhered to the terms and conditions outlined in the AIP. *Id.*; *see also* AIP, 2012 REP Settlement Evaluation and Analysis Study Documentation (Evaluation Study Documentation), REP-12-E-BPA-01B, at 2-11.

#### **1.5.4 Drafting and Offering of the March 3, 2011, Version of the 2012 REP Settlement**

Drafting of the 2012 REP Settlement ensued, with agreement over the key elements reached in December 2010.<sup>4</sup> Thereafter, the negotiating parties continued to negotiate other terms of the Settlement, such as dispute resolution, potential legislative language, and other provisions. Murphy and Kallstrom, REP-12-E-JP02-02, at 24. These discussions concluded in March 2011, and a final Settlement was submitted to regional parties for signature on or about March 3, 2011. *See* Settlement, REP-12-E-BPA-11.

In order for the Settlement to become effective, the March 3, 2011, version of the Settlement contained a condition precedent that required the following parties (excluding BPA) to sign by April 15, 2011:

- (a) COUs, having in the aggregate, Transition High Water Marks (as defined in the TRM) equal to or greater than 91 percent of the total Transition High Water Marks of all COUs, have signed and delivered to BPA this Settlement Agreement,
- (b) the Public Power Council and Northwest Requirements Utilities have signed and delivered to BPA this Settlement Agreement,
- (c) Pacific Northwest Generating Cooperative has signed and delivered to BPA this Settlement Agreement, and
- (d) each entity of the IOU Group has signed and delivered to BPA this Settlement Agreement ....

Settlement, § 1.2.2(i), REP-12-E-BPA-11. If the requisite number of parties and entities did not sign by the April 15, 2011 deadline, the Settlement would become “void *ab initio*.” *Id.* § 1.2.2.

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<sup>4</sup> BPA’s legal and ratemaking staffs participated in the negotiations of the Settlement with representatives of the IOUs and COUs until the commencement of the REP-12 proceeding with the publication of a Federal Register notice on December 16, 2010. Thereafter, BPA continued to participate in the negotiations, but only during publicly noticed meetings. *See, e.g.*, ROD section 1.6.4.

By the close of business on April 15, 2011, the IOUs, public utility commissions for three states, Citizens' Utility Board of Oregon, and the COU representative groups of Public Power Council, Northwest Requirements Utilities, and Pacific Northwest Generating Cooperative had signed the Settlement, thereby satisfying the conditions set forth in § 1.2.2(b), (c), and (d). However, the condition in part (a) that required COUs accounting for 91 percent of the Transition Period High Water Marks (THWM) of all COUs to sign the Settlement had not been met. Instead, COUs representing 81.5 percent of the THWM (roughly 83 percent of the COU customers) signed the Settlement. *See* Forman and Bliven, REP-12-E-BPA-27, at 2.

### **1.5.5 Drafting and Offering the April 22, 2011, Version of the 2012 REP Settlement**

Even though the 91 percent threshold amount of COU THWM load had not been achieved, the negotiating IOU and COU parties—along with state utility commissions from Oregon, Idaho, and Washington, and CUB—were highly encouraged by the overwhelming level of support shown for the Settlement. Together, the group of BPA customers that had signed the Settlement accounted for more than *90 percent* of the electric load in the Pacific Northwest. *See* Carrasco *et al.*, REP-12-E-JP05-02, at 4. Describing this level of support for the Settlement as “remarkable,” representatives from both IOUs and COUs stated publicly that “we cannot recall any other circumstance in which the public and private utilities serving more than 90% of the regional load have come together in a common cause.” *Id.* at 4. Calling this “opportunity for regional peace ... too important to let ... slip away,” representatives from the IOU and COU groups quickly re-engaged in around-the-clock negotiations in an attempt to revise the condition precedent in the Settlement. *Id.* at 5. On April 22, 2011, exactly one week after the original deadline had passed, a coalition of IOU and COU parties representing 90 percent of regional load filed a revised 2012 REP Settlement in the REP-12 proceeding. *See* Notice of Proposed Form of Revised REP Settlement Agreement, REP-12-M-SE-08. The revised Settlement was identical to the previous settlement in all respects except that the percentage of COU THWM load needed to meet the condition precedent was changed to 75 percent and the deadline for signing the revised Settlement was set for June 3, 2011. *Id.*; *see also* Forman and Bliven, REP-12-E-BPA-27, at 3, and Attachment A, at A-3.

By June 6, 2011, BPA notified parties that the conditions precedent in the Settlement had been met. In total, in addition to the same IOUs, state public utility commissions, and COU and IOU interest groups that had signed the earlier version of the Settlement, *88.1 percent* of the COU THWM load had also executed the Settlement, *6.6 percent more THWM than originally signed on April 15*. For the first time in the 30-year history of the REP, a *joint* Settlement of the REP involving virtually all of BPA's customers had been achieved, conditioned upon the Administrator's decision in this proceeding.

### **1.5.6 Significance of Achieving a Broad REP Settlement**

The historical significance of achieving a settlement of the REP that is supported by a large segment of BPA's customers is not lost on BPA. A broadly supported settlement of the REP has been a long-hoped-for but elusive goal. The complexity of settling the REP has been compounded because, as aptly noted by counsel for a large coalition of COUs, “the IOUs and

COUs have approached the REP and section 7(b)(2) from dramatically different perspectives since adoption of the Act, and those perspectives are sometimes charged with emotion.” Murphy and Kallstrom, REP-12-E-JP02-02, at 18. Nevertheless, despite these fundamental differences, one of the largest coalitions in recent history of COUs, IOUs, and aligned interest groups have put aside their differences and reached a major agreement that settles existing litigation and establishes a stable and predictable implementation of the REP for the next 17 years. These parties collectively represent roughly 93 percent of the load served in the Pacific Northwest. The enormous amount of effort expended by representatives of the COUs, IOUs, public utility commissions, ratepayer advocacy groups, PPC, NRU, and PNGC, who spent hundreds of hours in intense negotiations to achieve this settlement, must be commended.

The fruit of those efforts, the 2012 REP Settlement, is now before BPA. The question to be considered in this proceeding is whether BPA may, consistent with the Northwest Power Act, join these parties in ending the current disputes and avoid perpetuating the cycle of litigation over the REP for a period of 17 years. It is to that question that BPA now turns.

## **1.6 The Residential Exchange Program Settlement Agreement Proceeding (REP-12)**

### **1.6.1 Overview of the REP-12 Proceeding**

Although, as the Administrator stated in the WP-07 Supplemental ROD, WP-07-A-05, at xx-xxi, BPA firmly believes that settlement of the existing REP litigation is in the interest of all BPA ratepayers, nevertheless, BPA must ensure that the terms and conditions in the 2012 REP Settlement are reasonable and comply with all relevant statutory provisions before executing the Settlement. *See Proposed Residential Exchange Program Settlement Agreement Proceeding (REP-12); Public Hearing and Opportunities for Public Review and Comment*, 75 Fed. Reg. 78694, at 78702 (2010).

The negotiating parties presented BPA with the essential components of the Settlement in mid-December 2010. BPA reviewed the draft Settlement and determined that it had sufficient detail for BPA to evaluate whether the Settlement complies with BPA’s statutes and is otherwise reasonable. Consequently, on December 16, 2010, BPA commenced the Residential Exchange Program Settlement Agreement Proceeding (REP-12), pursuant to the procedural rules of section 7(i) of the Northwest Power Act, 16 U.S.C. § 839e(i), to provide a forum in which BPA and other interested parties could evaluate the reasonableness and legal sufficiency of the proposed Settlement in order to determine whether the Administrator should sign the Settlement. 75 Fed. Reg. 78694, at 78702 (2010).

To test the reasonableness of the Settlement and to determine whether it comports with BPA’s statutory requirements, BPA proposed to perform an analysis that developed a range of projected rate protection for BPA’s preference customers (and concomitant REP benefits the IOUs would receive) under the section 7(b)(2) rate test in the absence of the Settlement. *Id.* The range of rate protection and REP benefits would be developed by quantifying the major issues being litigated by BPA, the IOUs, the COUs, CUB, and state utility commissions from Oregon, Idaho, and Washington in the current and pending litigation. *Id.* For each of these main issues, most of

which involved the section 7(b)(2) rate test, BPA would develop a 17-year projection of rate protection and REP benefits that was based on the parties' respective legal positions. *Id.* The amounts of rate protection and REP benefits allowed under these various assumptions would then be compared to the rate protection and REP benefits afforded to the IOUs under the Settlement to test whether the terms of the Settlement were reasonable and consistent with the protections provided by law. *Id.* BPA also tested whether the benefits provided under the Settlement would be distributed to the IOUs in a manner consistent with section 5(c) of the Northwest Power Act. *Id.* In addition to the analysis of the litigation positions, BPA analyzed the effects of other factors that could affect future ASCs and PF rates, including changes in costs, loads, and other revenues. Evaluation Study, REP-12-FS-BPA-01, section 6.4.

In the Federal Register notice, BPA explained that at the conclusion of the REP-12 proceeding the Administrator would determine, after reviewing all evidence and arguments contained in the record, whether the terms of the Settlement comport with BPA's statutory requirements. 75 Fed. Reg. 78694, at 78702 (2010). If the Administrator determines that the settlement is consistent with applicable law, including the section 7(b)(2) rate test and section 5(c), and is broadly supported by BPA's customers and other interested parties, he will sign the Settlement and set BPA's FY 2012–2013 rates in accordance with the terms of the Settlement. *Id.* In such case, the Settlement will replace BPA's current construct of withholding REP benefits due the IOUs for their residential and small farm consumers and paying Lookback refund credits to eligible COUs as described in the WP-07 Supplemental ROD, the 2008 RPSA ROD, and the WP-10 ROD. *Id.* Instead, the Settlement will delineate the amount of rate protection afforded to COUs for the term of the agreement and resolve the issues relating to BPA's calculation and collection of the Lookback Amounts. Together, these features of the Settlement will act as a complete replacement for the decisions BPA reached in the WP-07 Supplemental ROD, the 2008 RPSA ROD, and the WP-10 ROD regarding the interpretation and implementation of sections 7(b)(2) and 7(b)(3) and the calculation, formulation, and collection of the Lookback Amounts. In this way, BPA's adoption of the Settlement will supplant the agency's previous response to the Court's decisions in *PGE* and *Golden NW*, thereby obviating the need to continue the REP-related litigation over BPA's prior decisions in the WP-07 Supplemental ROD, the 2008 RPSA ROD, and the WP-10 ROD.

To address the possibility that the Administrator would determine that the Settlement was not consistent with BPA's statutory duties or was otherwise unlawful, and also to address the possibility that the Settlement's conditions precedent were not met, BPA also proposed, as part of the REP-12 proceeding, an implementation of the REP for the FY 2012–2013 rates in the event the Settlement was not adopted. *Id.* at 78695. This alternative to the Settlement included a proposed implementation of the section 7(b)(2) rate test and a determination of the amount of Lookback refunds to collect from IOUs for the FY 2012–2013 rate period. *Id.* at 78702.

### **1.6.2 Procedural History of the REP-12 Proceeding**

The Federal Register notice announcing the commencement of the REP-12 proceeding was issued on December 16, 2010. 75 Fed. Reg. 78694 (2010). The REP-12 proceeding was conducted with the full procedural rights afforded by section 7(i) of the Northwest Power Act,

including a hearing with cross-examination, public opportunities to provide both oral and written views related to BPA’s proposal, opportunities to offer refutation or rebuttal material, and this ROD. *Id.* at 78695.

BPA’s Initial Proposal was filed on December 17, 2010. *Id.* at 78696. Subsequently, parties filed updated drafts of the Settlement reflecting additional edits by the negotiators. On February 25, 2011, BPA filed supplemental direct testimony responding to the new additions. Parties’ direct cases, including responses to BPA’s Initial Proposal, were filed on February 15, 2011. *See Forman et al.*, REP-12-E-BPA-10, at 1-2. Rebuttal testimony in response to parties’ direct testimonies was filed on March 15, 2011. *See Order*, REP-12-HOO-01. Rebuttal on BPA’s supplemental direct testimony was filed by March 28, 2011. *See Order*, REP-12-HOO-13, at 1-2. Cross-examination occurred on April 4-5, 2011. BPA received final revisions to the Settlement on April 22, 2011. *See Notice of Proposed Form of Revised REP Settlement Agreement*, REP-12-M-SE-08. BPA subsequently moved to reopen the record and permit the filing of direct and rebuttal testimony on the final edits. *See BPA Motion*, REP-12-M-BPA-09. The Hearing Officer granted BPA’s motion, and direct testimony and rebuttal testimony deadlines were established. *See Order*, REP-12-HOO-19. BPA and a joint group of IOUs and COUs filed direct testimony responding to the final revisions to the Settlement. No rebuttal testimony was filed.

**1.6.3 Standstill Agreement and Incorporation of the Records from the WP-07 Supplemental Rate Proceeding, the 2008 RPSA Proceeding, and the WP-10 Wholesale Power Rate Proceeding**

Because it was unknown whether the Administrator would adopt the Settlement, the scope of the REP-12 proceeding permitted the inclusion of material related both to the proposed Settlement and to BPA’s traditional implementation of the REP, including BPA’s implementation of the section 7(b)(2) rate test and Lookback refund-related decisions. 75 Fed. Reg. 78694, at 78696 (2010). Many of the parties had thoroughly briefed BPA’s implementation of the section 7(b)(2) rate test and Lookback-related decisions in the WP-07 Supplemental and WP-10 proceedings. To avoid the administrative burden of repeating all of these arguments in the REP-12 proceeding, BPA and the litigants agreed to a “Standstill Agreement” whereby the parties and BPA would agree to incorporate by reference arguments and evidence presented in these prior two BPA rate proceedings. To effectuate the parties’ agreement in the Standstill Agreement, BPA filed a Motion with the Hearing Officer requesting the issuing of an Order that incorporated by reference the prior arguments and evidence of the parties and BPA related to a number of topics. BPA Motion, REP-12-M-BPA-02. The Hearing Officer granted BPA’s Motion. Order, REP-12-HOO-11. The Order provides as follows:

Many of the issues that would likely be litigated in the REP-12 Settlement Proceeding have already been fully briefed by the parties and responded to in BPA’s 2007 Supplemental Wholesale Power Rate Case Administrator’s Final Record of Decision, BPA Document No. WP-07-A-05, (“WP-07 [Supplemental] ROD”), BPA’s 2010 Wholesale Power Rate Case Administrator’s Final Record of Decision, BPA Document No. WP-10-A-05 (“WP-10 ROD”), and BPA’s Final Record of Decision regarding the 2008 RPSAs (“2008 RPSA ROD”). Because

these issues have been thoroughly argued in the prior proceedings, it would not be a prudent use of BPA's or the parties' resources to require them to re-litigate these issues in the REP-12 Settlement Proceeding in order to preserve them or have them considered by the Administrator in this proceeding. Consequently, in the interest of administrative and judicial economy, BPA has requested that an order be issued (i) preserving in the REP-12 Settlement Proceeding the evidence from the WP-07 Supplemental Wholesale Power Rate Case ("WP-07 [Supplemental] Proceeding"), the WP-10 Wholesale Power Rate Case ("WP-10 Proceeding"), and the 2008 RPSA notice and comment proceeding ("2008 RPSA Proceeding") and (ii) preserving in the REP-12 Settlement Proceeding certain parts of the parties' arguments, and BPA's responses, from the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding.

Having duly considered BPA's Motion, the positions of the parties to this proceeding, and all other matters contained in the record, NOW THEREFORE IT IS HEREBY ORDERED as follows:

(1) By issuance of this Order, all evidence admitted in the WP-07S Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding is hereby preserved, shall be deemed to have been admitted in this proceeding, and is hereby incorporated into the record of this REP-12 Settlement Proceeding. Parties need not present evidence in this REP-12 Settlement Proceeding that was previously admitted into evidence in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding. In addition, by issuance of this Order, all arguments made by a party in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding for the issues identified in Sections 5, 6, and 7 of this Order are hereby preserved, shall be deemed to have been made by that party in this proceeding, and are hereby incorporated into the record of this proceeding. Parties and BPA need not repeat arguments in this REP-12 Settlement Proceeding that were previously submitted in the WP-07S Proceeding, the WP-10 Proceeding, or the 2008 RPSA Proceeding for the issues identified in Sections 5, 6, and 7. Duplicates of evidence may be subject to motions to strike pursuant to Section 1010.11(a)(4) of BPA's Rules of Procedure Governing Rate Hearings. This Order does not preclude any party to this proceeding or BPA from adding to or modifying in this proceeding evidence or arguments offered in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, or the 2008 RPSA Proceeding, to the extent such evidence or arguments are within the scope of this proceeding.

(2) If the Federal Energy Regulatory Commission (FERC) or a court of competent jurisdiction affirms, or remands, reverses, or otherwise determines that BPA has erred in any final decisions made in the WP-07 [Supplemental] ROD, the WP-10 ROD, or the 2008 RPSA ROD regarding the issues identified in Sections 5, 6, or 7, nothing in this Order prohibits BPA from taking into account in the REP-12 Settlement Proceeding any such decision by either FERC or by a court of competent jurisdiction, as either required or as determined to be appropriate.

(3) The official records of the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding are hereby incorporated by reference in their entirety into the official record of this case for the purposes of (a) providing such information as may be necessary to establish and thereafter justify the proposed REP-12 Settlement Agreement, and (b) preserving for the parties in this proceeding and BPA the arguments presented in the WP-07S Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding, and all record bases in support thereof regarding the issues identified in Sections 5, 6, and 7 of this Order. If the REP-12 Settlement Proceeding is challenged before the United States Court of Appeals for the Ninth Circuit, BPA will ensure that all record materials, including those record materials relevant to the issues identified in Sections 5, 6, and 7 of this Order, will be made part of the administrative record on review that BPA submits to the Court.

(4) Parties to this proceeding that did not intervene or otherwise participate in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, or the 2008 RPSA Proceeding may adopt any arguments, and all record evidence necessary to support such arguments, for the issues identified in Sections 5, 6, and 7 of this Order. Adoption of such arguments or evidence only preserves the party's rights for purposes of the REP-12 Settlement Proceeding, and does not modify or otherwise alter such party's ability to appeal the decisions made in the WP-07 [Supplemental] ROD, the WP-10 ROD, or the 2008 RPSA ROD.

(5) The arguments submitted by parties and BPA regarding the decisions made in the following sections of the WP-07 [Supplemental] ROD are hereby deemed to have been made in the REP-12 Settlement Proceeding, except to the extent a party or BPA expressly modifies such arguments in this proceeding:

- (a) Legal Issues Regarding BPA's Response to the Court's Decisions (*e.g.*, Section 2.6);
- (b) Calculation of the Lookback Amounts (*e.g.*, Chapters 3.0 – 8.0);
- (c) Lookback Recovery and Return (*e.g.*, Chapter 9.0);
- (d) Allocation of 7(b)(3) Trigger (*e.g.*, Section 15.2);
- (e) 7(b)(3): Multiple PF Exchange Rates (*e.g.*, Section 15.3);
- (f) Section 7(b)(2), Section 7(b)(2) Legal Interpretation (WP-07-A-06), and Section 7(b)(2) Implementation Methodology (WP-07-A-07) (*e.g.*, Chapter 16.0).

(6) The arguments submitted by parties and BPA regarding the decisions made in the following sections of the WP-10 ROD are hereby deemed to have been made in the REP-12 Settlement Proceeding, except to the extent a party or BPA expressly modifies such arguments in this proceeding:

- (a) Section 7(b)(2), Section 7(b)(2) Legal Interpretation, and Section 7(b)(2) Implementation Methodology (*e.g.*, Chapter 10);

- (b) Lookback Recovery and Return (*e.g.*, Chapter 15.0);
- (c) Allocation of 7(b)(3) Trigger (*e.g.*, Chapter 8).

(7) The arguments submitted by parties and BPA regarding the decisions made in the following sections of the 2008 RPSA ROD are hereby deemed to have been made in the REP-12 Settlement Proceeding, except to the extent a party or BPA expressly modifies such arguments in this proceeding.

- (a) Termination and Reentry Issues (*e.g.*, Section III.A);
- (b) Balancing Account Issues (*e.g.*, Section III.B);
- (c) *In lieu* Issues (*e.g.*, Section III.C);
- (d) Other Issues (*e.g.*, Section III.D).

(8) Nothing in this Order shall be construed as limiting or otherwise restricting the authority of the BPA Administrator to make final decisions in this proceeding.

*Id.* at 1-4.

#### **1.6.4 Workshops and Publicly Noticed Meetings**

As noted above, while the essential components of the Settlement had been drafted by December 2010, a number of tertiary provisions of the Settlement had not been completed by the commencement of the REP-12 proceeding. Consequently, throughout the REP-12 proceeding, the negotiating parties provided regular updates to various provisions of the proposed Settlement. Because of *ex parte* restrictions, these updates were provided by the representatives of the COUs and IOUs through filed submissions to BPA's secure rate case Web site and were automatically served on all parties to the proceeding. In the event Staff had questions or concerns with the proposed revisions, BPA held a publicly noticed workshop at which BPA and any party could provide comments on the proposed revisions to the REP Settlement. Several of these public workshops were held throughout the REP-12 proceeding. A list of these publicly noticed meetings is provided below.

Notice emailed January 7, 2011. Meeting held on January 12, 2011, at BPA Headquarters. Subject: Discussion of Residential Exchange Program Settlement, among other topics.

Notices emailed January 19 and 26, 2011. Meeting held on January 27, 2011, at BPA Headquarters. Subject: Discussion of dispute resolution provision proposed to be included in the 2012 Residential Exchange Settlement Agreement by the IOU and certain COU parties.

Notices emailed February 3, 8, and 10, 2011. Meeting held on February 11, 2011, at BPA Headquarters. Subject: Discussion of February 1, 2011 redlined version of the 2012 Residential Exchange Program Settlement Agreement.

Notice emailed February 11, 2011. Meeting held on February 17, 2011, at Idaho Consumer-Owned Utilities. Subject: BPA presentation regarding the Residential Exchange Program settlement.

Notices emailed February 16 and 25, 2011. Meeting held on February 28, 2011, at BPA Headquarters. Subject: Discussion of redlined version of the 2012 Residential Exchange Program Settlement Agreement.

Notice emailed March 4, 2011. Meeting held on March 7, 2011, at Clallam County PUD. Subject: BPA staff presentation regarding Residential Exchange Program settlement.

Notice emailed March 4, 2011. Meeting held on March 8, 2011, at Parkland Light and Water Company. Subject: BPA staff presentation regarding Residential Exchange Program settlement.

Notice emailed March 4, 2011. Meeting held on March 29, 2011, at Oregon Trail Electric Cooperative. Subject: BPA Administrator's presentation regarding Residential Exchange Program settlement.

Notice emailed March 7, 2011. Meeting held on March 9, 2011, at Hampton Inn, Boise, ID. Subject: Presentation regarding Residential Exchange Program settlement.

Notice emailed March 14, 2011. Meeting held on March 16, 2011, at Shilo Inn & Suites, Portland, OR. Subject: Presentation regarding participation in the Residential Exchange Program settlement.

Notices emailed March 11, 16, and 18, 2011. Meeting held on March 18, 2011, at BPA Headquarters. Subject: Discussion of proposals pertaining to settlement of consumer-owned utilities' participation in the Residential Exchange Program.

Notices emailed March 22 and 24, 2011. Meeting held on March 25, 2011, at BPA Headquarters. Subject: Discussion of proposal to settle consumer-owned utilities' participation in the Residential Exchange Program.

Notice emailed March 25, 2011. Meeting held on March 28, 2011, at Lewis County PUD. Subject: BPA staff presentation regarding the REP Settlement.

Notice emailed March 30, 2011. Meeting held on April 4, 2011, at Grays Harbor PUD. Subject: BPA staff presentation regarding the REP Settlement.

## **1.7 Concurrent Proceedings**

### **1.7.1 BP-12 Rate Proceeding**

Concurrent with the REP-12 section 7(i) proceeding, BPA is holding a consolidated rate proceeding, Docket No. BP-12, that establishes power and transmission rates for FY 2012–2013. The Federal Register notice for the BP-12 rate proceeding identified the issues within the scope of the case and those excluded from review.

In the BP-12 rate proceeding, Power Services is implementing the Tiered Rate Methodology for the first time to coincide with the commencement of power deliveries under new Regional Dialogue power sales contracts beginning in FY 2012. The TRM provides for a two-tiered

Priority Firm Power rate design applicable to firm requirements power service for those customers that signed new Regional Dialogue contracts. The tiered rate design differentiates between the costs of service associated with the existing Federal system resources (Tier 1) and the costs associated with additional amounts of power needed to serve the remaining portion of customers' net requirements (Tier 2). This rate design ensures, to the extent possible, that eligible customers will be able to purchase power at a Tier 1 rate that does not include the costs of serving other customers' load growth.

Among other things, the TRM addresses how costs will be allocated to the PF Tier 1 and Tier 2 rate pools and how rates for Tier 1 and Tier 2 sales and resource support services will be designed. These cost allocation and rate design methods are being implemented for the first time in the BP-12 rate proceeding. The TRM also addresses the rate design for Tier 1 rates, including the form of the rates and the billing determinants to which the rates are applied. Specifically, the TRM provides for three customer charge rates, a set of load shaping rates, and a new determination and application of demand rates.

Several of these issues pertaining to the implementation of the Lookback construct, the section 7(b)(2) rate test, forecasts of utilities' Average System Costs for FY 2014–2032, and other items related to the implementation of the REP were reserved for the REP-12 proceeding. The results of the REP-12 proceeding are carried over to the BP-12 rate proceeding and included in the final calculations of BPA's power rates for FY 2012–2013. In addition, the official record of the REP-12 proceeding will be merged with the official record of the BP-12 proceeding for submission to the Federal Energy Regulatory Commission. *See Fiscal Year (FY) 2012–2013 Proposed Power Rate Adjustments Public Hearing and Opportunities for Public Review and Comment*, 75 Fed. Reg. 70744, at 70747 (2010).

### **1.7.2 ASC Review Proceedings**

To receive REP benefits for FY 2012–2013, utilities must file proposed ASCs with BPA pursuant to the terms and conditions of the 2008 ASC Methodology. These filings are reviewed by Staff and other interested parties in ASC review processes, which are separate administrative proceedings conducted by BPA under the terms of the 2008 ASC Methodology. In the review processes, Staff and other parties evaluate the ASCs filed by participating utilities for conformance with the requirements of the 2008 ASC Methodology. At the conclusion of the process, BPA issues ASC Reports, which formally establish the utilities' ASCs for the Exchange Period, which coincides with BPA's rate period.

On June 1, 2010, ten utilities filed proposed ASCs with BPA for FY 2012–2013. One utility subsequently withdrew its ASC filing. Staff and other parties are reviewing the remaining nine filings in the ASC review processes. BPA issued Draft ASC reports for these parties on November 19, 2010. The Final ASC Reports are scheduled to be issued on or around July 26, 2011. Once the ASC review processes are complete, and BPA has issued final ASC Reports, BPA will incorporate the final ASCs into the administrative record of the REP-12 and BP-12 proceedings. Although these ASC determinations provide important information for setting BPA's rates, such determinations are not made in section 7(i) hearings. Parties intending to

challenge BPA's draft or final ASC determinations for FY 2012–2013 must raise such issues in the ASC review processes according to the procedures established in the 2008 ASC Methodology.

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## 2.0 DESCRIPTION OF THE 2012 REP SETTLEMENT TERMS

### 2.1 Basic Elements

The 2012 REP Settlement<sup>5</sup>, if adopted by BPA, would end the uncertainty and risk arising from the seemingly endless litigation over the REP by providing closure to BPA's past payments of refunds to the COUs and REP benefits to the IOUs while also resolving, for a term of 27 years, challenges over BPA's implementation of the REP. The Settlement achieves these ends by presenting an alternative to BPA's prior attempts at resolving the issues pertaining to the Court's decisions in *PGE* and *Golden NW*. This alternative, embodied in the terms of the Settlement, would replace BPA's decisions in the WP-07 Supplemental ROD and WP-10 ROD, which have been hotly contested by all parties, with the agreed-upon value established by the Settlement and signed by all of the region's IOUs, three public utility commissions, and 88 percent of BPA's COU customers (by load).

In presenting this alternative approach, the Settlement is not intended to answer all of the knotty legal and factual questions regarding the section 7(b)(2) rate test and BPA's Lookback construct that have plagued BPA's rate proceedings. The REP litigation involves all manner of claims, from alleged violations of statutory provisions (such as sections 7(b)(2) and 5(c) of the Northwest Power Act), to breaches of contract (such as the "Invalidity Clause" in the 2000 REP Settlements). In view of the diverse nature of these numerous claims, the settling COUs, IOUs, state commissions, and others have crafted the Settlement such that its focus is on reaching a reasonable resolution of the myriad conflicts in an equitable and timely manner without addressing individual claims, while also retaining the essential elements of the REP to ensure that the Settlement follows the key statutory requirements set forth in the Northwest Power Act.

The Settlement spans 104 pages and includes many complicated formulas and terms. However, at its core, the Settlement is comprised of five essential parts: (1) a schedule of REP benefits to be paid to the IOUs as a class over the term of the Settlement (17 years), which will be allocated among the IOUs every two years in accordance with section 5(c) of the Northwest Power Act; (2) a schedule of refund amounts to be paid to the COUs for the first eight years of the Settlement (FY 2012–FY 2019) as compensation for past overcharges, plus the right to retain any refund payments (Lookback Amounts) already received without further dispute; (3) terms that ensure that all BPA ratepayers appropriately share in the benefits and burdens of the Settlement; (4) terms preserving the Settlement, to the maximum extent possible, if challenged, and if successfully voided, preserving parties' prior litigation positions; and (5) miscellaneous other terms. Each of these components is viewed in greater detail below.

The Settlement settles the Current and Related Litigation, as those terms are defined in the Settlement, for a 27-year period, FY 2002–2028. The first ten years of this period are historical, FY 2002–2011, of which FY 2002–2006 comprise the Lookback period. Seventeen years of this

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<sup>5</sup> Throughout this ROD, BPA paraphrases and incorporates material from the Settlement. BPA believes that it correctly describes the Settlement, but BPA's description is not a definitive statement; ultimately, the Settlement speaks for itself.

period are prospective, FY 2012–2028. The 17-year future financial terms of the Settlement encompass the settlement of all 27 years. The benchmark for measuring the value of the Settlement was established in the mediation as the net present value of IOU REP benefits over the FY 2007–2028 period.

## **2.2 Schedule of REP Benefits to IOUs and Allocation of REP Benefits Among IOUs— Section 3.1 and Section 6 of the Settlement**

Section 3.1 of the Settlement establishes a fixed schedule of annual REP benefits to be paid to the IOUs in the aggregate (referred to as “Scheduled Amounts” in the Settlement) for each year of the rate period beginning in FY 2012 and ending in FY 2028. Settlement, REP-12-A-02A, § 3.1.1, Table 3.1. The Scheduled Amounts begin at \$182.1 million in FY 2012 and gradually increase over seventeen years to \$286.1 million in FY 2028. *Id.* The Scheduled Amounts are fixed amounts and not adjustable for inflation or interest. *Id.* § 3.1.1.

While the Scheduled Amounts in section 3.1 of the Settlement provide the IOUs as a class with a stable, predictable level of REP benefits, the Settlement does not guarantee that any individual IOU will receive any certain amount of REP benefits. In fact, under the Settlement, it is possible for an individual IOU to receive \$0 in REP benefits. This is because section 6 of the Settlement, in combination with sections 4 and 5 of the Residential Exchange Program Settlement Implementation Agreement (REPSIA) (the new form of BPA’s traditional RPSA, attached to the Settlement as Exhibit A), maintains the section 5(c) parameters of the REP. That is, individual IOU REP benefits will continue to be determined by comparing BPA’s PF Exchange rate and the IOU’s ASC filings. Settlement, REP-12-A-02A, § 6 and REPSIA, REP-12-A-02A, Exhibit A, §§ 4-5; *see also* Gendron *et al.*, REP-12-E-BPA-04, at 28-29. Consequently, under the Settlement, the IOUs will continue to file ASCs every two years with BPA pursuant to BPA’s ASC Methodology, and only those IOUs that have ASCs that exceed BPA’s PF Exchange rate will receive benefits under the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 29. If an IOU’s ASC fails to exceed BPA’s PF Exchange rate, which BPA will set in each future rate proceeding, the IOU receives no REP benefits during that rate period. *Id.*

Section 3.1 also provides cost protection to the COUs. Section 3.1.1 ensures that the COUs’ rates include costs of REP benefit payments to the IOUs of no more than the amounts set forth in Table 3.1. The COUs’ cost exposure to the REP, which otherwise could vary wildly from rate period to rate period, would be fixed at a predictable and stable level. Moreover, the Scheduled Amounts reflect the resolution of (1) all disputed claims arising from BPA’s REP, sections 7(b)(2) and 7(b)(3), and Lookback determinations for FY 2002 through FY 2011; and (2) the IOUs’ entitlement to REP benefits and the customers’ responsibility to pay for such REP benefits for FY 2012 through FY 2028. Murphy and Kallstrom, REP-12-E-JP02-02, at 26. In reaching the values in the table of Scheduled Amounts, the COUs involved in the negotiation were satisfied that the combined level of REP benefits set forth in the Scheduled Amounts, in conjunction with the Refund Amounts described below, reasonably accounted for the COUs’ outstanding claims, including claims for “Lookback refunds.” Murphy and Kallstrom, REP-12-E-JP02-02, at 26.

### **2.3 Schedule of Refund Payments to COUs, Allocation of Refund Payments Among COUs, and Retention of Past Refund Payments to COUs—Section 3.2, Section 3.4, and Section 7 of the Settlement**

Like the IOUs, the COUs also would receive a fixed stream of payments under the Settlement. The Settlement establishes that BPA would return to the COUs a fixed stream of refunds, referred to as “Refund Amounts,” for a term of eight years as a means of compensating the COUs that were overcharged as a result of the 2000 REP Settlements. Settlement, REP-12-A-02A, § 3.2; *see also* Murphy and Kallstrom, REP-12-E-JP02-02, at 26-27. Specifically, section 3.2 of the Settlement provides that in FY 2012 through FY 2019, BPA would pay the COUs \$76.5 million per year for eight years in bill credits, for a total of \$612 million. Settlement, REP-12-A-02A, Table 3.2. The \$612 million roughly reflects BPA’s calculation of the outstanding Lookback Amount (\$510 million as of the end of FY 2011) as adjusted for interest. Gendron *et al.*, REP-12-E-BPA-04, at 32-33. The Refund Amounts would be collected in rates in the same way Lookback Amounts have been collected by BPA in the WP-07 and WP-10 rate periods. *Id.* at 11-12. The \$76.5 million per year would be returned to BPA customers that purchase power at the PF Public rate based on an allocation approach described in the Settlement. Settlement, REP-12-A-02A, § 3.4; *see also* Evaluation Study, REP-12-FS-BPA-01, section 4.3.5; Gendron *et al.*, REP-12-E-BPA-04, at 13-15.

The fixed nature of the Refund Amounts provides a substantial amount of certainty to the COUs. Unlike BPA’s previous approach to returning Lookback Amounts to the COUs, the Refund Amounts would not be subject to adjustment by the Administrator. Gendron *et al.*, REP-12-E-BPA-04, at 11, 32-33. Moreover, the Refund Amounts would be refunded from the IOUs as a class, and would not be dependent upon a specific IOU becoming eligible for REP benefits. *Id.* Finally, the Refund Amounts would be returned within a defined period: eight years. BPA could not provide a similar guarantee of repayment for the Lookback Amounts due to variations in the REP benefits of individual IOUs. Gendron *et al.*, REP-12-E-BPA-04, at 32-33.

In addition to receiving \$612 million in refund payments, COUs are also allowed by the Settlement to retain without further dispute the refunds they have already received under BPA’s contested WP-07 Supplemental ROD decisions. Settlement, REP-12-A-02A, §§ 7.3, 7.4, 7.6; *see also* Gendron *et al.*, REP-12-E-BPA-04, at 33. Thus, under the Settlement, the \$587 million in refunds BPA will have distributed to the COUs by the end of FY 2011 (every dollar of which the IOUs contest) would be retained by the COUs and their ratepayers without fear of a disgorgement resulting from the litigation. Gendron *et al.*, REP-12-E-BPA-04, at 33. Combining the funds that BPA has already paid the COUs (\$587 million) with the new fixed schedule of Refund Amounts under the Settlement (\$612 million) results in a total refund payment by BPA to the COUs of approximately \$1.2 billion. *Id.*

### **2.4 Terms That Ensure That All BPA Ratepayers Share in the Benefits and Burdens of the Settlement—Section 3.3 and Section 3.7 of the Settlement**

As noted above, the Settlement reflects a delicate balance of interests and equities. This balance could easily be upended if BPA were to deviate from its current REP implementation practices.

To avoid this, section 3.3 of the Settlement codifies many aspects of BPA’s current implementation of the REP to ensure that all BPA ratepayers continue to share in the benefits and burdens of the REP during the term of the Settlement.

Section 3.3 of the Settlement expresses the results that BPA must achieve when establishing rates to recover the costs of the REP benefits provided under the Settlement. Settlement, REP-12-A-02A, § 3.3. Generally speaking, these provisions require BPA to establish rates such that the Scheduled Amounts plus the COU Refund Amounts (the sum of which is defined in the Settlement as the REP Recovery Amounts), plus any COU REP benefits, are recovered in BPA’s rates. *Id.* To be clear, the Settlement’s terms do not *describe* how BPA should set its rates. Bliven *et al.*, REP-12-E-BPA-12, at 14. Rather, the Settlement language describes the results that the settling parties wish to achieve in ratemaking. *Id.*

The Settlement first requires that an initial allocation of the REP benefit costs be made to the Industrial Firm Power (IP) and New Resources Firm Power (NR) rates. Settlement, REP-12-A-02A, § 3.3.1. As new rates are developed, BPA may also allocate such costs to such rates if determined by BPA to be appropriate. *Id.* § 3.3.3. Allocation of costs to the IP and NR rates occurs through application of the REP Surcharge. *Id.* § 3.3.1. The REP Surcharge is a formula that scales the costs allocated to the IP and NR rates for the settlement period to the costs borne by the IP and NR rates in the WP-10 rate proceeding, the last rate case in which BPA performed a traditional implementation of the section 7(b)(2) rate test and section 7(b)(3) reallocations. Evaluation Study, REP-12-FS-BPA-01, section 5.1. As stated above, the Settlement language describes the results of sections 7(b)(2) and 7(b)(3) rather than the methodology and rationale for the cost allocations. In this way, the Settlement effectively codifies BPA’s practice of allocating rate protection amounts to the IP and NR rates as directed by section 7(b)(3) of the Northwest Power Act. Bliven *et al.*, REP-12-E-BPA-12, at 14.

After the initial allocation of REP benefit costs to the IP and NR rates, the remaining costs are allocated to the IP, NR, and Tier 1 PF rates on a pro rata load-share basis. Settlement, REP-12-A-02A, § 3.3.4; *see also* Evaluation Study, REP-12-FS-BPA-01, section 5.1. COU parties to the Settlement agree to pay their Allocated Share of the REP Recovery Amounts based on the sum of COU parties’ Tier 1 Cost Allocators (TOCAs) divided by the sum of all PF customers’ TOCAs (TOCA Shares). Settlement, REP-12-A-02A, § 3.3.5. This TOCA Share approach ensures that the COUs that sign the Settlement pay in rates only their agreed-upon share of the REP benefits payable to the IOUs and Refund Amounts payable to the COUs. *Id.*

To ensure that the full value of the Settlement is being achieved and properly shared among BPA’s customers, BPA’s obligation to set rates consistent with the Settlement would extend not only to the COUs and IOUs that have signed the Settlement, but also to those that have not. Settlement, REP-12-A-02A, § 3.3.4; Gendron *et al.*, REP-12-E-BPA-04, at 19. Because setting these rates would mean recovering the costs of REP benefits from parties that may not support the Settlement, BPA would be required to make certain findings before it may execute the Settlement. Settlement, REP-12-A-02A, § 3.7. The specific findings are: (1) BPA will, for the duration of the Settlement, pay the IOUs the “Scheduled Amounts set forth in Table 3.1”; (2) BPA will include in the settling COUs’ rates only their share of the REP Recovery Amounts,

as determined by section 3.3.5 of the Settlement; and (3) BPA may lawfully set rates and establish Refund Amounts applicable to non-settling parties consistent with sections 3.2 through 3.5, and will do so for the term of the Settlement. *Id.* § 3.7(i)–(iii); *see also* Forman *et al.*, REP-12-E-BPA-10, at 3. If BPA is unable to reach these findings in its review of the Settlement, the Settlement terminates. *Id.* BPA addresses these issues later in this ROD.

## **2.5 Terms Preserving the Settlement, to the Maximum Extent Possible, if Challenged—Section 3.6, Section 7, and Section 8 of the Settlement**

Although the Settlement has received broad support from almost all of BPA’s customers, not all of BPA’s customers have signed the Settlement, and a few will likely object to their rates being set consistent with the Settlement’s terms. In view of these possible challenges, the parties developed a number of provisions that attempt to mitigate further disruption to the region by preserving the benefits and burdens of the Settlement in the face of litigation. The first of these provisions is the legislative commitment in section 8 of the Settlement. Settlement, REP-12-A-02A, § 8. In this section, the parties (not including BPA) would commit to “work together” to obtain legislation that would “affirm the Settlement and direct BPA to perform it according to its terms ....” *Id.* BPA would agree to “support” these legislative efforts, to the extent such efforts are “consistent with law and Administration policy ....” *Id.*

A second provision, section 3.6, addresses what actions BPA and the parties would undertake in the event the Settlement litigation or the existing REP litigation results in a final decision that upsets the ability to perform the Settlement as contemplated by the settling parties. Settlement, REP-12-A-02A, § 3.6. In this instance, BPA’s commitment to make payments and set rates consistent with Table 3.1 and Table 3.2 for all ratepayers is modified (1) if a court decides that BPA cannot apply the terms of the Settlement to the non-settling parties, or (2) if a court makes a final decision on the merits of any of the issues that pertain to the calculation of REP benefits under section 5(c) of the Act or other matters enumerated in section 7.4(i) through 7.4(vii) of the Settlement in the *APAC*, *IPUC*, *Avista*, or *PGE II* cases, and such decision(s) is inconsistent with the provisions of the Settlement. *Id.* § 3.6(i)–(ii). If either of these conditions is met, BPA would set rates for *non-settling entities* consistent with the court’s rulings. *Id.* § 3.6(1). That is, BPA would set rates for the non-settling entities to collect the costs of REP benefits consistent with the court’s decision, and provide these payments to the IOUs. Depending on the court’s holding, these amounts of REP benefits could be more (or less) than the amounts provided to the IOUs under the Settlement. The parties’ respective litigation positions would be preserved as described in the Settlement. *Id.* §§ 3, 6, 7, and 10; *see also* Issue 8.3.1.

As for *settling parties*, however, BPA would continue to set rates consistent with the terms of the Settlement. *Id.* § 3.6(2).<sup>6</sup> Under section 3.6, the IOUs and settling COUs have agreed to accept and comply with the results of the Settlement except to the extent that it affects non-settling parties. The parties have achieved this result by agreeing to “waive” as to each other and as to BPA the right to receive or be charged an amount different from the amounts set forth in the

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<sup>6</sup> The Settlement has special terms that apply if the court finds that BPA is without authority to apply the terms of the Settlement to settling parties. *See generally* REP Settlement, REP-12-E-BPA-11, at section 10.5.

Settlement. *Id.* § 3.6(2)–(3); *see also* § 7. If section 3.6 becomes operative, the IOUs would receive REP benefits under the Settlement scaled to the percentage of COUs that signed the Settlement. Thus, for example, if BPA’s rates collect 88 percent of the Scheduled Amounts from COUs that signed the Settlement and 12 percent of the Scheduled Amounts from parties that did not sign, then under section 3.6, BPA would continue to set rates to collect 88 percent of the of the Scheduled Amounts from the settling COUs. BPA would not continue to collect 12 percent of the Scheduled Amounts from the non-settling parties, but rather, would set their rates, and make REP benefit payments to the IOUs, consistent with the Court’s ruling. As noted later in this ROD, no party has objected to these provisions of the Settlement. *See* section 9.4.

In sum, even if the non-settling parties were successful in avoiding application of the Settlement to their rates, the Settlement would continue to affect *settling parties* because they have agreed, by application of their respective waivers, to live with the results of the Settlement. BPA notes again that the settling parties’ legal positions on the issues would be preserved as described in the Settlement.

## **2.6 Other Terms of the 2012 REP Settlement**

### **2.6.1 Interim Agreement True-Up Payments to IOUs—Section 4 of the Settlement**

Section 4 of the Settlement states that BPA will, consistent with the provisions of the 2008 Residential Exchange Interim Relief and Standstill Agreements (Contract Nos. 08PB-12438, 08PB-12439, 08PB-12441, 08PB-12442) (Interim Agreements), pay the IOUs Interim Agreement True-Up amounts determined by BPA, pursuant to the WP-07 Supplemental ROD and the 2010 Wholesale Power Rate Final Proposal: Lookback Recovery and Return (WP-10-FS-BPA-07). Settlement, REP-12-A-02A, § 4;

If the Settlement is not challenged, BPA will pay the True-Up amounts 95 calendar days after the effective date of the Settlement (which is the date the BPA Administrator executes the Settlement). *Id.* If the Settlement is challenged, BPA will pay the True-Up amounts 30 days after a final, non-appealable order by the Court that dismisses the challenges or that otherwise upholds the Settlement. *Id.* If Congress adopts the legislative authorization provided for in section 8 of the Settlement, any IOU with an Interim Agreement may notify BPA in writing that it wants to be paid its Interim Agreement True-Up amount. BPA is to pay the True-Up amount within 30 days of receiving the notice. *Id.*

The IOUs with Interim Agreements and the respective Interim Agreement True-Up principal amounts are stated in section 4 of the Settlement. Evaluation Study, REP-12-FS-BPA-01, section 4.3.8. Simple interest will accrue from April 2, 2008 through the date the true-up payment is made, with interest of 1.76 percent per year. *Id.*

## **2.6.2 Treatment of Environmental Attributes—Section 5 and Exhibit C of the Settlement**

Section 5 and Exhibit C of the Settlement address how possible future environmental attributes associated with the Tier 1 system resources would be shared with the IOUs. Settlement, REP-12-A-02A, § 5, Exhibit C. The Settlement provides that 14 percent of Transferable Renewable Energy Certificates (RECs) and 14 percent of Carbon Credits would be transferred to, or would be valued and the value paid to, the IOUs. Settlement, REP-12-A-02A, Exhibit C; *see also* Evaluation Study, REP-12-FS-BPA-01, at 36. Transferable RECs are RECs that may in the future accrue to the Tier 1 system resources. Settlement, REP-12-A-02A, Exhibit C. Transferable RECs do not include the RECs associated with existing Tier 1 renewable projects, which are listed in Exhibit C of the Settlement. *Id.* Carbon Credits are defined as Environmental Attributes consisting of greenhouse gas emission credits, certificates, and similar instruments. *Id.*

In order for 14 percent of the RECs and Carbon Credits to be transferred to the IOUs, COU parties to the Settlement agree to replace the current Exhibit H of their Contract High Water Mark (CHWM) contracts with the revised Exhibit H in the Settlement. Settlement, REP-12-A-02A, § 5.2. BPA would also offer Exhibit H of the Settlement to any COU that is not a party to the Settlement. Evaluation Study, REP-12-FS-BPA-01, section 4.3.6. If COUs that are not parties to the Settlement do not agree to replace their current Exhibit H with the Settlement Exhibit H, BPA would use its ratemaking authority as provided in section 9 of the current Exhibit H to determine and factor in the value or costs of RECs that are transferred to such COUs. *Id.*

## **2.6.3 Residential Exchange Program Settlement Implementation Agreement—Exhibit A of the Settlement**

As the name implies, the REPSIA contains the terms and conditions necessary to implement the Settlement during its 17-year term. Forman *et al.*, REP-12-E-BPA-10, at 17. Unlike the broader Settlement, which all settling COUs, IOUs, and other parties will sign, the REPSIA will be executed only by BPA and the individual IOUs. *Id.* In this respect, the REPSIA is in many ways similar to the RPSA that is currently used to implement the REP between BPA and the IOUs. *Id.* The REPSIA retains many elements of the RPSA but also adds a number of new features in order to implement the provisions of the Settlement. *Id.* at 17-18.

The REPSIA and RPSA are similar in that the REPSIA retains the RPSA's purchase and sale provisions, which govern the exchange-based relationship between BPA and the IOUs. *Id.* at 18. Thus, under the REPSIA, each IOU will continue to sell power to BPA at its ASC. *Id.*; *see also* REPSIA, REP-12-A-02A, Exhibit A, § 6. BPA also will continue to sell power to the IOUs at BPA's specified PF Exchange rate. Forman *et al.*, REP-12-E-BPA-10, at 18; *see also* REPSIA, REP-12-A-02A, Exhibit A, § 5. The REPSIA also retains the ASC requirements of the RPSA, such as the requirement that the IOUs file ASCs with BPA pursuant to the ASC Methodology. Forman *et al.*, REP-12-E-BPA-10, at 18. The administration features of the REPSIA and RPSA are also generally the same. *Id.* The REPSIA, like the RPSA, requires the IOUs to pass through

all of the REP benefits provided under the agreement to their residential and small farm consumers. *Id.* To ensure these payments are made in the right amounts and to the appropriate consumers, the REPSIA also preserves the audit and accounting requirements of the RPSA. *Id.*

The RPSA and REPSIA differ in some respects. The RPSAs between BPA and the IOUs are separate standalone agreements and are not dependent upon or connected to any other arrangement BPA has with the IOUs or any other customer group. *Id.* The REPSIA, by contrast, is dependent upon and inextricably linked to the Settlement, and therefore must be viewed in light of the larger context presented by the Settlement. *Id.* To that end, there are certain terms in the REPSIA that have been included for purposes of settling all issues pertaining to the REP. *Id.* For example, BPA has agreed to withhold its discretionary right to engage in *in lieu* purchases during the term of the Settlement. *Id.* at 18-19. In addition, BPA has removed a provision known as a Balancing Account or “deemer” provision, which is one of the key issues being litigated in the *IPUC* litigation. *Id.* at 20. As explained later in this Record of Decision, while BPA believes that these provisions are proper in a non-settlement context, they are generally incompatible with the Settlement presented in this case, which has certainty in the benefits and costs of the REP at its foundation, and the ending of protracted and contentious litigation. *Id.* at 21.

## **2.7 Issues**

### **Issue 2.7.1**

*Whether the Settlement is unsound because the DSIs were not involved in all of the negotiations leading up to the proposed Settlement.*

### **Parties’ Positions**

Alcoa asserts that the proposed Settlement will not achieve true regional harmony because it ignores one of BPA’s statutory customer classes—the DSIs. Alcoa Br., REP-12-B-AL-02, at 4. Alcoa also asserts that the DSIs were precluded from participating in the COU and IOU negotiations that gave rise to the proposed Settlement. *Id.*

Counsel for the JP02 parties takes issue with Alcoa’s representation that it was precluded from participating in the negotiations on issues important to Alcoa. While Alcoa was excluded from the discussions that ultimately led to the Agreement in Principle, counsel for the JP02 parties argues that he invited Alcoa’s counsel on a number of occasions to the discussions on the final Settlement elements that concerned the DSIs. Murphy, Oral Tr. at 149-150.

### **BPA Staff’s Position**

DSI representatives were involved in the negotiations, but the extent of involvement varied. DSI representatives were at various mediation sessions, but there were certain portions of the mediation that the DSIs were not invited to. Cross-Ex Tr. at 84. Staff agrees that the DSIs were not present when the substance of the framework on which the Settlement is built was put together. *Id.* at 85.

## **Evaluation of Positions**

Throughout this case, Alcoa has maintained that it has been excluded from the negotiations on the Settlement. For example, Alcoa argues that the DSIs were “precluded from participating in the COU and IOU negotiations that gave rise to the proposed Settlement.” Alcoa Br., REP-12-B-AL-02, at 4. Alcoa made similar representations in its direct case and at oral argument. Speer, REP-12-E-AL-01, at 6; Till, Oral Tr. at 70.

Factually, Alcoa is incorrect in stating that it was simply excluded from all negotiations that gave rise to the Settlement. While Alcoa’s participation varied throughout the mediation, it was invited to the mediation that was conducted to discuss resolution of the outstanding REP litigation. The record is clear that the mediation that resulted in the final Settlement was initially open to *all parties*. Because many of the issues in the mediation would affect the implementation of the REP, the litigants to the REP litigation invited regional parties not directly involved in the litigation to participate in the mediation. Evaluation Study, REP-12-FS-BPA-01, section 4.2. Alcoa was one of the parties invited, and Alcoa executed the mediation retainer agreement required for participation in the mediation. Alcoa admits this error in its brief on exceptions. *See* Alcoa Br. Ex., REP-12-R-AL-01, at 5.

During the mediation, members of the COU caucus did express concern with Alcoa being present as a member of *their caucus*. Till, Oral Tr. at 70. This concern can likely be attributed to the fact that the COUs and Alcoa are adverse parties on a number of issues, particularly on the question of BPA’s authority to provide power service to Alcoa and the DSIs under the Northwest Power Act. Alcoa’s claim for a long-term service arrangement with BPA has been a source of litigation among BPA, the COUs, and the DSIs. These challenges have resulted in two published opinions from the Ninth Circuit within the last two years, with even more cases pending before the Court today. *See Pac. Nw. Generating Coop. v. Dep’t of Energy*, 550 F.3d 846 (9th Cir. 2008), *amended on denial of reh’g*, 580 F.3d 792 (9th Cir. 2009); *Pac. Nw. Generating Coop. v. Bonneville Power Admin.*, 580 F.3d 828 (9th Cir. 2009), *amended and superseded*, 596 F.3d 1065 (9th Cir. 2010).

Since Alcoa believes that any settlement of the REP must include resolution of the unrelated “long-term access to BPA power at the statutory IP rate,” it is not surprising that the COU parties, who have vigorously opposed Alcoa’s view on these issues, would feel uncomfortable participating in a caucus with Alcoa. Alcoa Br., REP-12-B-AL-02, at 4.

As the scheduled mediation sessions neared their end, parties for the COUs and IOUs continued to meet to determine whether a long-term settlement of the REP could be achieved. Evaluation Study, REP-12-FS-BPA-01, section 4.2. These sessions eventually led to the Agreement in Principle, which was negotiated by representatives of the IOUs and COUs, with technical assistance from BPA Staff. *Id.* Alcoa claims that it was “precluded” from participating in the development of the AIP. Till, Oral Tr. at 70. It is true that these sessions were private, and that not all parties were involved in these discussions. Murphy, Oral Tr. at 149-150. However, Alcoa’s participation at this juncture would not have been critical. The negotiations on the AIP were focused on the central issues that would form the broader Settlement. Those issues

involved reaching terms that the parties believed equitably resolved the issues pending in the REP litigation, namely, BPA's implementation of the Lookback and calculation of REP benefits. At the time, neither of these issues could have reasonably been construed as critical to Alcoa. In terms of the Lookback, *up until this case*, Alcoa had not opposed BPA's performance, calculation, or implementation of the Lookback. Bliven *et al.*, REP-12-E-BPA-12, at 25-26; Cross-Ex. Tr. at 163. As for future REP benefits, the AIP did not need to address the implications of the REP on the IP rate for the simple reason that the IP rate is largely insulated from the effects of the section 7(b)(2) rate test. Bliven *et al.*, REP-12-E-BPA-12, at 11. The absence of any express terms involving Alcoa's other critical interest, long-term service to the DSIs, was omitted because such issues were not being resolved in the AIP.

When the settling parties moved to develop the AIP into final contract language, issues pertaining to the IP rate did arise. In these instances, the negotiating parties claim they made an effort to engage Alcoa. Murphy, Oral Tr. at 150. Alcoa, however, swears that no such efforts were made. *See* Alcoa Br. Ex., REP-12-R-AL-01, at 6-8, *citing* Exhibit 1, Affidavit of Michael C. Dotten. Counsel from JP02 counters with his own affidavit wherein he swears that he contacted Alcoa. *See* Motion to Strike, REP-12-M-JP02-01, at 1, Exhibit 1, Affidavit of Paul Murphy.

BPA need not resolve in this case whether Alcoa was or was not invited to participate in the final stages of the negotiations that led to the Settlement. As Alcoa notes in its brief on exceptions, resolution of this disputed factual issue has no "legal significance" with respect to BPA's decision to adopt or not adopt the Settlement. Alcoa Br. Ex., REP-12-R-AL-01, at 6. What matters is whether Alcoa has been afforded an adequate opportunity in *this* proceeding to make its concerns known.

Alcoa claims that it is "unfair in the extreme" to assert that Alcoa's concerns about the Settlement's flaws should somehow be disregarded. Alcoa Br. Ex., REP-12-R-AL-01, at 4. As the voluminous record in this case demonstrates, and as discussed throughout this ROD, Alcoa's concerns have not been disregarded but instead have been directly addressed by BPA and other parties to this proceeding. BPA has ensured that all parties have had a meaningful opportunity to raise concerns and issues with the Settlement in this REP-12 proceeding.

First, while this proceeding is not designed to renegotiate all the terms of the Settlement, the REP-12 proceeding has permitted parties and BPA to point out improvements, errors, and other adjustments to the proposed Settlement, which the settling parties have been very open to making. Bliven *et al.*, REP-12-E-BPA-17, at 13-14.

Second, this proceeding has provided Alcoa and other parties the opportunity to conduct discovery, offer testimony, rebut the testimony of others, and present oral argument and arguments in briefs regarding whether or not BPA should execute the Settlement. Alcoa has taken full advantage of these opportunities. Thus, even though Alcoa may have not been as involved in the negotiations of the Settlement as it wished, it has had ample opportunity to make its concerns known in this section 7(i) proceeding. BPA has not disregarded Alcoa's concerns and has addressed every substantive issue Alcoa has raised with the Settlement in this ROD.

Furthermore, as described later in this ROD, the Settlement will result in rates that are overall lower for most of BPA's ratepayers, *including Alcoa*. Bliven *et al.*, REP-12-E-BPA-12, at 13. These lower rates begin this rate period, and are expected to extend into the future. *Id.*; *see also* Evaluation Study, REP-12-FS-BPA-01, Figure 6. Thus, by adopting the Settlement and setting rates consistent with its terms, the resulting rates reveal that Alcoa is not being unfairly treated.

### **Decision**

*The fact that the DSIs participated in the mediation but did not participate in the negotiations leading up to the proposed Settlement does not make execution of the Settlement by BPA contrary to law; nor does it make execution of the agreement otherwise unreasonable.*

### **Issue 2.7.2**

*Whether BPA should examine whether the COUs that sign the Settlement have the authority to perform in accordance with its terms.*

### **Parties' Positions**

APAC argues that BPA must examine whether the COUs have the authority to sign the Settlement. APAC Br., REP-12-B-AP-01, at 7. APAC contends that the COUs' commitment under the Settlement is comparable to the commitment examined by the Washington Supreme Court in the Washington Public Power Supply System (WPPSS) litigation. *Id.*

### **BPA Staff's Position**

This is a legal issue, and Staff defers comments to this ROD.

### **Evaluation of Positions**

APAC claims that BPA should be "concerned" about the COUs' ability to perform their duties under the Settlement. APAC Br., REP-12-B-AP-01, at 7. BPA is not concerned. Any question BPA may have regarding a party's authority to sign is adequately addressed by the signing requirements of the Settlement itself. Settlement section 1.2.1 provides that each party that signs the settlement represents and warrants that its execution of the Settlement is within its powers, has been duly authorized by all necessary actions or regulatory consents, and does not violate any terms or conditions of any applicable law or contract. Settlement, REP-12-A-02A, § 1.2.1. BPA is satisfied that any entity that signs the Settlement will have performed the necessary due diligence to meet the requirements of section 1.2.1. To require a more thorough evaluation of this issue would have been unnecessary and would have unreasonably expanded the scope of this proceeding.

First, such an evaluation would be unnecessary. As APAC itself notes, such an evaluation does "not directly affect BPA's statutory obligations." APAC Br., REP-12-B-AP-01, at 7. Indeed, it is *not* BPA's statutory responsibility to ensure that all of its customers have the legal authority to execute contracts with BPA. Just as BPA must consider whether it has the authority to sign the

Settlement based on the Northwest Power Act and other statutes, the individual utilities and other parties must be left to do the same for their respective authorities. Many qualified counsel that do business in the Pacific Northwest region have far more experience and expertise on these issues than BPA. Many of these attorneys have been involved throughout the negotiation of the Settlement. If a party lacks authority to sign the Settlement, BPA assumes that party will not execute the Settlement.

Second, such an evaluation would unreasonably expand the scope of this proceeding, burdening the record and distracting BPA and the parties from considering the true question in this case: whether the *Administrator* should adopt the proposed Settlement. 75 Fed. Reg. 78694, at 78695 (2010). Because the Settlement concerns BPA's statutes and legal authority, BPA has rightfully limited the review in this proceeding to determining whether *BPA* has the legal authority to sign the Settlement. *Id.* at 78696. Expanding the scope of this case to test whether *any other entity* has the authority to sign the Settlement would have mired this proceeding in the internal machinations governing the various parties considering the Settlement. This would have been no small task. There are many different types of entities that are considering the Settlement, including municipalities, public utility districts, rural electric associations, non-profit organizations, cooperatives, and others. All of these entities are governed by specific state and local laws that define the entities' respective powers. Had BPA expanded the scope of this case to consider whether each of the various utilities, companies, non-profit organizations, and state government agencies had the authority to adopt the Settlement, the record in this case would have been flooded with statutes from eight states, corporate charters, board minutes, and other material irrelevant to evaluating the merits of the Settlement. Adding this data to the record of this case would not have furthered the goal of this proceeding, which is to provide a record to the Administrator to assist him in deciding whether to sign the Settlement. *Id.* at 78702. BPA believes the best approach is the one adopted here: allow each party to determine, based on its own evaluation of state and local laws, whether it has the authority to sign the Settlement.

In an attempt to bring these issues into the scope of this case, APAC next tries to draw similarities between the Washington Supreme Court's holding in *Chemical Bank v. Washington Public Power Supply System*, 666 P.2d 329 (Wa. 1983), *reh. en banc*, 691 P.2d 524 (*Chemical Bank*) and the authority of the Washington COUs to sign the Settlement. APAC Br., REP-12-B-AP-01, at 7. Because APAC's comparison concerns the application of state law to individual COUs, BPA will not opine on the obvious factual and legal differences between *Chemical Bank* and the Settlement. As explained later in this ROD, based on the analysis performed in this proceeding, BPA believes that it has complied with its statutory duties under section 5(c), section 7(b)(2), and other provisions of the Northwest Power Act. *See* Chapters 3-5.

The source of APAC's allegation that COUs are at risk of exceeding their authority is APAC's apparent misreading of the Ninth Circuit decision in *Golden NW*. APAC Br., REP-12-B-AP-01, at 7. APAC claims that in this opinion the Court "held several times" that the section 7(b)(2) rate test "guarantees" that COUs pay no more in rates than they would have paid absent the REP. *Id.* However, APAC misreads the Court's statement. The Court correctly stated that removal of the costs of the REP from the 7(b)(2) case rates was *one* of the five assumptions BPA must consider. *Golden NW*, 501 F.3d at 1048. In making this statement, however, the Court in no

way held that this was the *only* assumption BPA must consider or that the other *four* assumptions identified in the statute were somehow irrelevant when performing the section 7(b)(2) rate test. *Id.*; *see also* Chapter 7. Indeed, the Court was clear that the reason it was invalidating BPA’s rates was not that BPA improperly performed the section 7(b)(2) rate test, but that BPA “‘ignored its obligations’ under section 7(b)(2) and (3)” altogether. *Id.*, *citing PGE*, 501 F.3d at 1036. Beyond this basic holding, the Court did not delve into the intricacies of the 7(b)(2) rate test, and APAC will not be able to find any textual support in *PGE*, *Golden NW*, or any other Ninth Circuit precedent to maintain its position that only one of the five assumptions in section 7(b)(2) is relevant for determining the COUs’ rates. Further discussion on this issue is provided in Chapters 5 and 7.

APAC next contends that in providing a guaranteed benefit to the IOUs, the Settlement would force COUs to pay their share of those benefits regardless of the effects of the section 7(b)(2) rate test on their rates. *Id.* This argument is incorrect. As explained in Chapter 5, BPA has conducted seventeen 7(b)(2) rate tests in this case, one for each year of the proposed Settlement plus the following four years, and has demonstrated that the Settlement provides 7(b)(2) protection to the COUs. Thus, the Settlement does not provide that the COUs pay their share of REP benefits “regardless” of the section 7(b)(2) rate test.

### **Decision**

*BPA will not determine whether a utility has the legal authority to sign the Settlement. This issue is best resolved between counsel for the utility and the utility’s board or other governing body.*

### **Issue 2.7.3**

*Whether BPA should treat Federal agency customers as Settlement signers given recently discovered problems for these entities contained in sections 8 and 9 of the Settlement.*

### **Parties’ Positions**

JP02 believes that the settling parties did not intend to preclude Federal agency customers of BPA from executing the Settlement and becoming parties to the Settlement. JP02 Br. Ex., REP-12-R-JP02-01, at 4. JP02 states that BPA’s proposed remedy does not seem consistent with the Settlement in the situation where a court were to find that, absent the waivers in section 7.2 of the Settlement, preference customers are entitled to more 7(b)(2) rate protection than is provided by the Settlement. *Id.* JP02 believes it would be preferable to expand the scope of proposed amendments to the Settlement to include additional amendments that would exempt Federal agency customers from any obligations that are beyond their authority. *Id.* at 5. JP02 suggests that BPA should propose this approach in its Final ROD and seek agreement of the parties to a combined set of amendments that permit additional entities to join the Settlement and facilitate the inclusion of Federal agency customers. *Id.*

## **BPA Staff's Position**

Staff supports the proposal in the REP-12 Draft ROD to set rates and establish Refund Amounts applicable to Federal agencies as if the Federal agencies were parties to the Settlement and requested comments from parties on this proposal. Draft ROD, REP-12-A-01, at 44.

## **Evaluation of Positions**

BPA sells power to a diverse group of customer classes under the provisions of the Northwest Power Act. In addition to COUs, IOUs, and DSIs, BPA is also authorized to sell to other Federal agencies. 16 U.S.C. § 839c(b)(3). Sales to other Federal agencies are at the same rate that BPA charges its COU customers. 16 U.S.C. § 839e(b)(1)–(2).

The Settlement is intended to address longstanding litigation and uncertainty over BPA's implementation of the REP. In that regard, the settling parties have offered the Settlement to all of BPA's customer classes that pay for a portion of the REP through adjustable rates. The Settlement was thus offered to BPA's Federal agency customers.

The settling parties intended the Settlement to be executable by any current BPA customer. To that end, the Settlement defines "Party" as "as any entity that signs the Settlement and delivers it to BPA" by the signing deadline. Settlement, REP-12-A-02A, § 2. Under this definition, other Federal agencies that purchase power from BPA are eligible to sign the Settlement.

Although the terms and obligations of the "Parties" under the Settlement are generally intended to apply equally to BPA and the settling parties, it was recognized that for a few provisions, BPA, as a Federal entity, would have to be afforded different treatment because of existing Federal law. One such provision is the legislative obligations of the parties in section 8. Section 8, Legislation, of the Settlement states that "... Parties will jointly work in consultation with members of the Northwest Congressional delegation on ... legislation." *Id.* § 8. BPA, as a Federal entity, however, is limited in its ability to use public funds to lobby Congress or otherwise engage in efforts to seek legislation. *See* 18 U.S.C. § 1913. Thus, BPA expressly requested that section 8 be revised to exclude BPA from the definition of the term "Party" as used in section 8: "For purposes of this section 8 only, the terms 'Party' and 'Parties' will not include BPA ...." *Id.* Instead, BPA agreed to support such legislative efforts "if and to the extent consistent with law and Administration policy ...." *Id.*

Another such provision is the Dispute Resolution provision in section 9. Until legislation is passed ratifying the Settlement, BPA is bound by Federal law that prescribes the manner in which Federal entities may engage in pre-claim binding arbitration. The Settlement recognizes these limitations, and requires BPA to engage in binding arbitration only if consistent with law and the agency's Binding Arbitration Policy. *Id.* § 9.1.

While the Settlement is clear that *BPA* is afforded different treatment than a "Party" under these provisions, BPA and the settling parties inadvertently failed to provide a similar exclusion for other Federal agencies that signed the Settlement. As noted above, by signing the Settlement, a Federal agency will become a "Party" as defined in section 2. However, these Federal entities,

like BPA, generally cannot lobby or otherwise promote legislation, or engage in pre-claim arbitration contrary to their respective Binding Arbitration Policies. BPA and the parties that drafted the Settlement language did not consider that by not affording other Federal agencies the same treatment as BPA in sections 8 and 9 the Settlement's terms might create legal barriers to a Federal agency becoming a "Party" under the Settlement.

This is, in fact, precisely what happened. No Federal agency customer has signed the revised Settlement. Two Federal agency customers specifically cited the requirements of sections 8 and 9 as reasons for not signing the Settlement. In addition, the U.S. Navy identified that it could not enter into an agreement with a term greater than 10 years. BPA addressed this limitation in its Regional Dialogue agreements with the U.S. Navy by establishing the initial term through fiscal year 2018 with an option whereby the U.S. Navy could extend the agreement through September 30, 2028.

The U.S. Navy also informed BPA that even if the substantive issues preventing the U.S. Navy from executing the Settlement were addressed, it would take at least six months to get the agreement through the review process that would include the Secretary of the Navy.

By the terms of the Settlement, Federal agencies that do not sign the Settlement are Non-Settling Entities. *Id.* § 2. BPA has determined in this proceeding that it lawfully may and will set rates and establish Refund Amounts applicable to Non-Settling Entities consistent with the provisions of sections 3.2 through 3.5 of the Settlement. *Id.* § 3.7. The Settlement recognizes, however, that a court could make a final decision that precludes the recovery of any Settlement benefits through the rates of Non-Settling Entities. *Id.* § 3.6. In that circumstance, the Settlement provides that the rates and any refunds insofar as applicable to the Non-Settling Entities will be consistent with the court's decision. *Id.* § 3.6(1).

Federal agencies have inadvertently been placed in a no-win situation. These entities are precluded from signing the Settlement because its terms require actions they cannot perform. As Non-Settling Entities, these entities are subject to the risk that a court may determine they are subject to rates and refunds different from those provided to parties to the Settlement.

To address this situation, BPA proposed in its Draft ROD that it would set rates and establish Refund Amounts applicable to Federal agencies as if the Federal agencies were parties to the Settlement. Draft ROD, REP-12-A-01, at 44. Thus, BPA would propose to treat Federal agencies as settling parties *even if* the Court were to find that BPA may not apply its terms to non-settling parties and BPA was setting rates pursuant to section 3.6. Stated another way, BPA proposed to treat Federal agencies as non-settling parties *only if* the Court expressly provides that BPA is prohibited from setting the rates of Federal agencies consistent with the terms of the Settlement.

JP02 suggests that it would be preferable to expand the scope of proposed amendments to the Settlement to include additional amendments that would exempt Federal agency customers from any obligations that are beyond their authority and seek agreement of the parties to a combined set of amendments that permit additional entities to join the Settlement. JP02 Br. Ex., REP-12-

R-JP02-01, at 5. This would facilitate the inclusion of Federal agency customers. JP02's suggestion makes sense. However, the unique circumstances faced by the three Federal agencies that purchase power directly from BPA would require substantial amendment of the current Settlement in order to allow these entities to execute the Settlement. Although the general issues with the Settlement's terms were identified by the Federal agencies, BPA and the Federal agencies have not fully explored all of the changes that would be necessary to make the Settlement consistent with Department of Defense and Department of Energy policies and practices. It is BPA's expectation that obtaining these changes would require substantial additional work between BPA and representatives of the Federal agencies.

BPA is concerned that this effort to draft revised terms acceptable to all of the Federal agencies could take months given the multitude of other pressing issues demanding the time and attention of Federal agency staff and management. And it would appear at least for the US Navy, it would take six months or more to get authorization to sign the Settlement once final acceptable terms were established. BPA believes adopting JP02's remedy would result in substantial delay in getting an amendment before the parties so that a final amended Settlement could be effective. BPA is also concerned about making the amendment that all 111 current parties to the Settlement must consider and approve substantially more extensive and complex simply to address the unique circumstances of the three Federal agencies that purchase power from BPA.

JP02's suggested remedy might well be preferred even in light of BPA's concerns if there was a clear, known problem with the approach BPA proposed in its Draft ROD. JP-02 did not express any specific legal or technical problem with BPA's proposal to treat Federal agency customers as if they have signed the Settlement. COUs that sign the Settlement are unaffected by how BPA treats Federal agency customers and whether some or all Federal agencies execute the Settlement. The same holds for COUs that do not sign the REP Settlement.

The IOU parties could arguably be harmed by BPA's proposal to treat Federal agencies as signers if a court ultimately ruled that rates and refunds for non-signers should be determined differently than rates and refunds for signers *and* such treatment resulted in non-signers paying more REP costs than they would have had these entities signed the Settlement. The IOU parties, however, have raised no objections to BPA's proposed resolution of the Federal agencies' problems with the Settlement.

Moreover, Federal agency customers have not expressed any objection to BPA's proposal to set their rates consistent with the Settlement, even if a Court finds that BPA may not set the rates of non-signers pursuant to the Settlement. Federal agency customers have consistently relied on and deferred to BPA's expertise and decisions regarding power supply contract and rate setting matters.

BPA concludes that its proposed remedy of the unique Settlement issues facing the Federal agencies minimizes the scope of Settlement amendments that must be agreed to by all Settlement parties, minimizes the work and time required of BPA and the Federal agencies, and has not been objected to by any party that could potentially be negatively effected by the remedy. Given the

circumstances, BPA concludes it is reasonable to remedy the Federal agency issues with the Settlement in a way that achieves administrative efficiencies for all entities.

### **Decision**

*BPA will set rates and establish Refund Amounts applicable to Federal agencies as if the Federal agencies were parties to the Settlement, unless expressly prohibited from doing so by a judicial decision.*

### **Issue 2.7.4**

*Whether BPA should reform the Settlement to correct a scrivener's error in the definition of "Party" in section 2 of the April 22, 2011, version of the Settlement.*

### **Parties' Positions**

The drafters of the Revised Settlement Agreement failed to notice that the definition of "Party" was limited to entities that executed the Agreement by April 15, 2011, the original deadline for signing the Agreement. JP02 Br. Ex., REP-12-R-JP02-01, at 3. This was purely an oversight. *Id.* The COU Coalition agrees completely with BPA's proposal to correct the oversight of the drafters by replacing "April 15, 2011" with "June 3, 2011" in the definition of "Party" in the conformed copy of the Settlement Agreement BPA distributes. *Id.* This correction is needed to properly reflect the Parties' agreement in the document recording such agreement. *Id.*

The Pacific Northwest Investor-Owned Utilities support the proposal to reform the form of the REP Settlement Agreement by revising the phrase "April 15, 2011" in the definition of "Party" to "June 3, 2011" and making that revision when BPA provides conformed copies of the REP Settlement Agreement. JP04 Br. Ex., REP-12-R-JP04-01, at 2.

The OPUC also supports BPA's proposal. The OPUC states that BPA should reform the REP Settlement Agreement, in the manner proposed by BPA, to correct a scrivener's error discovered in the definition of "Party" in section 2 of the REP Settlement Agreement. OPUC Br. Ex., REP-12-R-PU-01, at 2.

### **BPA Staff's Position**

Staff was made aware of this drafting error after the evidentiary phase of the proceeding, so it did not address this issue. Staff supports revising the phrase "April 15, 2011" in the definition of "Party" in the Settlement to "June 3, 2011" when BPA provides Parties with conformed copies of the Settlement. REP-12-A-01 at 47.

### **Evaluation of Positions**

As noted earlier, discussions on the Settlement concluded in early March of 2011, and a final Settlement was submitted to regional parties for signature on or about March 3, 2011. Settlement, REP-12-E-BPA-11.

In order for the Settlement to become effective, the March 3, 2011, version of the Settlement contained a condition precedent that required the following parties (excluding BPA) to sign by April 15, 2011:

- (a) COUs, having in the aggregate, Transition High Water Marks (as defined in the TRM) equal to or greater than 91 percent of the total Transition High Water Marks of all COUs, have signed and delivered to BPA this Settlement Agreement,
- (b) the Public Power Council and Northwest Requirements Utilities have signed and delivered to BPA this Settlement Agreement,
- (c) Pacific Northwest Generating Cooperative has signed and delivered to BPA this Settlement Agreement, and
- (d) each entity of the IOU Group has signed and delivered to BPA this Settlement Agreement ....

Settlement, § 1.2.2(i), REP-12-E-BPA-11. If the requisite number of parties and entities did not sign by the April 15, 2011, deadline, the Settlement would become “void *ab initio*.” *Id.* § 1.2.2.

By the close of business on April 15, 2011, the IOUs, public utility commissions for three states, Citizens’ Utility Board of Oregon, and the COU representative groups of Public Power Council, Northwest Requirements Utilities, and Pacific Northwest Generating Cooperative had signed the Settlement, thereby satisfying the conditions set forth in § 1.2.2(b), (c), and (d). However, the condition in part (a) that required COUs accounting for 91 percent of the Transition Period High Water Marks of all COUs to sign the Settlement had not been met. Instead, COUs representing 81.5 percent of the THWM (roughly 83 percent of the COU customers) signed the Settlement. Forman and Bliven, REP-12-E-BPA-27, at 2.

Even though the 91 percent threshold amount of COU THWM load had not been achieved, the negotiating IOUs and COUs were highly encouraged by the overwhelming level of support shown for the Settlement. Together, the group of BPA customers that had signed the Settlement accounted for more than 90 percent of the electric load in the Pacific Northwest. Carrasco *et al.*, REP-12-E-JP05-02, at 4. Describing this level of support for the Settlement as “remarkable,” representatives from both IOUs and COUs stated publicly that “we cannot recall any other circumstance in which the public and private utilities serving more than 90% of the regional load have come together in a common cause.” *Id.* at 4. Calling this “opportunity for regional peace ... too important to let ... slip away,” representatives from the IOU and COU groups quickly re-engaged in around-the-clock negotiations in an attempt to revise the condition precedent in the Settlement. *Id.* at 5.

On April 22, 2011, exactly one week after the original deadline had passed, a coalition of IOU and COU parties representing 90 percent of regional load filed a revised Settlement in the REP-12 proceeding. Notice of Proposed Form of Revised REP Settlement Agreement, REP-12-M-SE-08. The revised Settlement consisted of a one-page amendment that incorporated by reference all of the previous terms of the Settlement with the exception that the percentage of COU THWM load needed to meet the condition precedent was changed to 75 percent and the deadline for signing the revised Settlement was set for June 3, 2011. *Id.*; *see also* Forman and Bliven, REP-12-E-BPA-27, at 3, and Attachment A, at A-3.

By June 6, 2011, BPA notified parties that the conditions precedent in the Settlement had been met. In total, in addition to the same IOUs, state public utility commissions, and COU and IOU interest groups that had signed the earlier version of the Settlement, 88.1 percent of the COU THWM load had also executed the Settlement, 6.6 percent of THWM more than originally signed on April 15. For the first time in the 30-year history of the REP, a joint Settlement of the REP involving virtually all of BPA's customers had been achieved.

As BPA prepared the Draft ROD, it was brought to BPA's attention that a scrivener's error had occurred in the April 22 version of the Settlement. Specifically, while the parties changed the April 15, 2011, deadline in the condition precedent in section 1.2.2, they failed to make a similar change in the definition of the term "Party" in section 2. The definition of a "Party" in section 2 is as follows:

"Party" means (i) any entity that signs this Settlement Agreement and delivers it to BPA on or before April 15, 2011, and (ii) BPA as of the Effective Date.

Settlement, REP-12-E-BPA-12, § 2 (emphasis added). The term "Party" is used in the definition of "IOU Party" and "COU Party" which is used throughout the Settlement. *Id.* BPA believes the record in this case clearly demonstrates that the parties inadvertently missed changing the April 15, 2011, date in the definition of "Party" when they revised the Settlement on April 22, 2011.

To address this error, BPA proposes to reform the Settlement to reflect the parties' clear intention. REP-12-A-01 at 47. JP02, JP04 and OPUC support BPA's proposal and no party raised concerns or objections. Reformation of an agreement is appropriate when the parties reached an agreement but then failed to express that agreement accurately in writing due to a mistake. *Am. Employers Ins. Co. v. United States*, 812 F.2d 700, 705 (Fed. Cir. 1987); *see also Williston on Contracts*, § 70:21 (4th ed.). A scrivener's error is a mistake in the reduction of the agreement into writing and is not a mistake about the agreement itself. *Williston on Contracts*, § 70:93 (4th ed.). Courts routinely reform an agreement to correct a scrivener's error if there is clear and convincing evidence that the mistake occurred and the written agreement does not reflect the parties' intent. *Int'l Union of Elec., Elec., Salaried, Mach. & Furniture Workers, AFL-CIO v. Murata Erie N. Am., Inc.*, 980 F.2d 889, 907 (3rd Cir. 1992); *Patton v. Mid-Continent Sys.*, 841 F.2d 742, 746 (7th Cir. 1988). That is clearly the case here. The failure of the drafting parties to change the deadline in the section defining "Party" from April 15, 2011, to June 3, 2011, was simply an oversight and a scrivener's error. Common sense dictates that all of the signing parties undoubtedly intended that each qualify as a Party to the Settlement and therefore intended that the extended June 3, 2011, deadline also apply to the definition of any other entity that qualifies as a "Party." Accordingly, BPA is reforming that section by changing the date from April 15, 2011, to June 3, 2011, in order to reflect the intent of any signing party to qualify as a "Party" to the Settlement.

Furthermore, BPA is tasked with presenting the parties with a final conformed version of the Settlement after the Administrator executes the document. Section 4 of the Settlement filed by parties provides:

If the Administrator executes this Revised REP Settlement Agreement as specified in section 1.4 of the Document as revised and incorporated herein, BPA will promptly deliver to each party hereto a conformed copy of this Revised REP Settlement Agreement in the form of the Document as revised hereby and dated as of the date on which the Administrator executes this Revised REP Settlement Agreement.

Notice of Proposed Form of Revised REP Settlement Agreement, REP-12-M-SE-08, § 4. In meeting this obligation, BPA will strike out the April 15, 2011, date in the definition of Party, and include the June 3, 2011, date as required by the parties' April 22 notice. This will ensure that all parties are on notice that this adjustment has been made.

As noted above, BPA received only supportive comments to the aforementioned change. No party opposes this change. Consequently, BPA concludes that this action is reasonable, within BPA's contracting authority, and does not conflict with any applicable laws.

### **Decision**

*BPA will revise the phrase "April 15, 2011" in the definition of "Party" in the Settlement to "June 3, 2011" when it provides Parties with conformed copies of the Settlement.*

### **Issue 2.7.5**

*Whether BPA should propose amending the Settlement to allow additional entities to sign the Settlement.*

### **Parties' Positions**

Canby endorses BPA's proposal to hold open the Settlement to allow additional consumer-owned utilities to join, if they wish to do so. Canby Br. Ex., REP-12-R-CA-01, at 1. Canby requests that BPA establish a date certain, such as October 1, 2011 (the start of FY 2012). *Id.* Canby understands that a new deadline will require an amendment to the existing Settlement and that existing signers must approve this language change. *Id.*

JP02 believes it would be highly desirable to allow entities that did not execute the Settlement Agreement by June 3, 2011 to join the Settlement if they so desire. JP02 Br. Ex., REP-12-R-JP02-01, at 3. That would require that the Settlement Agreement be amended to change the definition of Party to include a date later than June 3, 2011, and to add any new Parties. *Id.* JP02 suggests that BPA state in its final Record of Decision that it will propose creating a 60-day window of opportunity to add additional parties by proposing to amend the definition of Party to substitute "September 23, 2011" for "June 3, 2011" and to add the new Parties. *Id.* at 4. That will allow entities that failed to execute the Settlement Agreement by June 3rd the opportunity to review BPA's ROD in this proceeding and decide whether it is in their interest to join the Settlement. *Id.*

The Pacific Northwest Investor-Owned Utilities Group encourages the inclusion of additional BPA regional customers as Parties to the REP Settlement Agreement within a reasonable period. JP04 Br. Ex., REP-12-R-JP04-01, at 3. The Pacific Northwest Investor-Owned Utilities Group would seek to work with other Parties to the REP Settlement Agreement to develop a form of amendment of the REP Settlement Agreement necessary to include such additional Parties within a reasonable time, such as on or before September 30, 2011. *Id.*

The OPUC looks favorably on additional participation in the REP Settlement Agreement by other regional stakeholders, including customers. The OPUC is willing to work with other Parties to the Settlement to develop a form of amendment of the REP Settlement Agreement necessary to include, within a reasonable time, such additional entities. OPUC Br. Ex., REP-12-R-PU-01, at 2.

A number of the utilities joining in the WPAG brief have expressed an interest or intention of revisiting their decision on the execution of the Settlement subsequent to the filing of brief on exceptions. WPAG Br. Ex., REP-12-R-WG4-01, at 1, footnote 1.

### **BPA Staff's Position**

BPA would have no objection to parties signing the Settlement after the June 3, 2011 deadline. REP-12-A-01 at 47. BPA expects that if other non-signing parties express an interest in signing the Settlement, and act upon that interest in a timely manner, the settling parties would likely look favorably on the additional participation from other regional customers. *Id.* BPA encourages any customer that signed after June 3, 2011, or that may be interested in doing so to explore this issue with Parties to the Settlement. *Id.*

### **Evaluation of Positions**

Amending the Settlement to allow additional entities to become parties is broadly supported both by parties to the Settlement and by entities that are not parties. No entity expressed opposition.

With the issuance of this Record of Decision, all parties are now on notice of BPA's position as to the legal viability of the Settlement. Through the exhaustive analysis provided in this ROD, BPA hopes parties will see the value that the Settlement provides to the region in general and, more importantly, the way the Settlement satisfies the requirements of the Northwest Power Act, particularly in the manner in which it protects the position of the COUs.

As a party to the Settlement, BPA is in favor of allowing additional entities to sign the Settlement. BPA believes that an amendment to allow additional parties to the Settlement is reasonable, within BPA's contracting authority, and does not conflict with any applicable laws.

Several parties indicated giving additional entities until approximately October 1, 2011, to execute the Settlement. BPA is concerned that this may not allow for sufficient time to craft the amendment with representatives of the parties, get the amendment to all parties and for parties to act on the amendment. BPA's concern stems from the fact that there is a very substantial amount of work, including decisions by its COU customers in particular, between now and October 1,

2011 in order to implement service under the new Regional Dialogue contracts, implement the Settlement, and implement the new BPA power rates that are effective October 1. A number of COU utilities are also considering retail rate changes that may need to be implemented between now and the end of the calendar year.

BPA believes parties should be given ample time to consider and approve the amendment given that all current parties to the Settlement must agree to such amendment. While the specifics of the amendment need to be negotiated among current parties, BPA believes giving current parties until the end of November to sign the amendment and giving entities not currently parties until December 31, 2011 to sign the amended Settlement may be appropriate. BPA believes it is highly unlikely a court will issue any opinion between now and the end of the calendar year that would provide entities that are not currently parties to the Settlement new information on the pros and cons of signing the Settlement. Obviously, the possibility of court action prior to any new signing deadline will be one factor representatives of current parties will need to discuss when they draft the amendment.

BPA believes this amendment can be very simple and straightforward. As suggested by JP02, it appears sufficient to amend the definition of Party to substitute a new, later date for “June 3, 2011.” For example, “June 3, 2011,” could be replaced with “December 31, 2011.”

Canby requests that BPA “establish a date certain”, then notes, correctly, that a new deadline will require an amendment to the existing Settlement and that existing signers must approve this language change. Canby Br. Ex., REP-12-R-CA-01, at 1. Other parties similarly infer or state that the Settlement must be amended in order to allow for new signers. BPA believes it should lead an effort with representatives of current parties to the Settlement to accomplish the widely shared goal of allowing for additional signers.

### **Decision**

*BPA will work with representatives of current parties to the Settlement to draft an amendment that would allow for additional entities to sign the Settlement and will offer the resulting amendment to all parties as soon as practicable.*

### **Issue 2.7.6**

*Whether BPA should pay PF-02 Refund Amounts directly to Lost River Electric Cooperative and Salmon River Electric Cooperative and pay PF-02 Refund Amounts for all other PNGC members to PNGC for redistribution to its members.*

### **Parties' Positions**

PNGC states that PNGC, Lost River, and Salmon River believe that it is appropriate and advantageous for the Administrator to determine that all Lookback Credit Amounts due to Lost River and Salmon River should be paid or credited directly to those customers during FY 2012–2013 and subsequent years, instead of paying or crediting any portion of those amounts to PNGC

for the benefit of Lost River and Salmon River. PNGC Br., REP-12-B-PN-01, at 2. These parties state that this procedure is both consistent with the bilateral relationships that BPA and Lost River and Salmon River have under their respective FY 2012–2028 contracts and more efficient to administer. *Id.*

PNGC also states that the Administrator should determine that the Customer Specific PF-02 Refund amounts shown in the Settlement, Exhibit B, for Lost River and Salmon River will be paid or credited by BPA directly to those customers for FY 2012–2013 and subsequent years, instead of any portion of those amounts being paid to PNGC for redistribution to Lost River and Salmon River. *Id.* at 3. PNGC states that because it holds a section 5(b)(7) contract for purchase from BPA, and resale to its members, of power for FY 2012–2013 and subsequent years, BPA should pay or credit to PNGC, for redistribution to its members, the Customer Specific PF-02 Refund amounts shown in the Settlement, Exhibit B, for all members of PNGC (except Lost River and Salmon River, who will then not be members). *Id.*

### **BPA Staff's Position**

This is a new issue that arose as parties finalized the Settlement. BPA Staff took no position on this issue. Staff would comment here that the PNGC proposal is administratively possible and within the Administrator's prerogative.

### **Evaluation of Positions**

Two preference customers, Lost River Electric Cooperative and Salmon River Electric Cooperative, which have been members of PNGC during FY 2002–2011, will cease being members of PNGC after FY 2011 and will purchase power directly from BPA. PNGC Br., REP-12-B-PN-01, at 2. PNGC proposed, and the negotiating parties accepted, a revision to Exhibit B to the Settlement, REP-12-E-BPA-11, that recalculated the allocation of PF-02 Lookback Credit Amounts to reflect a PF-02 Customer Percentage for each preference customer. *Id.* These values aggregated the retained Slice, assigned Slice, and Block purchases of each PNGC member (including Lost River and Salmon River) and attributed each member's entire share to the member, and reduced PNGC's share to zero. *Id.* PNGC states that its proposal is not intended to, and it believes does not, result in any change in the Customer Specific PF-02 Refund amounts for PNGC and its members in the aggregate, or for any other preference customer. *Id.*

BPA reviewed the contractual relationships and calculations described by PNGC and the results contained in Exhibit B of the Settlement. BPA agrees with PNGC's characterizations and agrees that the results in Exhibit B do not result in any change in the Customer Specific PF-02 Refund amounts for PNGC and its members in the aggregate, or for any other preference customer.

BPA further agrees with PNGC's statement that BPA should take on the role of directly paying or crediting PF-02 refund amounts to Lost River and Salmon River, and that BPA's role in this regard would be consistent with the bilateral relationships that BPA and Lost River and Salmon River have under these entities' FY 2012–2028 Regional Dialogue power contracts with BPA. BPA also agrees that directly paying or crediting these customers would be more efficient to

administer for BPA and presumably for PNGC, Lost River, and Salmon River, than the alternative of providing the payments or credits to PNGC for redistribution to Lost River and Salmon River.

BPA believes PNGC's proposals are reasonable, provide administrative efficiencies, and cause no harm to other parties.

### **Decision**

*BPA will pay or credit the Customer Specific PF-02 Refund amounts shown in the Settlement, Exhibit B, for Lost River and Salmon River directly to those customers for FY 2012–2013 and subsequent years, instead of any portion of those amounts being paid to PNGC for redistribution to Lost River and Salmon River. Because PNGC holds a section 5(b)(7) contract for purchase from BPA, and resale to its members, of power for FY 2012 through FY 2028, BPA will pay or credit to PNGC, for redistribution to its members, the Customer Specific PF-02 Refund amounts shown in the Settlement, Exhibit B, for all BPA preference customer utilities that are members of PNGC as of October 1, 2011.*

### **3.0 CRITERIA, ANALYSIS, AND EVALUATION OF THE PROPOSAL**

#### **3.1 Introduction**

Although BPA Staff and settling parties believe that settlement of the existing REP litigation is in the interest of all BPA ratepayers, the Administrator must ensure that the terms and conditions in the Settlement are reasonable and comply with all relevant statutory provisions. Under the Settlement, BPA would not perform the section 7(b)(2) rate test in its rate cases in the traditional manner. Instead, the Settlement<sup>7</sup> would determine the amount of REP payments to the IOUs and, concomitantly, the amount of rate protection afforded to the COUs. Specific portions of the payments of REP benefits made pursuant to the Settlement must be allowed to be recovered from the rates for public body and cooperative customers in accordance with section 7(b)(2).

The rate protection and payments under the Settlement are well-defined. The total REP amounts—called REP Recovery Amounts in the Settlement—consist of REP benefit payments to the IOUs and REP benefits withheld to fund the Refund Amounts to the COUs. However, before the Administrator can make these payments and perform his obligations in the Settlement, the Settlement must have a clear and direct connection to the protections and requirements set forth in the Northwest Power Act. The criteria BPA relied upon to determine whether such a connection exists are described below.

#### **3.2 Overview of BPA’s Evaluation Criteria**

To evaluate the Settlement, Staff develops a set of criteria used to “test” the Settlement. These criteria include three primary criteria:

- (1) the Settlement would provide COUs with at least as much rate protection as the rate protection afforded under section 7(b)(2) of the Northwest Power Act;
- (2) the Settlement would provide REP benefits in a manner consistent with section 5(c) of the Northwest Power Act and distribute such REP benefits among the settling IOUs in a manner consistent with BPA’s current ASC Methodology and with rates that are consistent with section 7 of the Northwest Power Act; and
- (3) the Settlement would resolve, in a fair and equitable manner, all of the outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period.

Evaluation Study, REP-12-FS-BPA-01, at 165.

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<sup>7</sup> The Settlement was developed in a context informed by section 7(b)(2) rate tests for FY 2002–2006, 2007–2008, 2009, and 2010–2011 and was reviewed in part through seventeen 7(b)(2) rate tests (for FY 2012–2028) incorporating numerous litigation and economic scenarios.

In addition, two secondary criteria were developed:

- (1) the Settlement would recognize that not all COUs were equally harmed by the costs of the 2000 REP Settlements and that IOUs' respective residential consumers were differentially affected by BPA's setting off REP benefits for Lookback Amounts, and
- (2) the Settlement would provide reasonable rates for non-settling parties and other classes of BPA's customers.

*Id.* at 166. *See also* section 14.2 for additional discussion on secondary criterion (2).

Although more criteria could have been considered, a settlement that satisfies the aforementioned criteria would be, from an analytical perspective, reasonable and consistent with the protections and requirements of the Northwest Power Act. Most significantly, a settlement that meets the foregoing criteria would also avoid the key concerns expressed over previous settlements of the REP.

### **3.3 Evaluating the 2012 REP Settlement**

#### **3.3.1 Overview of Evaluation Methodology**

Staff's general method for testing the REP benefits under the Settlement for compliance with the Northwest Power Act is fairly simple: Staff compares the REP benefits set forth in the Settlement with a set of projections of REP benefits that would likely be generated if the traditional implementation of the REP were to be performed. Evaluation Study, REP-12-FS-BPA-01, section 6.2. To project future REP benefits, Staff begins by developing a case based upon BPA's view of the implementation of the REP. This case, referred to as the "Reference Case," reflects BPA's positions on all of the disputed REP-related issues.

To project the Reference Case for the full term of the Settlement, Staff developed a long-term rate model (LTRM) that produces estimates of rate protection amounts and aggregate REP benefits in the absence of Settlement. *Id.* at 48. The LTRM is a scaled-down version of the rates model BPA uses to perform the section 7(b)(2) rates in the no-settlement case (referred to as the 2012 Rate Analysis Model or RAM2012). *Id.* Most importantly, the LTRM performs the 7(b)(2) rate test for each year (plus the ensuing four years) of the 17 years of the Settlement to determine total annual aggregate REP benefits for each year. *Id.* In making projections of future REP benefits, the LTRM relies on the same data inputs as the RAM2012, including Staff's projections of future ASCs, PF rates, and exchange loads. *Id.*

From this projection, Staff then constructs a number of alternative streams of REP benefits, reflecting both inherent uncertainty in forecasting as well as alternative litigation scenarios based on differing implementations of the section 7(b)(2) rate test. Staff considers a wider range of effects from other factors that could affect future ASCs and PF rates, including changes in costs, loads, and other revenues. *Id.* at 50. In addition to the analysis of the cost drivers, Staff also considers alternatives to BPA's implementation of the REP because it is recognized that BPA's

implementation of sections 7(b)(2) and 7(b)(3) and BPA's decision to conduct a Lookback are being vigorously contested in the Ninth Circuit in the *APAC*, *IPUC*, *Avista*, and *PGE II* cases. In light of this reality, Staff analyzes projected REP benefits not only under BPA's view of the statutory language (*i.e.*, the Reference Case) but also under a variety of different litigation scenarios (Scenarios 1–22). Evaluation Study, REP-12-FS-BPA-01, section 10.1. These litigation scenarios reflect the litigating parties' respective positions as presented in briefs filed with the Ninth Circuit in the *APAC* and *IPUC* cases, and the parties' positions on the 7(b)(2) and 7(b)(3) rate issues as stated by the parties in their administrative briefs in BPA's WP-07 Supplemental and WP-10 proceedings, which are scheduled to be briefed in the *Avista* and *PGE II* cases in the fall of 2011. *Id.*, section 7.1.

### **3.3.2 Scenario Analysis**

As noted above, the Reference Case employs BPA's current 7(b)(2) implementation methodology and a base case, or best forecast, of inputs used in ratemaking. Staff's analysis does not, however, rely on a single static forecast of future costs. Recognizing inherent risk and uncertainty in forecasting, the analysis is stressed by a wide degree of future variation in the two "natural" drivers of REP benefits and associated rate protection: exchanging utility costs, reflected through ASCs, and BPA costs, reflected through PF rates.

Base ASC forecasts used in the Reference Case are adjusted in these risk scenarios to simulate a wide range of potential cost drivers through the last 15 years of the Settlement period. As with the ASCs forecast for the Reference Case, these adjustments rely on resource cost expectations expressed through individual IOU integrated resource plans (IRPs), and are increased (or decreased) by high (or low) cost estimates for resource additions. High ASC cost scenarios assume that the full ambit of new resource needs identified in each exchanging utility's IRP are included in new resource additions, while low ASC cost scenarios assume that these new resources are not built and future power needs are met solely through market purchases using BPA's current (and relatively low) market price forecast. These cost assumptions are used as a proxy for the many cost variations that can be reasonably expected to occur through the final 15 years. Additional variation around high and low ASCs is included by adjusting the natural gas and electricity market price assumptions.

BPA's cost forecasts used in the Reference Case are adjusted in these risk scenarios to reflect a wide range of outcomes through the final 15 years. Variance around the Reference Case is implemented through adjustments to the cost escalation rates assumed into the future. While the Reference Case assumes inflation plus 200 basis points, the high BPA cost scenario assumes inflation plus 400 basis points, while the low BPA cost scenario assumes costs grow solely at the rate of inflation. Additional variation around high and low BPA costs is included by adjusting uranium fuel costs, the quantity of secondary energy available in future rate cases, as well as natural gas and electricity market price assumptions.

Below, risk scenarios included in the analysis are listed and briefly described. For more complete descriptions, *see* Evaluation Study, REP-12-FS-BPA-01, Chapter 8 and section 10.4.

- **Scenario 0 – Reference Case:** models BPA’s current implementation of the REP. The Reference Case assumes that all of BPA’s stated positions on the REP, such as BPA’s implementation of sections 7(b)(2) and (3), and the Lookback construct, are sustained by the Court. The Reference Case is constructed from a base case, or best forecast, of inputs used in ratemaking. These inputs include forecasts of ASCs, exchange loads, COU loads, and BPA’s costs.
- **High ASCs, Low BPA Rates:** High ASCs are represented by assuming that 100 percent of IOU load growth is met by new resources as specified in the respective IOUs’ Integrated Resource Plans. Low BPA rates are represented by assuming that BPA’s costs and revenue credits increase at the rate of inflation for 2018 onward.
- **Low ASCs, High BPA Rates:** Low ASCs are represented by assuming that 100 percent of IOU load growth is met by market purchases, using the Reference Case market forecast. High BPA rates are represented by assuming that BPA’s costs and revenue credits increase at the rate of inflation plus 4 percent real growth for 2018 onward.
- **High Benefits – Risk:** builds upon the “High ASC, Low BPA Rates” in Evaluation Study section 10.7.1 and assumes high carbon costs, high gas prices, low nuclear fuel costs, and no loss in BPA generation. This, in general, causes IOUs’ ASCs to rise at a rate faster than BPA’s rates, which generally raises REP benefits.
- **Low Benefits – Risk:** builds upon the “Low ASC, High BPA Rates” scenario and assumes no carbon costs, low gas prices, high nuclear fuel costs, and a loss in BPA generation. This in general causes IOUs’ ASCs to rise at a rate slower than BPA’s rates, which generally depresses REP benefits.

In addition, Staff’s analysis of the Settlement further stresses the forecast REP benefits (and 7(b)(2) rate protection) through acknowledging that certain aspects of BPA’s REP implementation are currently under dispute. Ongoing litigation could have material rate effects on REP benefits (and 7(b)(2) rate protection). Scenarios are developed to analyze the impact of many of the issues in litigation. A scenario is developed for each major issue, followed by several scenarios that combine issues to represent the aggregate position of the COU parties or the IOU parties. Below, litigation scenarios included in the analysis are listed and briefly described. For more complete descriptions, *see* Evaluation Study, REP-12-FS-BPA-01, section 10.

- **Scenario 1 – No Lookback:** models the impacts of a successful challenge by the IOUs to BPA’s decision to recover Lookback Amounts from the IOUs.
- **Scenario 2 – Large Lookback without LRAs:** models the arguments by the COUs that BPA should limit its determinations of reconstructed REP

benefits to the analysis, data, assumptions, and methodologies BPA established in the WP-02 case.

- **Scenario 3 – Large Lookback with LRAs:** models a combination of the COUs’ argument that BPA should limit reconstructed REP benefits to the WP-02 rate record assumptions (*i.e.*, \$48 million) and the COUs’ argument that the LRAs are invalid and therefore not protectable in the Lookback Amount calculation.
- **Scenario 4 – Idaho Deemer Balance:** assumes that Idaho Power and IPUC prevail in their arguments against an outstanding deemer balance for Idaho.
- **Scenario 5 – Conservation = General Requirements without Conservation Costs:** models the COUs’ contention that the loads in the 7(b)(2) Case should not be adjusted for acquired conservation.
- **Scenario 6 – Conservation = General Requirements with Conservation Costs:** models the IOU exchange customers’ contention that if the loads in the 7(b)(2) Case should not be adjusted for acquired conservation, as in Scenario 5, the Program Case conservation costs should be included in the 7(b)(2) Case.
- **Scenario 7 – Same Repayment Study in Both Cases:** models the contention that inclusion of different repayment costs from the Program Case revenue requirement is not allowed in the 7(b)(2) Case.
- **Scenario 8 – Mid-Columbia Resources Included in 7(b)(2)(d) Resource Stack:** models the COUs’ contention that Mid-C resources should be included in the resource stack pursuant to section 7(b)(2)(D) of the Northwest Power Act.
- **Scenario 9 – No 7(b)(3) Allocation to Surplus:** models the COUs’ contention that the costs of rate protection should not be allocated to surplus and secondary sales.
- **Scenario 10 – Same Secondary Credit in 7(b)(2) Case:** models the IOUs’ contention that the surplus sales to Slice customers should include a 7(b)(3) Supplemental Rate Charge and that BPA has not properly accounted for this allocation in the 7(b)(3) reallocations.
- **Scenario 11 – Conservation Resource Costs Are Expensed:** models the IOUs’ contention that the conservation resources included in the resource stack should be expensed and the cost of such resources recovered in the year that the resource is called upon.
- **Scenario 12 – Conservation Resource Costs Are Capitalized:** models the COUs’ contention that the conservation resources included in the resource stack should be capitalized over the useful life of the resource.

- **Scenario 14 – Excluded Conservation Added to Resource Stack:** models the IOUs’ contention that all acquired conservation should be included in the resource stack rather than the smaller portion used in the Reference Case.
- **Scenario 15 – Inflation Rate Used for Discount Rate:** models APAC’s contention that the projected rate of inflation should be used to discount projected rate streams for the Program Case and the 7(b)(2) Case rather than the forecast BPA borrowing rate.
- **Scenario 16 – Investment Rate Used for Discount Rate:** models the alternative IOUs’ contention that the projected investment decision discount rate should be used to discount projected rate streams for the Program Case and the 7(b)(2) Case rather than the forecast BPA borrowing rate.
- **Scenario 18 – COU Best Case:** modeled by combining the COUs’ position on the treatment of conservation from Scenario 5, their position on the 7(b)(2) Case repayment study, their position on the inclusion of Mid-C resources in the resource stack, their position on allocating 7(b)(3) rate protection costs to surplus sales, their position on the capitalization of conservation resources, and their position on discounting rate streams.
- **Scenario 19 – IOU Best Case:** modeled by combining the IOUs’ position on the treatment of conservation, their position on allocating 7(b)(3) rate protection costs to Slice surplus sales, their position on the expensing of conservation resources, and their position on discounting rate streams.
- **Scenario 20 – IOU Alternative Case:** modeled by combining the IOUs’ position on allocating 7(b)(3) rate protection costs to Slice surplus sales, their position on the expensing of conservation resources, and their position on discounting rate streams. It omits their position on the treatment of conservation to allow the IOU position on expensing conservation resources to affect the combined results of the IOUs’ positions.
- **Scenario 21 – COU Brief Case:** modeled by combining the COUs’ position on the treatment of conservation, their position on the 7(b)(2) Case repayment study, their position on the inclusion of Mid-C resources in the resource stack, their position on allocating 7(b)(3) rate protection costs to surplus sales, and their position on the capitalization of conservation resources. It omits their position on discounting rate streams because it has not yet been briefed.
- **Scenario 22 – IOU Brief Case:** modeled by combining the IOUs’ position on the treatment of conservation and their position on allocating 7(b)(3) rate protection costs to Slice surplus sales. Excludes their position on the expensing of conservation resources and their position on discounting rate streams because these have not yet been briefed.

### 3.4 Staff’s Conclusions and Recommendation

The results of Staff’s analysis show that the Settlement, when compared to BPA’s traditional implementation of the REP, provides far less in aggregate REP benefits to the IOUs than otherwise would likely be permitted by the Northwest Power Act in the absence of the Settlement. BPA’s Reference Case, which is built from BPA’s current REP implementation, produces aggregate REP benefits of approximately \$3.072 billion (net present value or NPV) over the FY 2007–2028 period covered by the Settlement’s REP benefits. Evaluation Study, REP-12-FS-BPA-01, Table 10.4. This is compared to the Settlement’s aggregate REP benefits of \$2.05 billion (NPV) over the same period. *Id.* Thus, based on a comparison of BPA’s view of the proper implementation of the REP, the Settlement presents a very reasonable and acceptable basis for settling the REP.

It needs to be underscored that the analysis in this proceeding remains generally uncontested (excluding general critiques against use of forecasts and assignment of probabilities associated with litigation scenarios, which are addressed in the issues to follow). Thus, the implementation of the analysis is not in dispute, but rather the interpretation of the results.

Not surprisingly, Staff’s analysis of the parties’ respective positions in litigation produces a wide array of aggregate REP benefit levels. On one extreme is the IOUs’ position; if they were to succeed on most or all of their issues in litigation, Staff projects that REP benefits could increase to as high as \$6 billion (NPV). Evaluation Study, REP-12-FS-BPA-01, Table 10.4. On the other extreme is the COUs’ position, which, if successful, would reduce REP benefits to \$759 million (NPV) over the FY 2007–2028 period. *Id.* In between these two extremes are multiple variations on these amounts. *Id.* Of the 22 litigation scenarios considered by Staff, 18 of them produce aggregate REP benefits in excess of the amounts provided by the Settlement. *Id.* From this, Staff concludes that the analysis shows that, except in the extreme instance where the COUs prevail on multiple major contested issues and the IOUs succeed in virtually none of their issues, rate protection is greater and REP benefits smaller under the proposed Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 27.

**Table 3.4.1**  
**Net Present Values of Rate Test Scenarios**  
**(\$ millions)**

	NPV	Difference from Reference Case	Difference from Settlement
Settlement Value	2,051	(1,020)	—
Scenario 0 – Reference Case	3,070	—	1,020
<b>Cost/Rate Scenarios</b>			
High ASC; Low PF	3,383	313	1,332
Low ASC; High PF	2,743	(327)	693
High ASC; Low PF – Risk	3,760	690	1,709
Low ASC; High PF –Risk	2,521	(549)	470

<b>Litigation Scenarios</b>			
Scenario 1 – No Lookback	3,490	420	1,440
Scenario 2 – Large Lookback w/ Protected LRAs (50% rule)	2,961	(109)	911
Scenario 2 – Large Lookback w/ Protected LRAs (no 50% rule)	2,953	(118)	902
Scenario 3 – Large Lookback w/ LRAs Invalid (50% rule)	2,524	(546)	474
Scenario 3 – Large Lookback w/ LRAs Invalid (no 50% rule)	2,387	(684)	336
Scenario 4 – Idaho Deemer Relief	3,070	—	1,020
Scenario 5 – Conservation = Gen. Req. w/o Costs.	2,009	(1,061)	(41)
Scenario 6 – Conservation = Gen. Req. w/ Costs	3,043	(28)	992
Scenario 7 – Single Repayment Study	2,897	(173)	846
Scenario 8 – Mid-C in Stack	2,146	(925)	95
Scenario 9 – No 7(b)(3) to Surplus	2,952	(118)	901
Scenario 10 – Identical Secondary Credits	3,767	697	1,717
Scenario 11 – Conservation Res. Expensed	3,854	784	1,804
Scenario 12 – Conservation Res. Capitalized	2,836	(234)	786
Scenario 13 – No Exclusions	3,405	335	1,355
Scenario 15 – Discount Rate = Inflation	2,489	(582)	438
Scenario 16 – Discount Rate = Investment	3,656	585	1,605
Scenario 18 – COU Best Case	759	(2,311)	(1,292)
Scenario 19 – IOU Best Case	4,551	1,481	2,501
Scenario 20 – IOU Alternative Case	5,964	2,894	3,914
Scenario 21 – COU Brief Case	1,172	(1,898)	(878)
Scenario 22 – IOU Brief Case	4,006	936	1,955

It is based upon this expansive evaluation, alongside the stated evaluation criteria, that Staff recommends adoption of the Settlement. Under almost all outcomes of the analysis, the Settlement provides superior rate protection compared to the section 7(b)(2) rate test scenarios. *See* Evaluation Study, REP-12-FS-BPA-01, section 11.3. The analysis demonstrates that the Settlement provides superior rate protection from REP costs in almost all scenarios, excepting the instances where the COUs prevail on multiple contested issues and the IOUs succeed on virtually none of their issues. *Id.* Table 10.4. The conclusion is that under most likely future results of the rate test, rates for COUs would be higher without the Settlement than the rates would be under the Settlement, all other factors being the same.

On this last point, BPA wishes to emphasize that the lower projected costs of the REP that have been discussed in this case under Settlement are not mere ethereal guesswork. While some parties may opine that BPA cannot predict the future with certainty, there is no denying that the Settlement provides COUs immediate rate relief in the form of lower costs of near-term REP benefits. Without the Settlement, BPA would collect in rates for the FY 2012–2013 rate period an additional \$24 million under BPA’s traditional (and disputed) implementation of the REP.

See Evaluation Study, BP-12-FS-BPA-01, section 11.3. Stated another way, the IOUs are giving up \$24 million in REP benefits that BPA would be prepared to pay to their residential and small farm customers over the next two years under the traditional REP. In this way, the Settlement will result in real savings in REP costs that will be paid in the near-term by all of BPA's ratepayers. These savings, as described by Staff and supported by the analysis in this case, are expected to "grow over time[.]" Bliven *et al.*, REP-12-E-BPA-12, at 48.

### **3.5 Issues Related to BPA's Technical Analysis**

The following issues have been raised concerning Staff's analysis and evaluation of the Settlement.

#### **Issue 3.5.1**

*Whether BPA can adequately rely on 17-year projections in making determinations on 7(b)(2) rate test results for the duration of the 17-year period.*

#### **Parties' Positions**

APAC argues that "projecting costs over such an extended period produces an unreliable and unreasonable result." APAC Br., REP-12-B-AP-01, at 6. APAC contends that the reliability of a 17-year projection cannot be compared to the five-year projection chosen by Congress." *Id.* at 6.

WPAG<sup>8</sup> argues that Staff "has not demonstrated that the REP cost protection under the Settlement is the same as that which would be provided by the statutory rate directives in each rate proceeding." WPAG Br., REP-12-B-WG-01, at 29. According to WPAG, "the longer the forecast horizon of the values used, the more likely they were to be in error due to unforeseen events." *Id.*, at 31. Thus, "attempts to model events seventeen years into the future simply cannot capture the range of possible future events that will materially impact the operation of the [7(b)(2) rate test] in each rate proceeding, and the REP costs that can lawfully be charged preference customers." *Id.* at 32-33. Further, WPAG indicates that BPA has provided "no citation or authority for the proposition that reasonable forecast[s], which all concede will undoubtedly be wrong, can legally justify the REP cost protection determined in each rate proceeding." WPAG Br. Ex., REP-12-R-WG-01, at 28.

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<sup>8</sup> Eight WPAG members have signed the Settlement; three of which, Peninsula Light, Tanner Elec., and Wahkiakum PUD, are excluded from WPAG's initial brief. One WPAG member, Alder Mutual, signed the Settlement prior to the filing of WPAG's initial brief. Three WPAG members, Clark PUD, Clallam PUD, and Lakeview L&P, signed the Settlement after the filing of WPAG's initial brief and within the signing window. One WPAG member, the Town of Steilacoom, signed after the signing window. All eight do not join WPAG's brief on exceptions. WPAG states that a number of utilities joining its brief on exceptions have expressed an interest or intention of revisiting their decision on the execution of the Settlement subsequent to the filing of the brief on exceptions. WPAG Ex. Br., REP-12-R-WG-01-E01, n.1.

JP02 notes that ratesetting “on a forecast basis is both ‘statutorily mandated by the Northwest Power Act’ and ‘inherently unavoidable.’” JP02 Br., REP-12-B-JP02-01, at 11-12. JP02 contends that “[i]nsofar as the IOUs were willing to accept fixed REP benefits over this period, BPA properly concluded that ‘it makes sense to run the 7(b)(2) rate test for an equivalent amount of time to determine whether the protections afforded to the COUs by the rate test have been met.’” *Id.* at 11, *quoting* Bliven *et al.*, REP-12-E-BPA-12, at 3-4. JP02 notes that “forecasts extending for longer than 17 years are frequently used to inform important decisions.” JP02 Br., REP-12-B-JP02-01, at 11. In the context of the Settlement, JP02 reasons that the “proper question from a ratemaking perspective is not speculation as to whether any forecast can be perfectly accurate [in hindsight], but rather whether the projection is reasonable and based on the best available information.” *Id.* at 12, *quoting* Deen *et al.*, JP02-REP-12-E-JP02-05, at 7. JP02 argues that “by actually performing the 7(b)(2) rate test for each year of the 17-year period to test whether the rate protection provided under the Settlement is not less than the statutory requirements . . . , the Administrator can find ‘that the Settlement complies with BPA’s statutes, is consistent with the Court’s prior rulings, and is in the best interest of regional ratepayers.’” JP02 Br., REP-12-B-JP02-01, at 12, *quoting* Stiffler *et al.*, REP-12-E-BPA-13, at 3.

### **BPA Staff’s Position**

Staff states that “ratesetting on a forecast basis is inherently unavoidable.” Stiffler *et al.*, REP-12-E-BPA-13, at 7. Staff notes that because “forecasting is inherently uncertain, we provide a structured and interconnected set of scenarios that we believe accurately reflects a reasonable range of potential outcomes.” *Id.* at 7. Absent the use of forecasts, the Administrator would be placed in the untenable position of evaluating the Settlement without any analytical basis. *Id.*

### **Evaluation of Positions**

APAC argues that due to the “inherent uncertainty” embedded in long-term forecasts, “the conclusion of BPA Staff as to the reasonableness of the [S]ettlement is also defective because Staff’s analysis used projected costs over a 17-year period; all parties agreed that projections over such a period have inherent uncertainty.” APAC Br., REP-12-B-AP-01, at 15. APAC refers in the abstract to WPAG’s testimony, where WPAG states “[f]orecasts of this nature are not capable of providing reliable predictions of the precise future outcomes, such as the amount of REP cost protection that preference customers will or will not receive from the statutory provisions over the next 17 years.” Saleba *et al.*, REP-12-E-WG-01, at 19.

BPA disagrees that uncertainty in future projections means that BPA cannot rely on such projections to determine whether the Settlement complies with the Northwest Power Act. There is uncertainty in forecasting the future; forecasts rarely are “precise.” Yet, BPA continues to set rates based upon projections of future loads, resources, costs, and revenues, all of which vary significantly from year to year and forecast to forecast. Stiffler *et al.*, REP-12-E-BPA-13, at 7. In fact, this approach is statutorily mandated by the Northwest Power Act, and as such, ratesetting on a forecast basis is inherently unavoidable. JP02 Br., REP-12-B-JP02-01, at 11-12.

Arguments against using long-term projections to evaluate the Settlement pose two questions: first, whether the long-term projections produce unreliable and unreasonable results, and second, whether the results of the long-term analysis are the same as those that would be provided through coetaneous rate tests.

The parties in this proceeding debate whether the long-term projections produce unreliable and unreasonable results. JP02 notes that the long-term forecasts are both necessary and sufficient: “forecasts extending for longer than 17 years are frequently used to inform important decisions.” JP02 Br., REP-12-B-JP02-01, at 11. JP02 notes that ratesetting on a forecast basis is both “statutorily mandated by the Northwest Power Act” and “inherently unavoidable” and that the proper question from a ratemaking perspective is not speculation as to whether any forecast can be perfectly accurate in hindsight, but rather whether the projection is reasonable and based upon the best available information. *Id.* at 12.

Recognizing inherent hurdles with forecasting, Staff takes great effort in developing a range of forecasts upon which to support the Evaluation Study. First, it is important to recognize that the analysis does not rely on a single static forecast of future costs. Rather, the analysis recognizes that forecasting is inherently uncertain by providing a structured and interconnected set of scenarios that reflect a reasonable range of potential outcomes by varying key cost drivers for both BPA and REP participants.

The analysis inputs are intentionally robust in establishing varying forecasts for ASCs that reflect a wide range of outcomes throughout the 17-year period. Such forecasts are based upon resource cost expectations expressed in individual IOU IRPs, combined with both high- and low-cost estimates for resource additions (based on market-priced purchases on the low end, and complete sets of IRP renewable resource additions on the high end). These cost assumptions are an adequate proxy for the many cost variations that can be reasonably expected to occur through the next 17 years. Stiffler *et al.*, REP-12-E-BPA-13, at 7. A more comprehensive discussion of BPA’s methodology for forecasting ASCs is provided in Issue 4.5.4.

Both high and low BPA revenue requirement scenarios are tested and, when combined with the low and high ASC scenarios, produce a reasonable set of projections with upper and lower REP benefit bounds around the medium ASC and BPA rates, known as the Reference Case. The pairing of “Low ASCs” with “High PF costs,” by the nature of the arithmetic workings of the REP benefit calculations, results in a cautious while reasonable lower bound for benefits expected over the 17-year period (*i.e.*, \$2.5 billion). *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4. Conversely, the pairing of “High ASCs” with “Low PF costs” results in a generous while reasonable upper bound for benefits expected over the 17-year period. *Id.* (showing \$3.8 billion).

This pairing is deliberate: one would expect some positive degree of correlation between costs faced by BPA and costs faced by IOUs (regardless of the price scenario). The specific design of risk scenarios to test divergence between BPA and IOU costs (which therefore posits a negative correlation between costs faced by BPA and costs faced by IOUs) stresses the lower and upper bounds of REP benefits. This intentional design in the scenario development acknowledges

inherent uncertainty in forecasting and compensates for such uncertainty by expanding the “jaws” of foreseeable benefits, upon which the analysis and evaluation is based.

These “risk scenarios” are accompanied by careful modeling of the chosen set of known and currently briefed legal issues regarding the section 7(b)(2) rate test and Lookback implementation issues, culminating in an approach BPA believes to be sound and robust. In fact, WPAG finds Staff’s efforts in the analysis laudable: “BPA staff [is] to be commended for the substantial effort it put into this modeling effort.” WPAG Br., REP-12-B-WG-01, at 32. WPAG properly summarizes Staff’s modeling effort: “BPA looked at such factors as natural gas prices, resource operation cost risk, wind generation impact, resource portfolio standards, carbon costs and other environmental mandates. . . . In addition, BPA also performed more robust analysis of possible outcomes of pending litigation, comparing various outcomes on pending issues to a base reference case that assumed BPA’s current positions on these matters were sustained.” *Id.*

Despite the recognition of the scope of the analysis, WPAG argues that “the fact of the matter is that attempts to model events seventeen years into the future simply cannot capture the range of possible future events that will materially impact the operation of [7(b)(2) rate test] applied in each rate proceeding, and the REP costs that can lawfully be charged preference customers.” *Id.* at 32-33. WPAG states that “there is a broad range of possible future results that could obtain in the next seventeen years under the [7(b)(2) rate test].” *Id.* at 33. Because of this inability to capture the range of possible events that could affect the rate test, WPAG calls Staff’s analysis “analytically insufficient.” *Id.* at 33. WPAG reiterates this point in its brief on exceptions. WPAG Br. Ex., REP-12-R-WG-01, at 27.

BPA does not dispute that there are many possible outcomes of Staff’s analysis and that projections produced at different times may produce different results. However, as noted above, Staff attempts to mitigate the potential problems with long-term forecasting by presenting a robust analysis that looks to multiple variations on the key drivers of future REP benefits, *i.e.*, ASCs, exchange loads, BPA’s costs, litigation risks, and market variations. WPAG has neither identified a technical flaw in BPA’s analysis nor offered up another variable that Staff should have considered. Indeed, WPAG does not criticize the current projections at all; rather, WPAG posits that the projections might be different if performed at a later time. In effect, WPAG claims that Staff’s analysis is “analytically insufficient” simply because Staff “cannot capture the range of possible future events that will materially impact the operation of [the 7(b)(2) rate test] applied in each rate proceeding . . . .” *Id.* at 32-33.

BPA, however, disagrees that Staff must essentially be clairvoyant in order to make an “analytically sufficient” projection of future REP benefits. While WPAG may claim that such precision is necessary before BPA can make a reasoned decision on the Settlement, that is not the law. An agency need not “have perfect information before it takes any action.” *State of N. Carolina v. FERC*, 112 F.3d 1175, 1190 (D.C. Cir. 1997) quoting *United States Dep’t of the Interior v. FERC*, 952 F.2d 538, 546 (D.C. Cir. 1992). Rather, “in the face of ‘serious uncertainties,’ an agency need only ‘explain the evidence which is available, and . . . offer a rational connection between the facts found and the choice made.’” *Id.*, quoting *Motor Vehicle*

*Mfrs. Ass'n of the United States v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 52 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

In this case, BPA is considering the evidence presented on the record before it to determine whether or not to sign the Settlement. The analysis submitted in this proceeding is designed to review REP benefits under a wide variety of conditions and situations. The inputs to Staff's models have been thoroughly vetted by Staff and the parties. As expected, the resulting REP benefits reflect a wide range of analytical results—from \$759 million to \$6 billion. See Evaluation Study, REP-12-FS-BPA-01, Table 10.4. The vast spread of potential future REP benefits is a testament to the robustness of the analysis performed in this case.

Other parties to this proceeding concur that BPA's projection of REP benefits for a 17-year period is reasonable. JP02 notes that ratesetting "on a forecast basis is both 'statutorily mandated by the Northwest Power Act' and 'inherently unavoidable.'" JP02 Br., REP-12-B-WG-01, at 11-12. JP02 contends that "[i]nsofar as the IOUs were willing to accept fixed REP benefits over this period, BPA properly concluded that 'it makes sense to run the 7(b)(2) rate test for an equivalent amount of time to determine whether the protections afforded to the COUs by the rate test have been met.'" *Id.* at 11, quoting *Bliven et al.*, REP-12-E-BPA-12, at 3-4. JP02 notes that "forecasts extending for longer than 17 years are frequently used to inform important decisions." JP02 Br., REP-12-B-JP02-01, at 11. In the context of the Settlement, JP02 reasons that the "proper question from a ratemaking perspective is not speculation as to whether any forecast can be perfectly accurate [in hindsight], but rather whether the projection is reasonable and based on the best available information." *Id.* at 12, quoting *Deen et al.*, JP02-REP-12-E-JP02-05, at 7. JP02 argues that "by actually performing the 7(b)(2) rate test for each year of the 17-year period to test whether the rate protection provided under the Settlement is not less than the statutory requirements . . . , the Administrator can find 'that the Settlement complies with BPA's statutes, is consistent with the Court's prior rulings, and is in the best interest of regional ratepayers.'" JP02 Br., REP-12-B-WG-01, at 12, quoting *Stiffler et al.*, REP-12-E-BPA-13, at 3.

Finally, WPAG argues that "the predetermined annual REP benefits set out in the Settlement have virtually no chance of replicating the REP costs that the [7(b)(2) rate test] will permit BPA to lawfully charge the preference customers in any specific future rate period." WPAG Br., REP-12-B-WG-01, at 33. Further, "the forecasts of REP 'amounts to be charged' preference customers are not based on costs that BPA will actually use to set rates in future rate cases." *Id.* at 30. APAC supports this interpretation: (1) "in every other rate case, the result of the §7(b)(2) rate test can be directly, arithmetically linked to the rates," and (2) "in the §7(b)(2) rate test, one must project actual costs for the rate period and the following four years." APAC Br., REP-12-B-AP-01, at 6.

However, this is not the requirement provided in the statute. It is simply not stated in the Northwest Power Act that the results of the 7(b)(2) rate test must be replicated exactly in rates. Rather, section 7(b)(2) places a *limit* on the amounts to be charged to public body and cooperative customers. Although it requires that COUs be allotted full protection, exchanging utilities under section 5(c) of the Act are fully enabled to grant *greater* rate protection to public body customers due to the voluntary nature of the REP. See Issue 4.5.1. That is, the provision of

rate protection under section 7 of the Act provides for a “rate ceiling,” not a “rate floor.” *Id.* Therefore, the statute allows rates to be lower than the amounts allowed by the rate test, and this is precisely the case in the analysis of the Settlement. The rates established pursuant to the Settlement would charge public body and cooperative customers *less* than amounts allowed by the rate test. There is, therefore, no statutory infirmity with the Settlement in this respect.

In rebuttal testimony, Staff makes this point clear:

We do not view the Settlement as a mere substitution of negotiated numbers for values that would otherwise be determined in a rate case. This simplified view of the Settlement ignores the role of this proceeding in measuring the negotiated numbers in light of the 7(b)(2) rate test and other statutory provisions. It is our understanding that REP participants may lawfully agree to take lower REP benefits than they might otherwise be entitled to. Thus, as long as the amounts provided under the Settlement are less than the REP benefits projected pursuant to sections 7(b)(2) and 7(b)(3) of the Northwest Power Act, we see no legal infirmity.

Bliven *et al.*, REP-12-E-BPA-12, at 2-3.

In its brief on exceptions, APAC argues that long-term forecasting is acceptable in industrial planning because the company and its shareholders bear the consequences of inaccurate forecasts, but here the consequences of an inaccurate forecast would be imposed on preference customers and their consumers. APAC Br. Ex., REP-12-R-AP-01, at 7, n.15. Contrary to APAC’s argument, however, in any private concern the company and its stockholders are not the sole bearers of the risk of inaccurate forecasts. Companies can, among other things, increase prices to varying degrees to share the cost of inaccurate forecasts with consumers. More relevant here, in the utility industry a company may sign a contract based on reasonable forecasts but, if the forecasts are wrong, the utility usually can recover the costs of the contract through rates to its consumers. In the case of a publicly owned utility or BPA, there are no stockholders to pick up costs; nevertheless, such costs must be recovered and are properly recovered from ratepayers.

BPA will develop in other chapters of this ROD the particular findings that BPA makes with respect to rate protection under section 7(b)(2) and compliance with section 5(c) based on the long-term projections developed in this case. For purposes of this issue, however, BPA can see no reason to conclude that its forecast of future REP benefits is flawed in any material respect. Staff uses reasonable projections of future inputs to BPA’s ratemaking to determine a realistic projection of prospective REP benefits under a variety of scenarios. These inputs include reasonable adjustments to reflect inherent uncertainties with ASCs, market prices, loads, and other factors that could materially affect the section 7(b)(2) rate test and the resulting level of REP benefits. While these projections are certainly not “perfect,” BPA does not believe they have to be. Rather, they simply must be based on available evidence and reflect reasoned assumptions regarding future events. The record in this case demonstrates that Staff’s analysis satisfies these criteria, and the objecting parties have not demonstrated otherwise.

## **Decision**

*The analysis of the Settlement provides reliable 17-year forecasts useful for making determinations of 7(b)(2) rate test results for the duration of the 17-year period.*

### **Issue 3.5.2**

*Whether combinations of scenarios evaluated by Staff produce a reasonable set of REP benefits pursuant to section 7(b)(2) and whether the set of streams are biased toward showing the Settlement is reasonable.*

### **Parties' Positions**

APAC argues that scenarios are combined in such a way as to favor the terms of the Settlement and ignore the joint outcome of various COU litigated positions *in combination* with other COU litigated positions. APAC Br., REP-12-B-AP-01, at 14.

WPAG comments that BPA's analysis uses historically high REP benefit levels to support Staff's decision to adopt the Settlement. WPAG Br. Ex., REP-12-R-WG-01, at 5.

JP02 supports Staff's scenario analysis implementation, and defends the reasonableness criteria employed. JP02 Br., REP-12-B-JP02-01, at 11-12.

### **BPA Staff's Position**

Staff notes that COU positions cannot be analyzed in isolation from IOU positions, and that a balanced analysis is appropriate for evaluating the terms of the Settlement. Stiffler *et al.*, REP-12-E-BPA-13, at 18.

### **Evaluation of Positions**

APAC argues that the scenarios utilized by Staff in its evaluation are not comprehensive in their range of the possible contingencies for the future. APAC Br. Ex., REP-12-R-AP-01, at 2. APAC contends there are a multitude of possible scenarios that would demonstrate the failure of the Settlement to provide adequate rate protection. *Id.* As an example, APAC claims that a combination of scenarios supplementing the conservation issue would produce an even lower NPV, such as prevailing on conservation and on the issue of including the full payments under the Load Reduction Agreements, or prevailing on conservation in combination with a low ASC scenario. *Id.* at 6.

APAC's arguments are not persuasive. First, BPA disagrees that Staff's analysis is not comprehensive. BPA has quantified all of the major issues in litigation before the Court in the *APAC*, *IPUC*, and *Avista* cases. *See* Gendron *et al.*, REP-12-E-BPA-01, at 20-26. Scenarios 1–3 address Lookback-related issues, scenario 4 addresses deemer issues, and scenarios 5–17 address section 7(b)(2) and 7(b)(3) issues. APAC has not identified any additional issues in the litigation that Staff analysis should have considered.

Second, BPA disagrees that Staff should have considered more “combinations” of scenarios in its analysis. The key drivers for determining REP benefits have been identified in scenarios 1–17. In scenarios 18–22, Staff combines various litigation positions of the parties to determine the IOUs’ and COUs’ respective best cases. APAC contends that BPA’s conclusion that most “scenarios provide greater rate protection” is faulty because BPA did not consider enough scenarios. APAC Br. Ex., REP-12-R-AP-01, at 6. However, BPA does not see how adding combinations of scenarios would have been instructive in considering whether to adopt the Settlement or not. By modeling the litigation outcomes that most favor the IOUs and COUs, Staff has presented the full range of benefits that could be expected over the 17-year term of the Settlement. Stiffler *et al.*, REP-12-E-BPA-13, at 18. Any other combination of litigation outcomes would fall between the upper and lower bounds of the IOU Best Case and COU Best Case scenarios. *Id.* BPA does not believe, and APAC has not demonstrated, that increasing the sample size of the combinations would show any significant skewing of the total population toward either of the bounds. *Id.* Because this analysis is comparing the REP benefits under the Settlement to the results of the 7(b)(2) rate test under a number of litigation outcomes, it would be very hard to demonstrate that the combination of results, even if probability weightings were assigned, would show a significant number of outcomes that provided fewer REP benefits than set forth in the Settlement. *Id.*

Even if BPA had considered random “combinations” of issues, it is unclear what value the resulting analysis would have provided to this case. APAC claims BPA should have considered combining scenario 5 (COU conservation) with scenario 3 (COU large Lookback w/ LRAs). APAC Br. Ex., REP-12-R-AP-01, at 6. However, BPA can see neither rhyme nor reason for choosing the two issues identified by APAC over combining scenarios that support the IOUs’ positions, such as scenario 1 (IOU No Lookback) and scenario 11 (IOU conservation expensed). Whatever combination of issues that APAC claims Staff should have considered that would produce REP benefits below the Settlement, it would be just as valid for the IOUs to identify a combination of scenarios favorable to them that would produce REP benefits above the Settlement. Indeed, Staff determined that in order to run every possible combination of IOU and COU issue in the litigation, BPA would have to generate approximately 2200 scenarios. Stiffler *et al.*, REP-12-E-BPA-13, at 16. Producing 2200 scenarios, however, would do little else than add more lines to BPA’s charts; the range of expected benefits would not change. *Id.* BPA does not believe adding additional combinations of issues would have been either useful or instructive in determining whether or not to adopt the Settlement.

What is instructive and useful for determining whether to adopt the Settlement, however, is Staff’s quantification of the various issues in litigation. Of the many scenarios evaluating issues in litigation, only three scenarios result in REP benefits below the Settlement. These scenarios, however, require the COUs to prevail on two or more issues in litigation. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4; *see also* sections 10.5.5, 10.7.1, and 10.7.4. The instructive point here is that only a scenario with combined issues results in REP benefits below the Settlement. *Id.*, Table 10.4. The COUs thus do not have single issues that, if they prevailed, would result in REP benefits below the Settlement. They must prevail on multiple issues against BPA to achieve a better result.

Moreover, APAC's suggestion that BPA combine particular outcomes that favor the COUs' position is faulty because such an approach ignores the countervailing risk posed by the IOUs winning on their issues in the litigation. Ten of the scenarios modeled by Staff quantify the IOUs prevailing on their issues in the litigation, with the result that REP benefits in *all* such cases would be substantially above the Settlement amounts. *See* Evaluation Study, REP-12-FS-BPA-01, Tables 10.3 and 10.4. The important point revealed by these scenarios is that it shows the COUs must not only prevail against BPA on multiple issues to achieve a better result than the Settlement; they (and BPA) must also prevail against all of the IOUs' positions. For example, even if the COUs were to prevail on the combined conservation issues in scenario 5, the gains the COUs achieved would be erased if the IOUs were to prevail on their arguments regarding the discount rate in scenario 16. *Id.*, Table 10.4. The counterbalancing effects of the multitude of issues in the REP litigation reveal the difficulty in any attempt at predicting a particular "combination" of likely outcomes in litigation. Either side may win a few battles, but still lose the war if the Court finds for the IOUs or the COUs on the right issues.

APAC also charges that Staff's analysis fails to combine the scenarios analyzed with the high and low ASCs scenario BPA analyzed against the Reference Case. APAC Br. Ex., REP-12-R-AP-01, at 6. APAC also argues BPA should have combined the scenarios with the various discount rate assumptions BPA considered in scenarios 15 and 16. *Id.* APAC claims that such combinations "are not unlikely." *Id.*

However, BPA does not see what value would have been added to the record in this case by producing multiple variations on the projections already submitted by Staff. BPA produced a sensitivity analysis on the effects of non-litigation factors (such as ASCs and BPA costs) on REP benefits by comparing BPA's Reference Case to the high ASC/low PF rate and high PF rate/low ASC combinations. The results of this sensitivity analysis produced results that showed REP benefits could range from a low of \$2.5 billion to a high of \$3.8 billion, or roughly 20 percent above or 20 percent below what BPA projected in its Reference Case. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4. Applying the same combination of ASCs and BPA costs would generally produce a similar effect on the other litigation scenarios considered in this case; that is, the high ASC, low PF rate combined scenarios would produce more REP benefits than projected in the scenario analysis, while a combination of low ASCs and high PF rates would produce less.

Beyond quadrupling the number of scenarios in this case to consider, it is unclear to BPA what additional conclusions could be drawn from these scenarios. APAC appears to be asserting that if BPA were to apply the low ASC/high PF rate assumptions with certain COUs-based scenarios, lower overall REP benefits would be produced. APAC Br. Ex., REP-12-R-AP-01, at 6. This one sided-method of reviewing the scenario analysis, however, ignores the equally probable result that the high ASCs/low PF rate scenario could apply to the results of the COU-based scenarios, resulting in even greater REP benefits to the IOUs.

Moreover, from a practical perspective, BPA does not believe that the most likely future for the region is a combination of low ASCs and high BPA costs. Recent trends in the IOUs' ASCs

support this conclusion. In FY 2009, the average IOU ASC was approximately \$50.9 MWh. *See* FY 2009 Wholesale Power Rates Development Study, WP-07-FS-BPA-13, at 125. BPA’s current projections of ASCs (based on the final FY 2012–2013 ASC Reports) show an average ASC for the IOUs of approximately \$59 MWh for the FY 2012–2013 period. Evaluation Study Documentation, REP-12-FS-BPA-01A, Table 10.2.1.3. That is an \$8/MWh difference in a five-year period. While it is certainly possible the IOUs’ ASCs could become less in future years, it is at least equally reasonable, and indeed more likely, that ASCs will continue their current trend of rising as the IOUs absorb newer and more expensive resources to satisfy their respective state renewable portfolio standards.

APAC also argues that BPA’s scenario analysis does not combine any of the scenario outcomes with alternative discount rates. APAC Br. Ex., REP-12-R-AP-01, at 6. It is not entirely clear to BPA what APAC is attempting to argue in its brief when it refers to “discount rates.” Scenarios 15 and 16 address the issues in litigation regarding discount rates and their use in the 7(b)(2) rate test. Evaluation Study, REP-12-FS-BPA-01, sections 9.5.2, 10.6.3 and 10.6.4. APAC is contending that BPA should combine these scenarios with other scenarios to produce other “combinations” of outcomes. BPA already has responded to APAC’s suggestion above. Randomly combining various positions in litigation would only produce more lines within the ranges already established by the COU and IOU best cases.

APAC argues in its brief on exceptions that BPA’s analysis is also faulty because Staff has not produced a scenario that models reduced COU residential exchange costs due to the *in lieu* provisions embodied in section 5(c)(5) of the Northwest Power Act. APAC Br. Ex., REP-12-R-AP-01, at 2. Later in its brief, APAC argues again that circumstances in the future may open the possibility of an *in lieu* purchase, which Staff should have modeled in a scenario. *Id.* at 6.

APAC’s criticism of Staff’s analysis is unwarranted. First, APAC has waived these arguments. In its Initial Brief, APAC made no mention of BPA’s Staff’s analysis being faulty because it failed to model “reduce[d] COU residential exchange costs due to the *in lieu* provisions embodied in § 5(c)(5)” or because “Staff should have modeled” an *in lieu* scenario. APAC Br. Ex., REP-12-R-AP-01, at 2. Indeed, BPA has searched the administrative record in this case in vain for reference by any party to such a request. The only reference to “*in lieu*” and Staff’s scenario analysis that BPA could find was a single clause in a sentence of APAC’s witness’s rebuttal testimony, wherein Mr. Wolverton observed that Staff’s analysis “does not decide whether the *in lieu* provisions would increase the COU rate-test protection in FY2019 . . . .” Wolverton, REP-12-E-AP-02, at 7. However, Mr. Wolverton did not state that Staff should have added such a scenario to its list of scenarios, nor did he produce his own analysis for submission into the record of this case. In any case, APAC did not present this argument for BPA’s consideration in its Initial Brief, and consequently, APAC has waived it. *See Rules of Procedure Governing Rate Hearings*, § 1010.13(b), (c).

Second, to the extent that APAC’s challenge is appropriate, it is without merit. APAC first argues that Staff should have considered a scenario where BPA exercises its discretionary right to engage in *in lieu* purchases with exchanging COUs. APAC Br. Ex., REP-12-R-AP-01, at 2. It is not clear to BPA what import modeling an *in lieu* transaction for an exchanging COU

participant would have on the IOUs' REP benefits. As noted above, no party raised this issue, so Staff has not had any opportunity to consider it on the record. Staff did consider whether the *in lieu* features of the Northwest Power Act, as a ratemaking matter, generally reduce REP costs in rates. Staff found that the real savings of *in lieu* purchases were most apparent when the rate test does not trigger. See Bliven *et al.*, REP-12-E-BPA-17, at 17. However, if the rate test triggers, Staff's conclusion was that, on the whole, REP costs are not diminished significantly when BPA engages in *in lieu* purchases because it was uncertain whether the dollar saved due to the alternative purchase results in a dollar saved, or whether it results in a dollar of REP benefit being transferred from one REP participant to another REP participant. *Id.* Staff then provided an example of how this no-savings scenario could occur. *Id.* Consequently, had APAC timely raised this issue with Staff (which it did not), and had BPA had time to develop its analysis to run this scenario (which it does not), it is far from clear whether such scenarios would have produced results that would have substantially affected the results of Staff's analysis. Based on the available record material, the general conclusion to be drawn is that modeling an *in lieu* scenario would have either marginally affected the resulting REP benefits or not affected them at all.

APAC also opaquely argues that circumstances in the future may open the possibility of an *in lieu* purchase, which Staff should have modeled in a scenario. APAC Br. Ex., REP-12-R-AP-01, at 6. Again, this argument is so vague that BPA is unsure how to respond. If this argument is meant to refer to the *in lieu* purchases of COUs, BPA has responded above. If this argument is meant to claim that BPA should have modeled scenarios involving the *in lieu* transactions of the IOUs, then as noted above, it is unclear what value such a scenario would have produced. An *in lieu* transaction for one IOU may, in fact, have increased the REP benefits of another IOU, resulting in no net change to REP benefits (in a situation where the rate test has triggered, which is the case in all of BPA's scenarios).

Moreover, APAC's claim that BPA "should have" modeled an *in lieu* scenario is even less convincing when considering APAC has now raised this issue. Constructing a model that would have demonstrated the resulting level of REP benefits in a case where BPA is attempting to *in lieu* some or all of the IOUs' residential and small farm loads is no small task. To begin, BPA would have to establish some parameters around how BPA would engage in such an *in lieu* transaction. At present, BPA does not have an established *in lieu* policy, and therefore, has not addressed all of the administrative and technical issues that would attend with engaging in an *in lieu* transaction. Staff identified a host of policy issues that would have to be addressed for BPA to make reasoned assumptions related to *in lieu* purchases. See Bliven *et al.*, REP-12-E-BPA-12, at 61-62.

Assuming BPA were to develop such a policy for purposes of modeling a scenario, the complexity alone of developing the model itself would have been daunting. The IOUs' residential exchange load is over 5,000 aMW a year under BPA's analysis. See Evaluation Study Documentation, REP-12-FS-BPA-01A, Tables 10.4.1.3.1 through 10.4.1.3.3. For BPA to *in lieu* all or part of this load would require a model that would show BPA purchasing thousands of MW from the market to serve the IOUs. Modeling the effects of BPA's decision to purchase even half of this energy (2,500 aMW) on market and transmission prices (which in turn would

loop back and affect the *in lieu* purchase price) would have been a daunting technical and administrative task. Had APAC truly been concerned with Staff analyzing this scenario, APAC should have presented this issue in its direct case in order to permit Staff an opportunity to run this scenario and present its results in rebuttal. APAC, however, made no mention of this issue in its direct case. Instead, APAC made one inexplicit reference in its rebuttal case (to which Staff had no opportunity to respond on the record) and another inexplicit reference in its brief on exceptions that refers to a heretofore unknown *in lieu* scenario that BPA “should have modeled[.]” APAC Br. Ex., REP-12-R-AP-01, at 6. Staff simply could not have run these time-consuming and complex *in lieu* scenarios when APAC has neither presented its concerns at appropriate times in the record of this case nor given Staff an adequate opportunity to understand or respond to APAC’s less than clear arguments.

WPAG notes in its brief that since the WP-02 rate period, BPA has revised a number of its longstanding policy and legal positions, each of which had the effect of either increasing the level of the average system costs (“ASC”) of the IOUs, or increasing the amount of REP costs that could be included in the PF Rate pursuant to the 7(b)(2) rate ceiling. WPAG Br. Ex., REP-12-R-WG-01, at 5. WPAG argues that this increased the IOUs’ REP benefits, and that increase was not insubstantial. *Id.* WPAG asserts that REP benefits increased from \$48 million in the WP-02 rate case to over \$333 million in this proceeding. *Id.* WPAG claims that it is these increased IOU REP benefits that are being used in this proceeding as the basis for comparison between the Settlement and the continued implementation of the 7(b)(2) rate test in each rate proceeding. *Id.*

WPAG’s observations are factually incorrect. First, it must be made clear that the \$333 million referred to in the Draft ROD was a reference to the REP benefits for *all* REP participants in FY 2012–2013, including COU REP participants (such as Clark Public Utilities) under the no-settlement alternative. The IOUs’ REP benefits account for only approximately \$300 million of BPA’s initial proposal REP benefits. *See* Lookback Recovery and Return Study, REP-12-E-BPA-03, at 11. Regardless, the \$300 million in IOU REP benefits are based on BPA’s existing ASC Methodology, the IOUs’ current ASC reports, BPA’s current 7(b)(2) Implementation Methodology, BPA’s current 7(b)(2) Legal Interpretation, and current load and cost information. These underlying elements of the IOUs’ REP benefits have been established only after thorough formal review in BPA’s relevant REP and ratemaking proceedings and are supported by the administrative records in those proceedings. This is a proper basis against which to compare the Settlement benefits.

Second, WPAG’s comparison of BPA’s current implementation of the REP with the \$48 million included in the WP-02 rate proceeding is inapposite. The WP-02 rates were remanded to BPA in the *Golden NW* decision. *See* Chapter 7. In response to the Court’s remand, BPA subsequently removed the costs of the unlawful 2000 REP Settlements from rates, and revised the \$48 million REP calculation referred to by WPAG. BPA’s revised calculation of REP benefits for the WP-02 period was approximately \$134.6 million a year. *See* FY 2002–2008 Lookback Study, WP-07-FS-BPA-08, at 262.

Finally, as WPAG notes, the \$48 million in REP benefits for the WP-02 rate period was based on a different ASC Methodology, a different 7(b)(2) Legal Interpretation, and a different 7(b)(2) Implementation Methodology. WPAG Br. Ex., REP-12-R-WG-01, at 5, n.2. WPAG claims that “many of these decisions are on appeal before the 9th Circuit,” but that assertion is incorrect as to the 2008 ASC Methodology. No party has filed a challenge to the ASC Methodology, and the time for challenging it has long since passed. WPAG’s comparison of the no-settlement REP benefits presented in this case with old rate case data that has subsequently been revised and superseded is without merit.

APAC contends that Staff’s analysis is biased toward favoring the Settlement because “[t]he COUs are guaranteeing the payment of scheduled amounts to the IOUs without regard to the financial conditions of any particular rate period.” APAC Br., REP-12-B-AP-01, at 15. APAC argues that “[t]hey are also guaranteeing the IOUs a pre-determined amount while the Preference customers retain the risk of rates varying dependent upon the financial conditions during any particular rate period.” *Id.* at 15.

This statement ignores the risks the IOUs have undertaken if the Settlement is adopted; that is, of agreeing to a lower (while certain) stream of REP benefits than they could have obtained through continued litigation and Court decisions in their favor.

In conclusion, APAC’s and WPAG’s contention that BPA should have evaluated prospective REP benefits under section 7(b)(2) through a singular lens that is wholly favorable to the COUs’ case lacks merit. Such an approach ignores the possibility of material outcomes from Court decisions that are favorable to the IOUs, or forecast deviations in market prices and costs that would be favorable to the IOUs’ REP benefits under section 7(b)(2) without settlement. Staff’s scenario analysis is intentionally designed to look at the terms of the Settlement through an unbiased lens, which favors neither the COUs’ or IOUs’ litigation positions in order to assuage longstanding concerns of both sides in evaluating the Settlement. When evaluating the Settlement through this lens, the record in this case supports Staff’s recommendation, and BPA’s conclusion, that the scenario analysis produces reasonable levels of future REP benefits, which demonstrate that the level of REP benefits under the Settlement is consistent with the rate protection afforded under the Northwest Power Act.

### **Decision**

*The combinations of scenarios evaluated by Staff produce a reasonable set of REP benefits pursuant to section 7(b)(2), and the set of streams is not biased toward showing the Settlement is reasonable.*

### **Issue 3.5.3**

*Whether all scenarios must show adequate 7(b)(2) rate protection ex ante in order for BPA to adopt the Settlement, or whether scenario results can be evaluated holistically.*

## **Parties' Positions**

APAC argues that BPA must show that every scenario produces a stream of benefits under 7(b)(2) in excess of Settlement. “Even if prevailing on every issue was unlikely and if BPA chooses to rely on a scenario analysis to demonstrate compliance with statutory obligation, then every scenario should demonstrate compliance, or there is a possibility of a violation.” APAC Br. Ex., REP-12-R-AP-01, at 6.

WPAG makes the same argument: “Were it the case that BPA’s analysis showed only 7(b)(2) rate ceiling test results in excess of the 2012 Settlement REP payment amounts, BPA’s argument would have some merit. However, BPA’s own analysis shows there are a number of instances in which the REP payments under the 2012 Settlement, and the REP payment obligations that will be imposed on preference customers, exceed BPA’s forecast of what is lawful under the 7(b)(2) rate ceiling test.” WPAG Br. Ex., REP-12-R-WG-01, at 28.

## **BPA Staff’s Position**

The analysis of 7(b)(2) rate protection, associated benefits, and REP payments is inherently contentious and open to interpretation. BPA maintains that a balanced analysis must be presented in an unbiased way, *and be interpreted* in an unbiased way. Given the high degree of contentious legal and market uncertainty, a requirement that all scenarios must produce benefits in excess of payments under Settlement would be, in BPA’s view, wholly deferential to COU customers, and inconsistent with statutory rights of IOU customers under the Northwest Power Act. BPA maintains its premise that the Reference Case is the “most likely” scenario, and under that scenario, protection afforded under Settlement is clearly larger than provided by BPA’s traditional implementation of the REP and BPA’s ratemaking directives.

## **Evaluation of Positions**

APAC argues that combining just two positions would produce a stream of benefits under section 7(b)(2) that is far lower (on a net present value basis) than under Settlement: “If the COUs prevail on just two issues, the inclusion in the Lookback Amount of payments under the Load Reduction Agreements and the treatment of conservation, it would produce a significantly lower NPV of ResEx benefits than the [S]ettlement.” APAC Br., REP-12-B-AP-01, at 14. APAC reiterates this point in its brief on exceptions. APAC Br. Ex., REP-12-R-AP-01, at 2. APAC contends that the Settlement does not provide at least as much rate protection as required by the Northwest Power Act because the scenarios modeled by Staff include some that result in much greater rate protection than the Settlement. *Id.* APAC asserts that this demonstrates that the Settlement may provide inadequately low rate protection that violates section 7(b) of the Northwest Power Act. *Id.*

BPA disagrees with APAC’s view that the Settlement fails to meet section 7(b)(2) simply because BPA was able to project REP benefits below the Settlement’s value if parties were to succeed on a number of disputed issues in litigation. APAC makes much of the fact that Staff’s calculations demonstrate that REP benefits under certain litigated scenarios could be reduced below the Settlement. APAC Br., REP-12-B-AP-01, at 14; APAC Br. Ex., REP-12-R-AP-01, at 2. BPA views these scenarios, however, as evidence of the robustness of Staff’s analysis.

Indeed, the credibility of Staff's analysis would have been questionable had the major issues in litigation not produced at least some scenarios where REP benefits fell below the Settlement's values. But the key to understanding these low REP benefit scenarios is not simply that they can be modeled; rather, it is understanding that it takes multiple wins by the COUs against BPA's statutory interpretations (some of which go back for 25 years) to achieve these results.

Staff's scenario analysis can be divided up into five respective categories of scenarios. The first category is BPA's projection of REP benefits over the Settlement period assuming BPA's positions in the REP litigation (*APAC*, *IPUC*, *Avista* and *PGE II*) were to be sustained by the Court. Evaluation Study, REP-12-FS-BPA-01, section 10.3. Under this scenario, BPA's interpretations of section 7(b)(2) and 7(b)(3) are assumed to have been sustained by the Court. *Id.* In addition, BPA assumes in this scenario that its Lookback construct has been affirmed, and consequently, BPA would continue to reduce REP benefits to recover the Lookback Amounts in accordance with the WP-07 Supplemental ROD. *Id.* Under this scenario, referred to as the Reference Case – Scenario 0, BPA projects REP benefits of approximately \$3 billion (net present value) would be paid to the IOUs during the period covered by the Settlement. *Id.*, Table 10.4. This is roughly \$1 billion more than the Settlement would provide the IOUs over the comparable period. *Id.*

The second category of scenarios considers the effect of non-litigation factors on REP benefits, such as changes in ASCs and BPA's costs. *See* Evaluation Study, REP-12-FS-BPA-01, section 10.4. These scenarios demonstrate the variability in REP benefits that could occur under BPA's Reference Case if ASCs grow faster than BPA projects, or BPA's costs grow faster than BPA projects. Under these scenarios, BPA projects that REP benefits could range from \$2.5 billion to \$3.8 billion. *Id.*, Table 10.4.

The third category of scenarios considers the effect on REP benefits if BPA were to lose one or more of the issues in the *APAC* litigation. These scenarios encompass Scenarios 1–3. *See* Evaluation Study, REP-12-FS-BPA-01, section 10.5. These scenarios concern, primarily, the issues being litigated in the *APAC* case; that is, the method, manner, and appropriateness of BPA's decision to conduct the Lookback and issue refunds to the injured COUs.

Scenario 4 considers the effects of Idaho Power and IPUC prevailing on their arguments in the *IPUC* case that BPA should be prohibited from including provisions regarding the calculation and recovery of deemer balances from Idaho. *See* Evaluation Study, REP-12-FS-BPA-01, section 10.5.

Scenarios 5–16 address technical statutory issues with BPA's implementation of the section 7(b)(2) rate test and allocation of rate protection under section 7(b)(3). These issues reflect parties' positions as briefed, in part, in *APAC* or as will be briefed in the challenges in *Avista*.

Scenarios 18–22 reflect combinations of the parties' positions in litigation. These scenarios reflect the broad range of potential outcomes in litigation. The COU best case produces REP

benefits of \$759 million, while the IOU best case produces REP benefits of \$6 billion. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4.

Looking at the specific issues in litigation, BPA believes the Settlement provides greater protection to COUs, and lower overall REP benefits to the IOUs, when considering BPA's positions in the litigation, and the potential effects on REP benefits if BPA were to lose on various issues in litigation.

First, under BPA's view of the issues in litigation, projected REP benefits are expected to be approximately \$3.07 billion over the term of the Settlement. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4. Thus, when measuring the Settlement against BPA's view of the issues in litigation (many of which involve questions of statutory interpretation), the Settlement is unquestionably reasonable and below what BPA otherwise projects as lawful.

Second, when measuring the Settlement against the issues being litigated in the APAC case (specifically, the Lookback-related issues, scenarios 1-3), the Settlement provides, once again, a more reasonable outcome. If BPA is sustained in its interpretation of sections 7(b)(2) and 7(b)(3), but loses technical issues with respect to the Lookback analysis, REP benefits could range from a low of \$3.0 billion (if the COUs were to win, see scenario 2) to as high as \$3.5 billion (if the IOUs were to win, see scenario 1). *Id.* Here again, these REP values are above what would otherwise be provided to the IOUs under the Settlement.

APAC objects to BPA's consideration of scenario 1 because APAC claims that this scenario assumes if the IOUs prevail in some of their arguments that COUs would be responsible for BPA's past legal errors. APAC Br. Ex., REP-12-R-AP-01, at 7. APAC claims that scenario 1 does not demonstrate greater rate protection to COUs because it "overstate[s]" the harm to COUs. *Id.*

BPA, however, disagrees that scenario 1 improperly calculates the potential outcome if BPA were to lose on the fundamental question of whether to recover Lookback Amounts from the IOUs. As noted above, if the Court sustains the IOUs' arguments, it logically follows that BPA would have engaged in legal error beginning with the WP-07 Supplemental rate proceeding and would need to rectify the error by reclaiming the funds erroneously paid to COUs as if they had never been paid. Bliven *et al.*, REP-12-E-BPA-12, at 22. This is not a novel concept. APAC to date has not opposed BPA's proposal to recover Lookback Amounts from the IOUs that were overpaid REP benefits under the 2000 REP Settlement. If a court subsequently finds that BPA should not have been withholding REP benefits to fund the Lookback Amounts, and must return these withheld funds, then it follows that one logical option for BPA to adopt is to reclaim these refunds from the COUs that received them. APAC's assertion that scenario 1 "overstates" the COUs' exposure to REP costs is unpersuasive.

Third, when looking at the specific section 7(b)(2) and 7(b)(3) issues to be litigated in *Avista*, (scenarios 5–16), REP benefits could range between \$2.01 billion and \$3.9 billion. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4. In evaluating section 7(b)(2) and 7(b)(3) issues, BPA found only one scenario, scenario 5, would result in REP benefits below the

Settlement. However, scenario 5 involves the COUs winning on a combination of *two* issues at the Court with respect to BPA's treatment of conservation resources in the section 7(b)(2) rate test. Specifically, the COUs would have to (1) overturn BPA's 25-plus-year treatment of including conservation resources in the section 7(b)(2) resource stack; and (2) establish that Congress intended conservation resources to be provided to COUs for free when performing the section 7(b)(2) rate test. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4. If the COUs fail in establishing that Congress intended conservation resources to be provided for free, then the level of REP benefits becomes scenario 6, or \$3.04 billion. *Id.*

APAC mistakenly argues that if the petitioners in the Lookback Appeal were to prevail solely on their argument that BPA should not treat existing conservation as a new resource in the 7(b)(2) rate test (*i.e.*, scenario 5), the net present value (NPV) of REP benefits would be less than that of the Settlement. APAC Br. Ex., REP-12-R-AP-01, at 5. APAC, however, misstates scenario 5. As noted above, scenario 5 is not a single-issue scenario, but a combined-issue scenario that requires the COUs to win two statutory issues against BPA. If APAC were to win the issue it notes in its brief, one would still not know whether REP benefits would be above or below the Settlement's value. Some determination must be made as to the costs of the conservation resources included in the 7(b)(2) Case customers' loads. Indeed, the IOUs have, in fact, made the same argument as the COUs (that BPA should exclude conservation resources from the resource stack) but with the result that REP benefits would barely move in comparison to BPA's Reference Case. *See* Scenario 6. Thus, the critical issue with BPA's treatment of conservation is not simply that one remove these resources from the resource stack in 7(b)(2) and not adjust the COUs' load for conservation resources; rather, it is what one does with the costs of the conservation resources after the associated accumulated load reduction from conservation is included in the 7(b)(2) Case. Although Staff would not assign a specific probability to the chances of either scenario 5 or scenario 6 occurring, Staff was willing to opine that, from a rate analysis perspective, scenario 6 was the more likely outcome. As noted by Staff:

[A]ssuming the COUs are successful in their argument regarding the treatment of conservation in the 7(b)(2) Case such that general requirements in the 7(b)(2) Case are unchanged from the Program Case by accumulated conservation procured pursuant to the Northwest Power Act, the likelihood of BPA retaining the current implementation methodology of excluding conservation costs in the 7(b)(2) Case, as the IOUs have argued, is unknown and untested. What is known at this time is that BPA has rejected the COUs' and IOUs' argument in favor of adjusting the general requirements; if BPA is unable to adjust general requirements, BPA would take a fresh look at each side's arguments regarding the treatment of conservation costs in the 7(b)(2) Case. Indeed, it would be hard to argue that absent the Northwest Power Act, 7(b)(2) Case loads should be reduced by conservation acquired under section 6 of the Act, and that Public customers should benefit from those programs at a zero cost.

Stiffler *et al.*, REP-12-E-BPA-13, at 19-20.

The takeaway from scenarios 5–16 is that there is no single section 7(b)(2) or 7(b)(3) argument that will produce REP benefits below the Settlement. Rather, in order for the COUs to reach a

result that is below the Settlement, the COUs must win multiple statutory issues against BPA, and the IOUs must win none of their issues.

The results of the IOUs or COUs prevailing against BPA on multiple statutory interpretation issues are described in scenarios 18–22. Looking at the COUs’ and IOUs’ combined best 7(b)(2) and (3) positions (as presented in briefs or material filed with BPA), REP benefits could range from \$759 million to almost \$6 billion. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4. Comparing this broad range of benefits to the benefits provided under the Settlement (\$2.05 billion) reveals, once again, that the REP benefits provided under the Settlement trend towards the lower end of the spectrum of possible REP benefit amounts if litigation were to continue. JP02 agrees with Staff on this point: “the [S]ettlement dollar amounts are somewhat below the average of the IOU best case and COU best case dollar amounts ... [indicating] that the [S]ettlement amount from 2012 to 2028 is certainly in the ‘zone of reasonableness’ when judged based on the COU and IOU litigation positions.” Deen *et al.*, REP-12-E-JP02-03, at 4.

APAC contends that Table 10.4 also demonstrates that if the COU petitioners prevailed on every issue in their brief, the NPV would be dramatically less than that of the Settlement. APAC Br. Ex., REP-12-R-AP-01, at 5. APAC claims that BPA’s response to this possibility is that such an outcome is very unlikely. APAC acknowledges that prevailing on every issue may be unlikely, but prevailing on one or two key issues would change the NPV significantly. *Id.* at 6. Even if prevailing on every issue is unlikely and if BPA chooses to rely on a scenario analysis to demonstrate compliance with a statutory obligation, APAC asserts that every scenario should demonstrate compliance, or there is the possibility of a violation. *Id.* WPAG raises a similar point in its brief. WPAG Br. Ex., REP-12-R-WG-01, at 26, 36.

However, APAC and WPAG are mistaken in asserting that BPA’s analysis must demonstrate that in all circumstances the IOUs must receive less REP benefits in order for the Settlement to be lawful. First, as explained in Chapter 5, if the legality of a settlement of the REP is measured only by whether it provides the lowest REP benefits based on the COUs’ winning most, if not all, of their positions in litigation while BPA and the IOUs win none, there would never be a settlement of the REP. If there is to be any compromise in the implementation of the REP, it follows that such compromise must recognize that no one side is guaranteed to win all of its issues. There would never be a settlement of the REP if the legal standard for approving such a settlement were simply that BPA must codify the COUs’ litigation position.

Second, to suggest such a standard is to assume that there is an established, indisputable interpretation of the statute from which BPA may measure the results of the Settlement. As demonstrated in this case, there are multiple interpretations of the Northwest Power Act presented by the parties, all of which are in active cases pending before the Court, and each of which produces a different range of potential “lawful” REP benefits. These interpretations are interrelated and, when viewed together, can have an offsetting effect depending upon the particular combination of issues successfully litigated in the Court. APAC and WPAG appear to argue that in order for BPA’s analysis to be valid, BPA must assume the worst-case scenario for the IOUs and BPA, and the best-case scenario for the COUs to ensure that no such “possibility of a violation” as to the COUs could occur. However, no such certainty exists in the real world for

the COUs' case, so BPA fails to see why it would be either reasonable or necessary for BPA to tether its analysis to a scenario that even APAC admits is “unlikely” to occur. APAC Br. Ex., REP-12-R-AP-01, at 5-6.

### **Decision**

*The combinations of scenarios evaluated by Staff produce a reasonable set of REP benefits pursuant to section 7(b)(2), and the set of REP benefit streams is not biased toward showing the Settlement is reasonable.*

### **Issue 3.5.4**

*Whether BPA needs to assign probabilities to litigation outcomes to establish an expected value of REP benefits under section 7(b)(2) when evaluating the Settlement.*

### **Parties' Positions**

APAC argues that Staff's analysis of the Settlement is flawed because no attempt is made to assess the likelihood of various scenarios occurring. APAC Br., REP-12-B-AP-01, at 14; APAC Br. Ex., REP-12-R-AP-01, at 13. APAC states that BPA has not constructed an “expected value” among the scenarios tested because probabilities are not assigned to each scenario. *Id.*

### **BPA Staff's Position**

Staff declines to assess probabilities associated with various litigated outcomes, and maintains that its Reference Case (and costs and market price assumptions associated with the Reference Case) is the “most probable” outcome, but acknowledges both price/cost and litigation risks in scenarios that develop bounds around the Reference Case. Stiffler *et al.*, REP-12-E-BPA-13, at 20. These bounds are considered in evaluating the expected outcomes under section 7(b)(2) versus the Settlement. *Id.* at 21.

### **Evaluation of Positions**

APAC contends that Staff's analysis is “fundamentally flawed” because it declines to apply subjective probabilities to each of the scenarios tested (as well as those combinations untested). APAC Br., REP-12-B-AP-01, at 14.

BPA disagrees that presenting subjective probabilities on the likelihood of success of the various issues in litigation would have been a useful exercise for the record in this case. In developing the quantitative analysis of the issues in litigation, Staff did not assign any probabilities to the IOUs' and COUs' respective cases. Stiffler *et al.*, REP-12-E-BPA-13, at 13-14. This was done with good reason.

First, Staff avoided making what it referred to as “*ad hoc* and unsupportable assumptions as to subjective probabilities associated with the full set of combinations of both litigation and risk scenarios.” *Id.* at 13. In Staff's view, any assumption made would not be based in fact, would

be subject to undue scrutiny and criticism, and would have served no purpose other than to turn the REP-12 proceeding into another forum to debate the merits of the issues pending before the Court. *Id.* at 13-14. Further, Staff finds that assessing the likelihood of each scenario (and combinations thereof) would have been of little probative value to the Administrator because such evidence would have been based on Staff's lay speculations on the likely outcome in Court of the parties' respective legal arguments. *Id.* If Staff had engaged in this speculation, it would not have assessed all of the litigation scenarios "at 50 percent." *Id.*

A principal purpose of the Settlement is to resolve longstanding litigation. Attempting to assign probabilities to the outcome of each litigated issue would embroil this proceeding in an endless debate over which parties' arguments are better, which defeats the principal purpose of a structured Settlement. Further, Staff has supplied sufficient information regarding the outcomes of each litigation scenario to allow BPA to assess the risks, including qualitative judgments regarding the potential combined effects. BPA must ensure that the terms and conditions in the Settlement are reasonable and comply with all relevant statutory provisions. Prognostication over the probability of occurrence of unknown and untested events would do little to inform BPA in this proceeding.

Moreover, in past and current rate cases, BPA has refrained from attaching probabilities to the outcome of litigation. For example, in assessing the risk of adverse outcomes of litigation over biological opinions on the effects of river operations on fish mitigation and enhancement efforts, BPA has refrained from predicting outcomes in its risk analysis. Lovell *et al.*, BP-12-E-BPA-15, at 69. Rather, BPA implemented mitigation measures, including the NFB Adjustments. *Id.* at 69-77.

Finally, the purpose behind BPA's decision to use the scenario analysis is not to establish who would win or lose the litigation, but rather to establish a quantitative value to the various issues in litigation. Up to this point, the parties' respective arguments (with the exception of the Lookback issues) were largely unquantifiable. The scenario analysis puts a rough dollar figure on each of the major issues in litigation. Placing this quantitative value on the issues in litigation is essential to evaluating whether the Settlement's fixed REP benefits properly protect the position of the COUs.

APAC alleges that while BPA has refused to provide a probability analysis, elsewhere in this ROD BPA has argued that assessing the Settlement on only the COUs' positions in litigation is unreasonable because it is unlikely that the COUs will win on all issues. APAC Br. Ex., REP-12-R-AP-01, at 6. APAC claims BPA cannot argue that the COUs' position is unlikely to occur, but at the same time claim it would be improper to evaluate the likelihood of all of the litigation outcomes. *Id.*

BPA does not see the alleged incongruity between BPA's general observation that it is unlikely that the COUs will win all of their issues in litigation and BPA's refusal to produce subjective and speculative probability assessments of parties' respective positions. To say something is "unlikely" to occur is not the same thing as calculating a precise percentage based on a probability assessment. In the first instance, BPA is making the commonsense statement that it

is unlikely that the COUs will prevail on all of the litigated issues. On this point, APAC itself agrees: “Of course, prevailing on every issue may be unlikely ....” APAC Br. Ex., REP-12-R-AP-01, at 5-6. As to APAC’s claim that BPA should have adopted a speculative probability analysis to go along with the quantification of the issues in litigation, BPA has already responded above.

APAC argues that BPA has devoted incredible time and resources in the WP-07 Supplemental and WP-10 RODs arguing why its decisions on various issues are legally proper. APAC Br. Ex., REP-12-R-AP-01, at 6, n.12. APAC contends that BPA cannot at this time reverse course and pretend the sustainability of its determinations is uncertain. *Id.* This argument, however, is not persuasive. First, as APAC is aware, BPA’s positions in the WP-07 Supplemental ROD and WP-10 RODs *are* uncertain until finally affirmed by the Court in the pending litigation. BPA certainly believes that its positions *will* be sustained if litigated, but BPA cannot be sure. A remand by the court on a key issue could result in BPA unwinding a decade of rates. For BPA, the primary value of the Settlement is that it ends (or at least largely diminishes) the uncertainty to BPA and its ratepayers over the past and future implementation of the REP.

Second, APAC’s comment seems to imply that BPA is not giving its prior decisions sufficient weight in conducting the analysis in this case. APAC claims that BPA “cannot at this time reverse course and pretend the sustainability of its determinations is uncertain.” APAC Br. Ex., REP-12-R-AP-01, at 6, n.12. Following APAC’s suggestion, then, it would appear to be appropriate to assume that *BPA’s* position is the most likely to occur. In such case, the Settlement is clearly a better outcome for COUs because it produces fewer REP benefits and greater overall rate protection for COUs when compared to BPA’s Reference Case. Evaluation Study, REP-12-FS-BPA-01, Table 10.4. APAC’s comment, when read in light of other statements made in APAC’s brief, however, makes clear that this critique is not broadly applicable. Rather, APAC believes that this assumption should only be applied to positions BPA has taken *against the IOUs’* arguments. As to the *COUs’* positions, however, APAC contends that the best course for BPA to take is to assume that the COUs win most, if not all, of their issues against BPA’s decisions in the WP-07 Supplemental ROD and WP-10 ROD. APAC Br. Ex., REP-12-R-AP-01, at 6. BPA does not agree that this manner of reviewing the various issues in litigation is proper. APAC’s decision to support BPA’s case in some instances, but then use its own positions in others, demonstrates why BPA has avoided placing precise probability numbers on the various scenarios.

In its brief on exceptions, APAC reiterates that it is proper in assessing the reasonableness of a settlement to judge the likelihood of an outcome in litigation. APAC Br. Ex., REP-12-R-AP-01, at 13, citing *Synfuel Technologies, Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646, 653 (7th Cir. 2006) (*Synfuel*). The approach taken in *Synfuel*, however, has been expressly rejected by the Ninth Circuit:

We are not persuaded otherwise by Objectors’ further submission that the court should have specifically weighed the merits of the class’s case against the settlement amount and quantified the expected value of fully litigating the matter. For this they rely on the Seventh Circuit’s opinion in *Synfuel Tech., Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646 (7th Cir. 2006), which follows that circuit’s

precedent requiring district courts to determine the strength of the plaintiff's case on the merits balanced against the amount offered in settlement by "quantifying the net expected value of continued litigation to the class." *Id.* at 653 (quoting *Reynolds v. Beneficial Nat'l Bank*, 288 F.3d 277, 284-85 (7th Cir. 2002)). To do this, the Seventh Circuit directs courts to "estimate the range of possible outcomes and ascrib[e] a probability to each point on the range." *Id.* However, our approach, and the factors we identify, are somewhat different. We put a good deal of stock in the product of an arms-length, non-collusive, negotiated resolution, *Hanlon*, 150 F.3d at 1027; *Officers for Justice*, 688 F.2d at 625, and have never prescribed a particular formula by which that outcome must be tested. As we explained in *Officers for Justice*, "[u]ltimately, the district court's determination is nothing more than an amalgam of delicate balancing, gross approximations and rough justice." 688 F.2d at 625 (internal quotation marks and citation omitted). The Seventh Circuit also recognizes that precision is impossible, and that even its more structured approach is apt to produce only a "ballpark valuation." *Synfuel*, 463 F.3d at 653.

In reality, parties, counsel, mediators, and district judges naturally arrive at a reasonable range for settlement by considering the likelihood of a plaintiffs' or defense verdict, the potential recovery, and the chances of obtaining it, discounted to present value. *See* Federal Judicial Center, Manual for Complex Litigation § 21.62, at 316 (4th ed. 2004) (one factor "that may bear on review of a settlement" is "the advantages of the proposed settlement versus the probable outcome of a trial on the merits of liability and damages as to the claims, issues, or defenses of the class and individual class members"); *In re Gen. Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 806 (3d Cir. 1995).

Although the district court did not put it this way, the amount of the alleged overcharge, the estimated recovery ranges by both parties and their experts, and the results of a mediated resolution, were before it. Objectors do not explain how reversing the math on the record would have yielded a meaningfully different result. Accordingly, the court did not clearly abuse its discretion in concluding that this factor weighs in favor of approving the settlement.

*Rodriguez v. West Publishing Corp.*, 563 F.3d 948, 965-966 (9th Cir. 2009). As noted by the Ninth Circuit, what matters most for approval of a settlement (in the context of class action cases) is not the probabilities assessed by the district court, but rather whether the settlement reflects "the product of an arms-length, non-collusive, negotiated resolution ...." *Id.* at 965. That is precisely what the Settlement being considered in this case is. Moreover, BPA has evaluated the Settlement in light of the "advantages of the proposed settlement versus the probable outcome" of continuing the litigation on the merits. *Id.* at 966. Staff has quantified the issues in litigation, and Staff's analysis reveals that for the COUs to receive a better outcome they would have to prevail on multiple issues in the litigation, while at the same time the IOUs would have to win on essentially none. Thus, BPA's decision to not produce specific probabilities for the outcome of issues in litigation is reasonable and consistent with the Ninth Circuit's precedent for approving settlements in other areas.

Furthermore, assuming *arguendo* that BPA were required to establish probabilities on the various scenarios to predict which positions would most likely succeed at Court, BPA has already implicitly performed that analysis. As noted above, the issues in this proceeding are not being evaluated in a vacuum. BPA and the litigating parties have established positions on all of the relevant issues as presented in filings with BPA, Records of Decision issued by BPA, and briefs with the Court. In BPA's Records of Decision, BPA has identified each party's position on each issue, identified BPA Staff's positions on each issue, and evaluated the merits of the parties' arguments on each issue. BPA has then reached a conclusion on each issue based on a careful review of the law and the facts, in order to ensure that BPA's decisions would have a strong basis for approval on judicial review. Although the parties vigorously disagree with many of BPA's conclusions, BPA can see no reason why it should depart from its previous findings on all of the contested issues for purposes of a probabilistic analysis. In other words, if BPA were required to assign probabilities to the issues in litigation, BPA would adopt probabilities that would show a high likelihood of BPA prevailing on the contested issues (*i.e.*, the Reference Case) and a low probability of the parties succeeding on their issues in the litigation (*i.e.*, scenarios 1-22). Considering that BPA's Reference Case demonstrates that the Settlement is better for COU ratepayers by about \$1 billion, BPA finds that conducting a probabilistic analysis based on the Reference Case would not alter BPA's general conclusion that the Settlement provides overall greater rate protection to COUs and lower REP benefits to the IOUs. But, again, no such analysis is necessary for the review of the Settlement in this case. As noted above, the Ninth Circuit does not require such precision when approving a settlement involving a large number of plaintiffs.

Moreover, other courts agree that a settlement does not require a specific resolution of each issue resolved by the settlement. In *Grunin v. International House of Pancakes*, 513 F.3d 114 (8th Cir. 1975), the Eighth Circuit considered settlement of an antitrust class action which was alleged to "perpetuate illegal tying requirements." *Id.* at 123. The court agreed that it could not "lend its approval to any contract or agreement that violates the antitrust law," but it emphasized that:

... neither the trial court in approving the settlement, nor this Court in reviewing the approval have the right or the duty to reach any ultimate conclusions on the issues of fact and law which underlie the merits of the dispute.' *City of Detroit*, 495 F.2d [448,] 456 [(2d Cir. 1974)]. As stated in *Young v. Katz*, 447 F.2d 431, 433 (3d Cir. 1971), 'In examining a proposed compromise for approval or disapproval ... the court does not try the case. The very purpose of compromise is to avoid the delay and expense of such a trial.' [Citations omitted.] Thus, unless some of the terms of the agreement are per se violations of antitrust law, we must apply a 'reasonableness under the totality of the circumstances' standard to the court's approval.

*Grunin*, 513 F.3d at 123-24. The *Grunin* court then reviewed the "vigorously contested" theories of antitrust deficiencies advanced by objecting parties and upheld the settlement because "the alleged illegality of the settlement agreement is not a legal certainty." *Id.* at 124. See also *State of West Virginia v. Pfizer & Co.*, 440 F.2d 1079, 1086 (2d Cir. 1971) (court "need not and should not reach any dispositive conclusions on the admittedly unsettled legal issues which the case

raises, yet at the same time ... attempt to arrive at some evaluation of the points of law on which the settlement is based” to determine if objectors had shown “that the rules of law for which [they are] contending are so clearly correct that it was an abuse of discretion for the district court to approve the settlement”). BPA has evaluated the parties’ positions regarding the issues resolved by the Settlement and the Settlement itself and has determined that “the alleged illegality of the settlement agreement is not a legal certainty.”

### **Decision**

*BPA does not need to assign probabilities to litigation outcomes to establish an expected value of REP benefits under section 7(b)(2) when evaluating the Settlement. Such an effort is highly subjective, would create endless controversy regarding which party’s arguments were better, and is unnecessary to evaluate the Settlement.*

## 4.0 THE 2012 REP SETTLEMENT'S COMPLIANCE WITH NORTHWEST POWER ACT SECTION 5(c)

### 4.1 Introduction

The Residential Exchange Program was created by section 5(c) of the Northwest Power Act to provide residential and small farm customers of Pacific Northwest (regional) utilities a form of access to low-cost Federal power. *See* 16 U.S.C. § 839c(c)(1). Under the REP, BPA purchases power from each participating utility at that utility's Average System Cost of resources. A utility's ASC is calculated pursuant to a methodology BPA establishes pursuant to section 5(c)(7). 16 U.S.C. § 839c(c)(7). Once a utility's ASC is established, BPA offers, in exchange, to sell an equivalent amount of electric power to the utility at BPA's PF Exchange rate. The amount of power purchased and sold between BPA and the utility is equal to the utility's qualifying residential and small farm load.

Because the purchase and sale between BPA and the utility involve the same amount of power and are simultaneous, in almost all instances no actual power is bought or sold under the REP. Instead, the REP is generally implemented as a paper transaction in which the net difference between the utility's ASC and BPA's PF Exchange rate is multiplied by the utility's exchange load and converted into a cash payment to the utility.<sup>9</sup> Thus, "[i]n practice, only dollars are exchanged, not electric power." *CP Nat'l Corp. v. BPA*, 928 F.2d 905, 907 (9th Cir. 1991) (as amended), *quoting Public Util. Comm'n of Oregon v. Bonneville Power Admin.*, 583 F. Supp. 752, 754 (D. Or. 1984). However, in order to set rates in compliance with the rate directives in section 7 of the Northwest Power Act, BPA treats the REP as an actual purchase and sale in its ratesetting computations. *See* 16 U.S.C. § 839e(b)(1). The Northwest Power Act requires that all of the net benefits of the REP be passed through directly to the residential and small farm customers of the participating utilities. 16 U.S.C. § 839c(c)(3).

### 4.2 Overview of the Calculation and Determination of REP Benefits Under Settlement

As explained in Chapter 1, section 3.1 of the Settlement establishes a fixed schedule of annual REP benefits to be paid to the IOUs in the aggregate (referred to as "Scheduled Amounts" in the Settlement) for each year of the rate period beginning in FY 2012 and ending in FY 2028. Settlement, REP-12-A-02A, § 3.1.1, Table 3.1. The Scheduled Amounts begin at \$182.1 million in FY 2012 and gradually increase over 17 years to \$286.1 million in FY 2028. *Id.* The Scheduled Amounts are fixed amounts and not adjusted for inflation or interest. *Id.* § 3.1.1. In total, the IOUs as a class will receive no more than \$3.3 billion (real 2010 dollars) in REP

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<sup>9</sup> For example, assume Utility X has residential and small farm load of 10,000 MWh. Utility X offers to sell power to BPA at its ASC of \$65/MWh. BPA purchases this power at \$65/MWh and, in turn, offers to sell 10,000 MWh of power to Utility X at BPA's PF Exchange rate (as adjusted by sections 7(b)(2) and (3)) of \$45/MWh. No power changes hands; instead, Utility X receives a cash payment from BPA based on the difference between Utility X's ASC and BPA's PF Exchange rate multiplied by Utility X's small farm and residential load (*i.e.*, (\$65/MWh – \$45/MWh) × 10,000 MWh). In this instance, the cash payment would be \$200,000 (\$20 × 10,000 MWh).

benefits for the 17 years of the Settlement. To put this amount in perspective, the IOUs received (as a class) \$4.08 billion (real 2010 dollars) during the first 17 years that the section 7(b)(2) rate test was in effect (1985–2001).

While the Scheduled Amounts in section 3.1 of the Settlement provide the IOUs as a class with a stable, predictable level of REP benefits, the Settlement does not guarantee any individual IOU any amount of REP benefits. This is because section 6 of the Settlement, in combination with sections 4 and 5 of the Residential Exchange Program Settlement Implementation Agreement (REPSIA) (the new form of BPA’s traditional RPSA, attached to the Settlement as Exhibit A), maintains the exchange-based relationship of the REP wherein BPA determines individual utility benefits based on a comparison of BPA’s PF Exchange rate and the IOU’s ASC filings. REP Settlement, REP-12-A-02A, § 6 and REPSIA, REP-12-A-02A, Exhibit A, §§ 4-5; *see also* Gendron *et al.*, REP-12-E-BPA-04, at 28-29.<sup>10</sup> Consequently, under the Settlement, the IOUs will continue to file ASCs every two years with BPA pursuant to BPA’s current ASC Methodology, and only IOUs that have ASCs that exceed BPA’s PF Exchange rate will receive benefits under the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 29. If an IOU’s ASC fails to exceed BPA’s PF Exchange rate, which BPA will reset in each future rate proceeding, the IOU receives no REP benefits. *Id.*

### **4.3 BPA Staff’s Evaluation Criteria and Conclusions**

#### **4.3.1 Overview of BPA Staff’s Evaluation Criteria**

In *PGE*, the Court held that BPA could settle the REP, but only on “terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” *PGE*, 501 F.3d at 1030. The Court also noted that a “settlement of BPA’s REP obligations must be grounded in the REP program authorized by § 5(c) that creates the occasion for the settlement in the first place. A settlement agreement cannot be a means of bypassing congressionally mandated requirements.” *Id.* at 1031. In reviewing the 2000 REP Settlements, the Court found the settlement did not reflect the section 5(c) exchange Congress had intended. ASCs served essentially no role under the 2000 REP Settlements. BPA nominally used forecasts of ASCs (most of which were based on ASC determinations made in the 1980s and the early 1990s) to determine which utilities would be eligible to sign the 2000 REP Settlements. To reach the conclusion that all IOUs would be eligible, BPA had to assume that a new ASC Methodology would be adopted. *Id.* at 1034-1035. Once the eligibility of the respective IOUs was established, ASCs no longer were used in determining either the amount or allocation of the REP benefits payments made under the 2000 REP Settlements. This approach to allocating REP benefits was particularly troubling to the Court:

Not only did BPA dramatically revise its assumptions about ASCs to determine eligibility, it ignored the ASCs entirely to decide how to allocate its settlement.

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<sup>10</sup> For ease of reference, when referring to the provisions of the REPSIA, BPA will cite directly to the REPSIA as in REPSIA, REP-12-E-BPA-11, at (the applicable section). In all instances, these references should be understood as referring to Exhibit A of the Settlement.

Instead of allocating the settlement through its traditional REP model, BPA proposed to allocate 1800 aMW total power to the IOUs and then asked the public utility commissions of Idaho, Montana, Oregon and Washington to negotiate a proposal for dividing the power among the IOUs.

*Id.* at 1034.

The Court concluded its opinion by reciting again that BPA has broad settlement authority. *Id.* However, the 2000 REP Settlements were not a proper exercise of that authority because the “settlement does not resemble the REP program created in §§ 5(c) and 7(b) that it purports to be settling.” *Id.* at 1037.

As representatives of the COUs and IOUs approached BPA with the broadly supported Settlement of the REP, it was not lost on BPA that any settlement of the REP must have a clear and direct connection to the protections and requirements set forth in the Northwest Power Act. Proposed Residential Exchange Program Settlement Agreement Proceeding (REP-12); Public Hearing and Opportunities for Public Review and Comment, 75 Fed. Reg. 78694, at 78702 (2010). As Staff considered what criteria to include in its evaluation of the Settlement, Staff returned to the Court’s clear directive in *PGE* that such settlement be “grounded” in section 5(c) and “resemble the REP program created by §§ 5(c) and 7(b)[.]” *PGE*, 501 F.3d at 1031, 1037. To ensure that such an evaluation would be central to BPA’s decisions, Staff includes as its second evaluation criterion for the review of the Settlement the following standard:

(2) the settlement would provide REP benefits in a manner consistent with section 5(c) of the Northwest Power Act and distribute such REP benefits among the settling IOUs in a manner consistent with BPA’s current ASC Methodology and with rates that are consistent with section 7 of the Northwest Power Act[.]

Evaluation Study, REP-12-FS-BPA-01, at 165; *see also* Gendron *et al.*, REP-12-E-BPA-04, at 26.

#### **4.3.2 Staff’s Conclusions and Recommendation**

As noted above, Staff committed to recommend the Settlement only if it met the requirements of section 5(c). Over the following months, Staff reviewed the technical terms of the Settlement to decide whether they complied with Staff’s evaluation criteria. This evaluation reveals that the Settlement retains essentially all of the substantive features of the REP required by section 5(c).

First, Staff finds that the exchange-based relationship of the REP would remain unchanged under the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 28. BPA would continue to “purchase” power pursuant to section 5(c) at the average system cost of the IOU. *Id.*; Bliven *et al.*, REP-12-E-BPA-12, at 41; *see also* REPSIA, REP-12-A-02A, Exhibit A, §§ 5-6. In addition, BPA would continue to “sell” power pursuant to section 5(c) at rates established pursuant to sections 7(b)(1), 7(b)(3), and 7(g) of the Northwest Power Act. Gendron *et al.*, REP-12-E-BPA-04, at 28. Based on these provisions, Staff concludes that the Settlement would provide REP benefits in a manner

consistent with the administrative features of section 5(c), which require the REP be implemented as an exchange. *Id.* at 29.

Second, Staff finds that the distribution of REP benefits under the Settlement would continue in a manner consistent with ASCs established under BPA's current ASC Methodology and rates established under section 7 of the Northwest Power Act. *Bliven et al.*, REP-12-E-BPA-12, at 42. The Settlement requires no changes to the ASC Methodology, and no changes have been proposed or are contemplated. *Id.* Moreover, each IOU would continue to make ASC filings with BPA pursuant to BPA's existing ASC Methodology. *Id.*; see REPSIA, REP-12-A-02A, Exhibit A, § 4 ("Once «Customer Name» files an initial Appendix 1, «Customer Name» shall continue to file a new Appendix 1 as required by the ASC Methodology, unless and until «Customer Name» elects to suspend this Agreement pursuant to section 11 below."). As with the existing implementation of the REP, under the Settlement these ASC filings would be used to determine (1) whether the IOUs would be eligible to receive REP benefits, and if so, (2) the amount of REP benefits BPA pays to the settling IOU based on a comparison of the utility's ASC and BPA's PF Exchange rate. *Bliven et al.*, REP-12-E-BPA-12, at 42. Significantly, Staff finds that unlike the previous 2000 REP Settlements, no single IOU is guaranteed any REP benefits. *Id.* If an IOU's ASC is less than the PF Exchange rate, then under the Settlement, such IOU receives no REP benefits. *Id.*

Third, Staff finds that rates under the Settlement would continue to be set in a manner reflecting the purchase and sale of exchange power as required by section 7 of the Northwest Power Act. *Bliven et al.*, REP-12-E-BPA-12, at 41-42. To demonstrate this, Staff compares the ratemaking steps that would be employed to determine the rate protection amounts and the ultimate PF Exchange rate applicable to the IOUs. For this comparison, Staff looks to the Power Rates Study (PRS) in the BP-12 docket, which sets forth the manner in which REP costs are included in ratesetting. *Id.* Staff explains that, as shown on Table 2.1.3 of the PRS Documentation, ASCs are multiplied by exchange loads to derive exchange resource costs for each year of the rate period. *Id.*, citing PRS Documentation, BP-12-E-BPA-01A, at 24. The total exchange resource purchase costs are included in the revenue requirement (which amounts also include internal BPA REP support costs). *Id.*, citing PRS Documentation, BP-12-E-BPA-01A, Table 2.3.2, line 30. These costs are then allocated to the rate pools. *Id.* The amounts of exchange resource purchase costs allocated to the PF rate are a portion of the total costs used to set the PF Exchange rates to determine base exchange benefits, otherwise called Unconstrained Benefits. *Id.* The PF Exchange rate is then allocated a share of the costs of rate protection. *Id.* The rate protection costs allocated to the PF Exchange rate are then allocated to each REP participating utility to determine the 7(b)(3) surcharge for each utility. *Id.* Finally, once the PF Exchange rates have been determined, the REP benefits payable to each utility can be determined. *Id.* Staff concludes that, as demonstrated by the tables in the PRS Documentation, REP benefits continue to be determined based on utility ASCs and PF Exchange rates, just as they were in the two prior rate periods, and would continue to be if the Settlement is not adopted. *Bliven et al.*, REP-12-E-BPA-12, at 42.

Based on the fact that the Settlement retains the exchange relationship between BPA and the IOUs, requires the IOUs to continue to file ASCs pursuant to the ASC Methodology, limits REP benefit payments to only IOUs whose ASCs exceed BPA's PF Exchange rate, and makes REP benefit payments based on a comparison of the utilities' ASCs with BPA's PF Exchange rate, which would be determined in each rate proceeding, Staff concludes that the second criterion for evaluating the Settlement has been met. Gendron *et al.*, REP-12-E-BPA-04, at 28.

#### **4.4 Overview of Parties' Objections**

The parties lodge a number of arguments against the Settlement, claiming that it does not follow the express terms of section 5(c) or the Court's mandates as described in *PGE*. These objections can be categorized into four general arguments.

First, almost all of the objecting parties claim that the fixed nature of the REP benefits in the Settlement runs afoul of section 5(c). These parties claim that section 5(c) mandates that the REP be implemented in only one way and result in only one answer on the total amount of REP benefits that may be included in rates. BPA addresses these parties' misperceptions on the requirements of section 5(c), the right of parties to waive statutory rights, and BPA's obligations to set rates, in Issues 4.5.1 and 4.5.2.

Second, the parties make the general accusation that the Settlement departs from the statutory administrative structure envisioned by Congress in section 5(c). These arguments generally assert that the Settlement does not "resemble" the REP as required by the Court in *PGE* because REP benefits for the IOUs will not be based on a comparison of their respective ASCs and BPA's PF Exchange rates. These arguments, as will be discussed in Issue 4.5.3, are patently wrong and ignore the Settlement's terms and the analysis Staff performs in this case.

Third, a number of parties claim that BPA will not calculate the "aggregate" amount of REP benefits to the IOUs through application of ASCs and PF Exchange rates. BPA disagrees. In Issue 4.5.4, BPA discusses how it derives the "aggregate" amount of REP benefits from which to test the amount under the Settlement. This section also addresses arguments challenging BPA's long-term projections of ASCs. Certain parties contend that the Court in *PGE* rejected BPA's earlier attempt to settle the REP based on forecasts of ASCs, and BPA's attempt to rely on such forecasts is merely repeating the errors of the past. BPA will address this misreading of the Court's opinion in *PGE* as well in Issue 4.5.4.

Finally, some parties object to the terms of the Settlement that exempt the REP benefits provided under the Settlement from further reduction. These arguments specifically challenge provisions of the Settlement that limit BPA's use of discretionary *in lieu* purchases, and exemptions from Cost Recovery Adjustment Clauses (CRACs). These objections are addressed in Issues 4.5.5 and 4.5.6.

## 4.5 Issues

### Issue 4.5.1

*Whether the fact that the total amount of REP benefits is fixed under the Settlement violates section 5(c) of the Northwest Power Act.*

#### Parties' Positions

Alcoa argues that the REP benefits provided under the Settlement violate section 5(c) of the Northwest Power Act because the total amount of REP benefits will not be calculated based on a comparison between the utilities' ASCs and BPA's PF Exchange rate. Alcoa Br., REP-12-B-AL-02, at 14.

Similarly, WPAG argues that the comparison of the PF Exchange rate to the ASCs of the participating utilities will not establish the total amount of REP benefits available during each rate period, as that will be governed by the predetermined amount set out in the REP Settlement for each year of each rate period. WPAG Br., REP-12-B-WG-01, at 10.

APAC also objects to the fixed nature of the REP benefits under the Settlement, arguing that this approach "turns the Northwest Power Act's directives on its head." APAC Br., REP-12-B-AP-01, at 8. APAC also contends that no specific iteration of the section 7(b)(2) rate test produces the level of REP benefits BPA proposes to set rates on for the FY 2012–2013 rate period. APAC Br. Ex., REP-12-R-AP-01, at 9.

#### BPA Staff's Position

IOU REP benefits under the Settlement will continue to be determined pursuant to section 5(c) of the Northwest Power Act. Bliven *et al.*, REP-12-E-BPA-12, at 41. In particular, BPA will continue to purchase an amount of exchange power from each eligible IOU in the amount of its qualified residential and small farm load and sell an equal amount of power to each eligible IOU. *Id.* BPA will continue to pay each IOU at the rate established by its ASC, and each IOU will continue to pay BPA at the PF Exchange rate established in each rate case. *Id.* Each IOU will also be required to make ASC filings with BPA pursuant to BPA's existing ASC Methodology. *Id.*

#### Evaluation of Positions

A common theme in the opposing parties' briefs is that one of the Settlement's chief flaws is that it establishes a fixed amount of aggregate REP benefits for the IOUs as a class. These parties claim that by fixing the aggregate REP benefits, the Settlement violates section 5(c) of the Northwest Power Act.

Alcoa argues that the Settlement runs afoul of section 5(c) principally because BPA would not calculate the total amount of REP benefits pursuant to the plain language of section 5(c). Alcoa Br., REP-12-B-AL-02, at 12. In Alcoa's view, BPA is not determining each utility's REP

benefits on a case-by-case basis by comparing each utility's ASC with the PF Exchange rate and multiplying the difference by qualifying loads. *Id.* Instead, Alcoa contends, the total REP benefits are fixed pursuant to the Settlement. *Id.* In this regard, Alcoa claims that the annual amount of aggregate REP Settlement Benefits/Scheduled Amounts is not calculated by BPA, but instead results from settlement discussions between the COUs and IOUs that negotiated the Settlement. *Id.* at 13. Alcoa repeats this argument numerous times in its brief. *Id.* at 14-15.

Similar arguments are made by WPAG and APAC. WPAG Br., REP-12-B-WG-01, at 10; APAC Br., REP-12-B-AP-01, at 8.

WPAG argues that the comparison of the PF Exchange rate to the ASCs of the participating utilities will not establish the total amount of REP benefits available during each rate period, as that will be governed by the predetermined amount established in the REP Settlement for each year of each rate period. WPAG Br., REP-12-B-WG-01, at 10. Specifically, WPAG contends that the "REP Settlement establishes predetermined annual REP benefit amounts for the life of the settlement, which amounts constitute a global settlement available to the IOUs as a class. The total amount of annual REP benefits available to the IOUs as a class does not vary regardless of how much the ASCs of individual IOUs may fluctuate over the term of the REP Settlement." WPAG Br., REP-12-B-WG-01, at 10.

APAC also raises this issue. APAC Br., REP-12-B-AP-01, at 8. APAC claims that the Settlement violates the Northwest Power Act by setting a fixed amount of REP benefits without regard to the IOUs' ASCs or the difference between the ASCs and the PF Exchange rate. *Id.* APAC states that the REP benefit amount should be set as the difference between the PF Exchange rate and the utilities' ASCs, based on the sale and purchase construct established in the Northwest Power Act. *Id.*

The parties' arguments are misguided. The fact that the Settlement fixes the aggregate amount of REP benefits that BPA must include in the PF Public (preference utilities') rate does not render the REP benefits provided under the Settlement unlawful. This is because neither section 5(c) nor any other provision of the Northwest Power Act prohibits the utilities that engage in the REP from taking fewer REP benefits than they otherwise would be entitled to under the law. Provided that the aggregate payments under the Settlement are not in excess of what is permitted by section 7(b), and are distributed in a manner consistent with section 5(c), no statutory violations have occurred. BPA will address these latter two issues in later sections of this ROD. Here, BPA addresses the parties' contention that section 5(c) is being violated simply because the Settlement establishes a fixed total amount of REP benefits for the IOUs.

Alcoa argues that the Settlement runs afoul of section 5(c) principally because BPA would not be calculating future total amounts of REP benefits pursuant to the plain language of section 5(c). Alcoa Br., REP-12-B-AL-02, at 12. APAC makes a similar argument, claiming that this case is "another example of BPA's efforts to turn the Northwest Power Act's directives on their head." APAC Br., REP-12-B-AP-01, at 8. APAC asserts that the Northwest Power Act is clear that the PF Exchange rate is set first, as a result of the 7(b)(2) rate test. *Id.* Then, APAC explains, the

level of REP benefits is determined as the difference between that rate and the utilities' ASCs. APAC contends that under the Settlement, the level of REP benefits is set first, and the PF Exchange rate will vary in each rate period to support the predefined benefit amount. *Id.*

Alcoa and APAC, however, have it backward: in BPA ratemaking, total permissible REP costs included in rates (whether under the Settlement or no-settlement) are *always* determined first; thereafter, BPA establishes utility-specific PF Exchange rates to achieve the total REP benefits. Bliven *et al.*, REP-12-E-BPA-17, at 20. BPA determines the “total amount of REP benefits available to the IOUs” in its ratemaking. *Id.*; *see also* Evaluation Study, REP-12-FS-BPA-01, section 3.3; Forman *et al.*, REP-12-E-BPA-10, at 5; Bliven *et al.*, REP-12-E-BPA-12, at 41. This determination occurs by operation of BPA's forecast of ASCs, the utilities' exchange loads, BPA's own costs, and 7(b)(2) rate protection. Bliven *et al.*, REP-12-E-BPA-17, at 20. Once BPA has determined the allowable amount of REP benefits to include in rates, BPA sets the PF Exchange rates such that this amount of REP benefits will be paid to the exchanging utilities when the utilities' ASCs are compared to BPA's rates. *Id.*

The Settlement fully retains this construct. Total IOU REP benefits would be fixed by the Settlement. BPA would then establish utility-specific PF Exchange rates using the same methodology BPA uses today in the no-settlement context to ensure the IOUs in total receive no more than the amounts permitted by the Settlement. Bliven *et al.*, REP-12-E-BPA-05, at 6 (“For the most part, the PF Exchange rates will be calculated in the same manner as they have been calculated prior to the Settlement.”); *id.* at 6-7. Provided that the “total REP benefits” provided under the Settlement do not exceed the limitations set forth in section 7(b)(2), an issue that is separately addressed in Chapter 5, there is nothing unlawful in BPA's establishing PF Exchange rates to ensure that no more (or less) of the Settlement amounts are paid to the IOUs through section 5(c).

Alcoa argues that the Settlement violates section 5(c)(1) of the Northwest Power Act because the Settlement establishes the aggregate REP benefits. Alcoa Br., REP-12-B-AL-02, at 12. This argument is without merit, however, because section 5(c)(1) does not speak to calculating the exchange benefits for the IOUs as a class at all. Rather, section 5(c)(1) directs BPA to engage in exchange transactions with *individual* utilities based on certain terms and conditions:

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

16 U.S.C. 839c(c)(1) (emphasis added).

As the plain language of section 5(c)(1) makes clear, section 5(c) is concerned with the individual exchange relationship between BPA and each exchanging utility. Thus, BPA is obligated by section 5(c)(1) to purchase the power of “*a* Pacific Northwest electric utility” and sell an equivalent amount of power to “*such utility* for resale to *that utility's* residential

users ....” *Id.* Section 5(c) is notably silent on what rate BPA must use to sell its power to the utility or how BPA is to recover the costs in rates of the purchase and sale required by section 5(c). BPA assumes that Congress was intentionally silent because section 5(c) was focused on the mechanical structure that would govern the exchange between BPA and the individual exchanging utility. In contrast, the aggregating of the section 5(c) purchases and sales and the calculation of the PF Exchange rate that will ultimately be used in the REP all occur as a function of section 7(b). 16 U.S.C. § 839e(b)(1)–(3); *see also* Bliven *et al.*, REP-12-E-BPA-17, at 20. This sequence conforms with what Congress intended, because it is only after BPA has evaluated all relevant rate steps in section 7(b) that BPA can establish a PF Exchange rate as the basis for its exchange with each individual utility under section 5(c). To be clear, section 5(c) does provide information that is used in section 7(b) for purposes of determining aggregate REP benefits and the resulting PF Exchange rate, such as BPA’s obligation to exchange, the exchangeable load, and the general manner in which to determine the IOUs’ ASCs. Section 5(c) does not, however, dictate how BPA is to use this information in ratesetting to determine aggregate REP benefits. The instructions for determining aggregate REP benefits come from section 7(b). In this way, it is section 7(b) that ultimately establishes the amount of the REP costs that BPA may recover in rates, while section 5(c) (in addition to providing information used in section 7(b)) establishes how the REP benefits are distributed among the REP participants.

APAC argues that section 5(c) of the Northwest Power Act requires BPA to first set the PF Exchange rate *and then* determine its total REP costs. APAC Br., REP-12-B-AP-01, at 8. This view of the statutory language makes no sense. The PF Exchange rate is the rate BPA increases to reduce the cost of the REP in the 7(b) rate as required by sections 7(b)(2) and 7(b)(3). 16 U.S.C. §§ 839e(b)(2)–(3). If BPA does not know the total permissible cost of the REP after running the 7(b)(2) rate test, then BPA has no way of setting the PF Exchange rate. APAC’s view of the statutory language would create a hopeless tautology between sections 5(c) and 7(b): the PF Exchange under section 7(b) rate can be set only when BPA knows the total cost of the REP under section 5(c), but BPA cannot determine its total cost under section 5(c) until it sets a PF Exchange rate under section 7(b). Again, the statutory approach requires that the total permissible REP costs first be calculated; once that is known, then BPA may establish the PF Exchange rate to distribute those benefits to the recipients in the REP. As emphasized by Staff: “adjusting the PF Exchange rate to permit the payment of the amount of REP benefits that BPA believes is appropriate under the law is not a new concept; it is the way BPA would set the PF Exchange rates even without the Settlement.” Bliven *et al.*, REP-12-E-BPA-17, at 22.

Alcoa, APAC, and WPAG claim that the fixed nature of the REP benefits under the Settlement violates the statutory method for calculating total REP benefits because BPA is not comparing ASCs and the PF Exchange rate to determine the total amount of REP benefits to pay to the IOUs and include in rates. Alcoa Br., REP-12-B-AL-02, at 12; APAC Br., REP-12-B-AP-01, at 8; APAC Br. Ex., REP-12-R-AP-01, at 9; WPAG Br., REP-12-B-WG-01, at 10. First, these parties are incorrect because BPA *has* compared ASCs to a PF Exchange rate for each year of the Settlement to determine whether and to what extent the Settlement’s value are permissible under the Northwest Power Act. *See* Chapter 5.

Second, these parties misread the requirements of section 5(c). As noted above, section 5(c) does not prescribe the manner for determining the total cost of the REP that BPA may include in rates. That is a function of BPA ratemaking under section 7(b). The primary rate directive that affects the total amount of REP benefits available to the IOUs under section 7(b) is section 7(b)(2). 16 U.S.C. § 839e(b)(2). Section 7(b)(2) does not require BPA to either pay the IOUs or charge the COUs in rates the *exact amount* of REP benefits established by a comparison of the utilities' ASCs and BPA's PF Exchange rate. Instead, the plain language of section 7(b)(2) provides:

After July 1, 1985, the projected amounts to be charged for firm power for the combined general requirements of public body, cooperative and Federal agency customers, exclusive of amounts charged such customers under subsection (g) of this section for the costs of conservation, resource and conservation credits, experimental resources and uncontrollable events, may not exceed in total, as determined by the Administrator, during any year after July 1, 1985, plus the ensuing four years, an amount equal to the power costs for general requirements of such customers if, the Administrator assumes [five assumptions]

16 U.S.C. § 839e(b)(2).

As the plain language of the statute makes clear, section 7(b)(2) directs that the “projected” power costs to the COUs “may not exceed” the power costs necessary to serve the general requirements of the COUs. *Id.* Alcoa, APAC, and WPAG construe the phrase “may not exceed” to mean that BPA is permitted to include in rates only the exact amount of REP benefits found to be lawful after the performance of the section 7(b)(2) rate test. This is not the statutory language. Section 7(b)(2) creates only a cap—not a floor—on the aggregate amount of REP benefits that BPA must pay to the exchanging utilities and include in rates. Had Congress intended to restrict BPA and the exchanging utilities from varying the amount of REP benefits below what is statutorily permissible, Congress would have revised section 7(b)(2) to say “the projected amounts to be charged ... must equal ....” Congress did not draft the language this way, thereby leaving it open that the IOUs as a group could agree to take less of their statutorily entitled REP benefits, such as through a fixed payment stream. If the IOUs wish to share among themselves a smaller amount of REP benefits through a fixed payment stream that settles future uncertainties around the amount of REP benefits, there is nothing in section 5(c) or section 7(b)(2) that prohibits BPA from honoring such a decision.

As further proof that the IOUs have the option to take less in REP benefits than the maximum allowable under section 7(b), section 5(c)(2) states that “[t]he purchase and exchange sale ... with any electric utility shall be limited to an amount not in excess of ... 100 per centum of such load in ... each year ....” 16 U.S.C. § 839c(c)(2). Here Congress uses the term “not in excess of” rather than “equal to.” In addition, section 5(c) sets the REP as a voluntary matter for a utility by prefacing section 5(c) with the language “[w]hensoever a Pacific Northwest utility offers to sell electric power to the Administrator ....” This further establishes a REP participant's right to exchange for less than the maximum allowable amount.

Ninth Circuit case law confirms that customers of BPA may waive their right to receive statutory benefits under the Northwest Power Act, including REP benefits. In *Avista Corp v. Bonneville Power Admin.*, 380 Fed. Appx. 652 (9th Cir. 2010), the Court reviewed a provision of BPA’s Regional Dialogue contracts that required COUs to waive their statutory rights to billing credits (section 6 of the Northwest Power Act) and modified their participation in the REP (section 5(c) of the Northwest Power Act) as a condition of receiving rates under the Tiered Rate Methodology. The Court noted that “absent some affirmative indication of Congress’ intent to preclude waiver, we ... presume[ ] that statutory provisions are subject to waiver by voluntary agreement of the parties.” *Id.* at 654, quoting *United States v. Mezzanatto*, 513 U.S. 196, 201, (1995). The Court also noted that it would “not interpret Congress’ silence as an implicit rejection of waivability.” *Id.* at 654-655, quoting *Mezzanatto*, 513 U.S. at 203-204. After reviewing the provisions of sections 5(c) and 6 of the Northwest Power Act, the Court held that the petitioner had not “pointed to any provisions of sections 5 or 6 of the Northwest Power Act that preclude waiver of benefits as effected in sections 12.1 or 12.2 of its Regional Dialogue Contract.” The Court went on to note that “neither [section 5(c) or 6] limits a customer’s ability to waive the right to request such benefits nor, in the latter case, to agree to a particular formula for determining that customer’s ‘average system cost.’” *Id.* at 655. Thus, the Ninth Circuit has directly held that parties (such as the IOUs) may waive their rights under section 5(c) to receive their full statutory REP benefits.

A decade before *Avista*, the Ninth Circuit reached a similar decision in the context of payments under section 4(h)(11)(A)(ii) of the Northwest Power Act. See *Pub. Util. Dist. No. 1 of Douglas County v. Bonneville Power Admin.*, 947 F.2d 386, 396 (9th Cir. 1991). In *Douglas County*, the Court reviewed a BPA policy that established the criteria and procedures for compensating non-Federal owners of dams for lost power production if the lost power was due to a “measure” that was “imposed upon” the owner pursuant to Northwest Power Act. *Id.* at 391-396. As part of BPA’s claim procedures, BPA evaluated whether the party requesting compensation had waived its right to the statutory payments. *Id.* at 396. Petitioners claimed that the “statute does not include a waiver limitation,” but the Court disagreed, noting “nothing in the statute suggests that a non-Federal project cannot waive its right to compensation” under section 4(h)(11)(A)(ii) of the Northwest Power Act. *Id.* at 396.

The Court’s holdings in *Avista* and *Douglas County* apply equally to the Settlement BPA is considering in this case. APAC complains that no specific iteration of the section 7(b)(2) rate test produces the level of REP benefits BPA proposes to set rates on for the FY 2012–2013 rate period. APAC Br. Ex., REP-12-R-AP-01, at 9. But even if no combination of IOU ASCs and BPA PF Exchange rates generates the exact amount of aggregate REP benefits to include in FY 2012–2013 or any other year provided for in the Settlement, no statutory violation has occurred because the IOUs may agree to waive their statutory rights to receive the full amount of REP benefits provided by sections 5(c) and 7(b). This is, in fact, precisely what the IOUs have agreed to do. Section 7.3 of the Settlement provides:

... each IOU waives any and all past or future rights it may have to receive REP Benefit Payments for the Payment Period that differ from its share of the REP

Settlement Benefits provided for in this Settlement Agreement. This waiver includes (i) a waiver of any claims that BPA should set rates inconsistent with this Settlement Agreement, (ii) a waiver of any statutory rights to REP Benefit Payments for the Payment Period that are greater than the REP Settlement Benefits provided for in this Settlement Agreement, notwithstanding any past or future legal interpretations of section 5(c), 7(b)(2), or 7(b)(3) of the Act by BPA, any court, or any other entity....

REP Settlement, REP-12-A-02A, § 7.3. Just as the Court found in *Avista* and *Douglas County*, unless there is some statutory language to the contrary, the IOUs may agree to waive their rights to REP benefits above the Scheduled Amounts set forth in the Settlement. Nothing in section 5(c) or 7(b) prevents them from doing so.

Alcoa contends that BPA recognizes that REP benefits are not fixed under traditional Northwest Power Act ratesetting. Alcoa Br., REP-12-B-AL-02, at 13. But traditional Northwest Power Act ratesetting also does not involve a long-term settlement of the REP. Nothing in the Northwest Power Act ratesetting directives precludes BPA from resolving a component of its ratemaking for a long-term period. Certainly, BPA cannot settle the REP in a manner that contradicts “clear statutory directives,” but that is not what the Settlement does in this case. *See PGE*, 501 F.3d at 1031 (*quoting Utility Reform Project v. Bonneville Power Admin.*, 869 F.2d 437, 433 (9th Cir. 1989)). As explained elsewhere in this ROD, the REP benefits provided to the IOUs under the Settlement do not violate section 7(b)(2), are distributed in a manner consistent with section 5(c), and result in overall lower rates for all of BPA’s ratepayers—including Alcoa. *See* Chapters 5 and 6. The fact that the total IOU REP benefits are “fixed” does not in any way render them unlawful.

Alcoa asserts that, under the Settlement, BPA would not determine total REP benefits by taking the difference between the utilities’ ASCs and the PF Exchange rate and multiplying those amounts by the qualified load. *Id.* Instead, the aggregate amount of REP benefits for a 17-year period would be fixed pursuant to the Settlement’s terms, and BPA would calculate “rates that achieve [the negotiating parties’] intended results [a]nd one of the results is the total amount of REP benefits that matches the amount set forth in the agreement.” *Id.* at 13-14.

Alcoa is incorrect in assuming that utilities’ ASCs and BPA’s PF Exchange rates will not be used in the calculation of the aggregate amount of REP benefits permitted by the Northwest Power Act. First, when setting rates, BPA will use ASCs as determined in BPA’s ASC processes and qualifying exchange loads determined pursuant to the Settlement. Settlement, REP-12-A-02A, § 2. These inputs will be used to determine exchange resource purchase costs to be included in the revenue requirement allocated pursuant to section 7(b)(1) of the Northwest Power Act. PRS, BP-12-FS-BPA-01, section 2.1.3.2. The allocated revenue requirement is used to calculate the Base PF Exchange rates through application of the section 7 rate directives up to the point where the 7(b)(2) rate test is performed. *Id.* at 37-38. With these three required elements, the ASCs, the base PF Exchange rates, and the exchange loads for each qualifying REP participant, the individual and aggregate Unconstrained Benefits are calculated. Evaluation Study, REP-12-FS-BPA-01, section 5.1. Once Unconstrained Benefits are known, the total amount of rate

protection afforded under the Settlement can be calculated. *Id.* at 41-42. The portion of rate protection costs allocated to the PF Exchange rates is then allocated among the REP participants. *Id.* at 42. The cost of the Refund Amounts is allocated to the IOU REP participants. *Id.* at 44. When all of the allocations are complete, an additional redistribution of costs allocated among the IOU REP participants is performed pursuant to section 6 of the Settlement, *Id.* at 43. With these steps completed, the final utility-specific PF Exchange rates are calculated. *Id.* at 44. Thus, in ratemaking, all three traditional elements of the REP are used in the determination of rates.

Once rates are established, each REP participant will submit to BPA each month its qualifying exchange load. REPSIA, REP-12-A-02A, Exhibit A, § 8. Upon receipt, BPA will generate an invoice for the utility that performs the purchase and sale described in sections 5 and 6 of the REPSIA. *Id.* BPA will purchase from the REP participant the amount of power equal to its monthly qualifying exchange load. *Id.* § 5. BPA will simultaneously sell an equivalent amount of power at the utility's specific PF Exchange rate. *Id.* § 5. The net of the payment for the purchase and the revenue from the sale will equal each REP participant's REP benefit for the month. The REP participant is required to pass through this benefit to its residential and small farm customers. *Id.* § 10. Thus, in implementation, all three traditional elements of the REP are used in the determination of REP benefits. BPA's total REP expense for each month is the aggregate payment to REP participants.

As explained in Issue 4.5.4, ASCs and exchange load are used in this proceeding to estimate the total aggregate amount of REP benefits that would be paid pursuant to section 5(c). Moreover, as explained in Chapter 5, Staff tests multiple implementations of section 7(b)(2) to determine alternative PF Exchange rates. Using all three elements of the traditional exchange, Staff calculates the aggregate amount of allowable REP benefits for each scenario. Additionally, as explained above, the mere fact that the Settlement fixes total REP benefits does not, perforce, render those benefits unlawful. If the level of those fixed payments does not exceed what is permitted by sections 5(c) and 7(b), no statutory issues arise. Furthermore, BPA's decision to set PF Exchange rates that achieve the results of the Settlement is not unlawful. As explained in response to APAC's similar concern, BPA's current practice is to set the PF Exchange rate to ensure that the amount of REP benefits determined pursuant to section 7(b) is achieved in the exchange under section 5(c).

Finally, it must be emphasized that the REP benefits established under the Settlement were not pulled out of thin air. The settling parties developed the Scheduled Amounts of IOU REP benefits and the rate provisions in section 3 of the Settlement only after careful consideration of forecasts of future ASCs and PF Exchange rates prepared by a technical panel assisted by BPA Staff during the mediation process. *See* Murphy and Kallstrom, REP-12-E-JP02-04, at 3. Representatives for the COUs and IOUs were also on the expert panel. Waldron, Oral Tr. at 9. This is not to say that the expert panel's recommendation would supplant BPA's own independent analysis. BPA was clear both preceding the mediation and in this process that the agency would have to conduct its own independent review of the Settlement to determine

whether its terms and values were valid. BPA makes this point merely to note that the Scheduled Amounts in the Settlement were derived with extensive knowledge of the Northwest Power Act.

APAC contends that it is not sufficient to assert that the IOUs can agree to accept REP benefits lower than those provided by the 7(b)(2) rate test. APAC Br. Ex., REP-12-R-AP-01, at 11. APAC argues that whether the IOUs are accepting lower benefits can only be determined for the current FY 2012 rate period in which BPA has conducted the 7(b)(2) rate test using the most current forecast of costs. *Id.* APAC claims that no such finding can be made for all seven other rate periods within the 17 year period of the Settlement, because it cannot be determined at this time whether the Scheduled Amounts in the Settlement are greater or lesser than those to which the IOUs would otherwise be entitled. *Id.*

BPA disagrees. In essence, APAC asserts that BPA has no choice but to implement the traditional REP because there is no other way of showing that the IOUs' are actually "giving up" REP benefits under the Settlement. However this approach leads to a nonsensical result. Following APAC's view, there can be no settlement of the REP because all of the REP issues would have to be addressed in each rate period before BPA could determine whether the IOUs were taking less REP benefits. But, if BPA must determine all of the REP issues in its cases, BPA does not see what, in fact, would be "settled" by the settlement. BPA would have to reach final REP decisions to calculate the REP benefits, and as a consequence, all of the attendant legal risks that the COUs and IOUs have tried to avoid through a settlement would continue to be present. Participants in the REP would never agree to "give up" REP benefits in such a case because there would be no certainty over the past, present, or future REP implementation.

In its brief on exceptions, WPAG claims that were it the case that BPA's analysis showed only 7(b)(2) rate test results in excess of the 2012 Settlement REP payment amounts, BPA's argument regarding the IOUs' ability to waive REP benefits would have some merit. WPAG Br. Ex., REP-12-R-WG-01, at 28. However, WPAG contends that BPA's own analysis shows there are a number of instances in which the REP payments under the 2012 Settlement, and the REP payment obligations that will be imposed on preference customers, exceed BPA's forecast of what is lawful under the 7(b)(2) rate test. *Id.* Under these circumstances, WPAG claims the IOUs' waiver does not cure the legal infirmity. *Id.*

WPAG, however, misstates BPA's argument and analysis. BPA's position on the ability of the IOUs to waive REP benefits responds to parties' contention that a fixed stream of REP benefits is not permissible under the Northwest Power Act. As noted in this issue, fixed REP benefits are not prohibited by the Northwest Power Act because the IOUs may always agree to accept less in REP benefits. In making this argument, BPA is in no way stating that simply because the IOUs can waive their REP benefits that "any legal flaw" with the Settlement could be rectified. Rather, BPA is clear that the total REP benefits under the Settlement must also be found to be consistent with section 7(b). As noted in the Draft ROD (and this Final ROD) decision on this issue: "The fact that the Settlement establishes a fixed schedule of total REP benefits does not violate section 5(c) of the Northwest Power Act. Provided that the total REP benefits under the Settlement do not exceed the limit established in section 7(b), and are distributed in a manner

consistent with section 5(c), no statutory violation has occurred.” Draft ROD, REP-12-A-01, at 86. That decision is being reaffirmed here.

WPAG also misunderstands BPA’s analysis. BPA’s analysis shows what level of REP benefits would be permissible if (1) BPA’s positions were sustained by the Court, and (2) if the parties were to prevail on some or all of their positions. In terms of deciding whether the Settlement provides greater or lesser rate protection under section 7(b), BPA’s forecast of future REP benefits indisputably demonstrates that REP benefits are fewer, and rate protection greater. Evaluation Study, REP-12-FS-BPA-01, Table 10.4. The other scenarios modeled by Staff explore what other results would occur if BPA were to lose key statutory interpretation questions in the Ninth Circuit. WPAG claims these scenarios demonstrate that there are a number of instances where the Settlement “exceed[s] BPA’s forecast of what is lawful under the [7(b)(2) rate test].” WPAG Br. Ex., REP-12-R-WG-01, at 28. However, WPAG fails to recognize that these scenarios do not reflect BPA’s positions on the “lawful” implementation of the REP, but the parties’ positions. In looking at these scenarios, it is clear that in almost all instances REP benefits would be above the Settlement value. It is only when the COUs win multiple statutory issues against BPA, and the IOUs prevail on none of their key issues, do REP benefits fall below the Settlement. In considering whether the Settlement provides fewer REP benefits than would be permitted under the parties’ respective litigation positions, BPA does not see why greater credence must be given to the COUs’ positions in litigation over BPA’s and the IOUs’ positions in litigation.

The contention of Alcoa, APAC, and WPAG that the Settlement is unlawful simply because the total REP benefits provided under the Settlement are “fixed” in the Settlement is without merit. As has been made clear, the IOUs may waive their statutory rights to receive the maximum allowable REP benefits. Neither section 5(c) nor section 7(b)(2) of the Northwest Power Act prohibits such a waiver. Furthermore, the fact that the Settlement calls for BPA to work backward, from the fixed REP benefits to the individual PF Exchange rates, is also not contrary to the Northwest Power Act. Under BPA’s non-settlement ratemaking methods, BPA follows a similar order. The total amount of REP benefits is determined pursuant to section 7(b), and then BPA establishes PF Exchange rates to ensure that this amount is distributed correctly to the utilities participating in the section 5(c) exchange. Provided that the aggregate payments under the Settlement do “not exceed” what is permitted by section 7(b)(2), and such payments are distributed in a manner consistent with the purchase and sale features of section 5(c), no statutory violations have occurred.

### **Decision**

*The fact that the Settlement establishes a fixed schedule of total REP benefits does not violate section 5(c) of the Northwest Power Act. Provided that the total REP benefits under the Settlement do not exceed the limit established in section 7(b), and are distributed in a manner consistent with section 5(c), no statutory violation has occurred.*

## **Issue 4.5.2**

*Whether BPA has unlawfully delegated to the negotiating parties its statutory authority to determine REP benefits.*

### **Parties' Positions**

Alcoa contends that if the Settlement is adopted, BPA will have unlawfully delegated to the negotiating parties its obligation to determine, through statutory tests, the level of IOU REP benefits (if any) pursuant to section 5(c), as well as the level of COU rate protection (if any) pursuant to the section 7(b)(2) test. Alcoa Br., REP-12-B-AI-02, at 9. WPAG raises a similar concern. WPAG Br., REP-12-B-WG-01, at 14, n.9. APAC raises this issue as well. APAC Br. Ex., REP-12-R-AP-01, at 9.

### **BPA Staff's Position**

Although this issue is primarily a legal issue, Staff notes that BPA has not delegated any of its statutory duties to the negotiating parties. The Administrator will execute the Settlement only if it comports with the requirements and limitations of the Northwest Power Act. 75 Fed. Reg. 78694, at 78702 (2010). This determination will be made by the Administrator, not the negotiating parties, after the Administrator reviews all of the evidence and arguments in this proceeding. Because the Administrator retains the ultimate authority to determine whether the requirements for determining REP benefits under sections 5(c) and 7(b)(2) of the Northwest Power Act have been met, no unlawful delegation has occurred.

### **Evaluation of Positions**

Alcoa contends that if the Settlement is adopted, BPA will have unlawfully delegated to the negotiating parties its obligation to determine through statutory tests the level of IOU REP benefits (if any) pursuant to section 5(c), as well as the level of COU rate protection (if any) pursuant to the section 7(b)(2) test. Alcoa Br., REP-12-B-AI-02, at 9.

Alcoa is incorrect. BPA will comply with the terms of the Settlement. What Alcoa is missing, though, is that before the Administrator signs the Settlement, he must determine that the terms of the Settlement comply with the very statutory provisions Alcoa claims BPA is impermissibly delegating to the negotiating parties. The proposed Settlement is just that: a proposal. BPA is not required to sign it, and the negotiating parties have not been clothed with any official role or special magical powers to control BPA's actions in this case in any way. The settling parties have presented BPA with an agreement that embodies an alternative to BPA's previous response to the Court's opinion in *Golden NW* and *PGE*. Settlement, REP-12-A-02A; *see also* Chapter 2 for a summary. Although BPA encouraged the parties to explore a settlement that would resolve the endless litigation over the REP, WP-07 Supplemental ROD, WP-07-A-05, at xx-xxi, BPA has never said it was simply handing over the keys to the Northwest Power Act for the negotiating parties to do with as they please. Gendron *et al.*, REP-12-E-BPA-04, at 26-27. Far from it: BPA has been clear from the beginning of this proceeding that the Administrator will make an independent evaluation of the Settlement and will accept the Settlement only if it

complies with sections 5(c), 7(b), and other provisions of the Northwest Power Act. *Id.*; 75 Fed. Reg. 78694, at 78702 (2010). No unlawful delegation can occur in this instance because the Administrator’s decision to sign (or not sign) the Settlement will come only after he independently concludes that the values and terms in the Settlement comply with the limitations and duties set forth in the Northwest Power Act. 75 Fed. Reg. 78694, at 78702 (2010). While the negotiating parties believe they have created a Settlement that comports with BPA’s statutory duties, Murphy and Kallstrom, REP-12-E-JP02-02, at 33, the Administrator has not taken their word for it. It is BPA’s duty to determine whether the Settlement comports with the law, and that is what BPA is doing in this case. Forman *et al.*, REP-12-E-BPA-10, at 3-4.

The Settlement itself is clear that the key statutory conclusions Alcoa is concerned about must be made by the Administrator alone. Section 3.7 provides a set of decisions that must be reached in the Final ROD in this case in order for the Settlement to become effective at the end of the REP-12 proceeding. Forman *et al.*, REP-12-E-BPA-10, at 3. The specific decisions are: (1) BPA will, for the duration of the Settlement, pay the IOUs the “Scheduled Amounts set forth in Table 3.1”; (2) BPA will include in the settling COUs’ rates only their share of the REP Recovery Amounts, as determined by section 3.3.5 of the Settlement; and (3) BPA may lawfully set rates and establish refund amounts applicable to non-settling parties consistent with sections 3.2 through 3.5, and will do so for the term of the Settlement. *Id.*; *see also* REP Settlement, REP-12-A-02A, § 3.7(i)–(iii). If BPA is unable to reach these conclusions when making its final decisions, the Settlement becomes void *ab initio* even if the Administrator executes the Settlement. *Id.* As noted by the negotiating parties, this language was included in the Settlement to emphasize that it is BPA’s responsibility to determine whether the Settlement is lawful or not and complies with all relevant statutory criteria. Murphy, Oral Tr. at 131-134. Even without this language, though, the Administrator would naturally have addressed these statutory issues before deciding to adopt the Settlement. Forman *et al.*, REP-12-E-BPA-10, at 3-4. In short, BPA has delegated nothing to the settling parties, and the Settlement itself leaves it to BPA to make the key statutory decisions.

Moreover, the REP benefits arrived at in the Settlement were not picked out of thin air by the negotiating parties. The settling parties developed the Scheduled Amounts of total IOU REP benefits and the rate provisions in section 3 of the Settlement only after careful consideration of forecasts of future ASCs and PF Exchange rates prepared by a technical panel assisted by BPA Staff during the mediation process. Murphy and Kallstrom, REP-12-E-JP02-04, at 3. Representatives for the COUs and IOUs were also on the expert panel. Oral Tr. at 9. Although the final dollar figure in the Settlement did reflect the results of a negotiation, the parties’ negotiations were informed by reference to REP values derived from future forecasts of REP benefits.

Alcoa further argues that during cross-examination BPA conceded that if the Settlement is adopted, BPA would have to implement the ratesetting methodologies set out in the Settlement in order to achieve the negotiated REP benefits and COU rate protections. Alcoa Br., REP-12-B-AL-02, at 10. Alcoa argues that in adopting the ratesetting mechanisms set out in the Settlement,

BPA will impermissibly delegate a number of statutorily mandated ratemaking steps to the negotiating COUs and IOUs. Alcoa Br., REP-12-B-AL-02, at 3.

Alcoa's argument is faulty for two reasons. First, Alcoa mischaracterizes BPA's witness's answer from cross-examination. Staff never conceded that the Settlement dictates to BPA the "ratesetting methodologies" that BPA must use to achieve the results of the Settlement. Rather, Staff has consistently stated that the Settlement only points BPA to a particular result to achieve in rates; the methodologies or manner in which BPA sets those rates is left to BPA. Evaluation Study, REP-12-FS-BPA-01, section 5.1; Bliven *et al.*, REP-12-E-BPA-12, at 2-4; Cross-Ex. Tr. at 76-78. Alcoa's counsel previously attempted to make this mischaracterization of BPA's testimony and the terms of the Settlement during cross-examination, but BPA's witness properly corrected him:

[APAC Counsel]: Q. And rates in each rate proceeding will be set pursuant to the express terms of the settlement agreement, if adopted, recognizing that there's an open question as to whether the terms of the settlement would be applied to non-settling parties?

A. (Mr. Bliven) Well, you say the express terms. The settlement uses terminology that has the results that are supposed to occur. It does not guide the exact method of calculating the rates. It says Bonneville will develop rates consistent with these results, but it does not dictate exactly how those rates will be set. The settling parties did not undertake to lay out exactly how the rate-setting methodology works. They set out the results that they intend to see from those rate-setting methodologies, so that's the distinction I would draw.

Cross-Ex. Tr. at 78. Counsel for Alcoa then asked:

Q. And in such rate settings, then, Bonneville would have to implement rate-setting methodologies that achieve the negotiated results of the agreement; is that correct?

A. (Mr. Bliven) Yes, yes.

As the full discussion in the transcript makes clear, BPA's witness stated only that BPA would use "ratesetting methodologies" to achieve the results set forth in the Settlement, not the Settlement's ratesetting methodologies, as Alcoa now contends. Thus, the Settlement does not supplant BPA's ratesetting duties as set forth in the Northwest Power Act. BPA will continue to set rates as required by section 7 of the Northwest Power Act, but in setting those rates, will use the flexibility afforded to BPA by section 7 to achieve the values in the Settlement.

Second, Alcoa's objection that BPA will set rates consistent with the Settlement is immaterial. In effect, Alcoa is making the unremarkable observation that BPA would have to comply with the terms of the Settlement after the Administrator signs the Settlement. But, as noted before, the Administrator will sign the Settlement only if he finds that it comports with all relevant provisions of the Northwest Power Act. If the Settlement violated a statutory provision, Staff

would not have recommended to the Administrator that he sign it. As discussed during cross-examination:

Q. Alcoa made a number of comments—or I guess they were questions—throughout the cross noting that the REP settlement had negotiated a value in the document. And my question to you, would it be staff’s recommendation to the Administrator to adopt the settlement if that negotiated value violated some provision in the Northwest Power Act that you’re familiar with?

A. (Mr. Bliven) I believe that if we found a violation of the statute that was an error in the settlement that we would not be recommending the settlement to the Administrator.

Cross-Ex. Tr. at 154. In this case, the Administrator has determined that the Settlement comports with the provisions of the Northwest Power Act. There is nothing wrong with complying with the terms of a lawful settlement.

Alcoa claims that rather than performing a section 7(b)(2) rate test for each rate period, the Settlement dictates how BPA will calculate the amount of rate protection the COUs are entitled to during the Settlement’s 17 years. Alcoa Br., REP-12-B-AL-02, at 3-4. Alcoa asserts that there is “no dispute” that, if adopted, the Settlement will displace the 7(b)(2) rate test with a level of COU rate protection calculated pursuant to the Settlement’s terms. *Id.* at 9.

Alcoa’s argument misses the antecedent to BPA’s decision to adopt the Settlement: BPA has determined that the Settlement complies with sections 5(c) and 7(b)(2). *See* Chapter 5. To make this determination, BPA performed the section 7(b)(2) rate test in this case for the term of the Settlement and has found that the Settlement provides substantial rate protection to BPA’s COU customers. Evaluation Study, REP-12-FS-BPA-01, Chapter 11. The fact that the parties negotiated the value of the REP benefits set forth in the Settlement does not mean the payments under the Settlement are inherently in violation of section 7(b)(2). Bliven *et al.*, REP-12-E-BPA-12, at 7-8. Section 7(b)(2) directs that the “projected” power costs to the COUs “may not exceed” the power costs necessary to serve the general requirements of the COUs assuming the five assumptions in section 7(b)(2). 16 U.S.C. § 839e(b)(2). Importantly, the statutory language does not say the “projected amounts to be charged ... must equal ....” Thus, the section 7(b)(2) rate test creates a cap, not a floor, on REP benefits. Bliven *et al.*, REP-12-E-BPA-12, at 8. A settlement that provides REP benefits below the cap, then, is lawful under section 7(b)(2). As Staff’s analysis demonstrates, the amount of REP benefits provided under the “fixed” schedule in the Settlement is well below the amount of REP benefits Staff believes would be available to the IOUs in nearly every scenario considered by Staff, including non-modeled combinations of the issues. Bliven *et al.*, REP-12-E-BPA-12, at 8. If the IOUs are willing to agree to take less in REP benefits under the Settlement than they might otherwise be entitled to, then section 7(b)(2) certainly does not prohibit BPA from letting them do so. *Id.*

Moreover, it is incorrect to view BPA’s adoption of the Settlement as simply substituting a set of negotiated numbers for values that would otherwise be determined in a rate case by implementation of section 7(b). By signing the Settlement, the Administrator has made the

Settlement his new decision and approach in responding to the Court's opinions in *PGE and Golden NW* and as to how to administer the REP. *See* Chapter 8; *see also* Stiffler *et al.*, REP-12-E-BPA-13, at 3. And by actually performing the 7(b)(2) rate test for each year of the 17-year period to test whether the rate protection provided under the Settlement is not less than the statutory requirements, Bliven *et al.*, REP-12-E-BPA-12, at 5, the Administrator can find that the Settlement complies with BPA's statutes, is consistent with the Court's prior rulings, and is in the best interest of regional ratepayers. *See* Chapter 5; *see also* Stiffler *et al.*, REP-12-E-BPA-13, at 3.

Alcoa claims that BPA has similarly delegated to the settling parties the operation of section 5(c) by providing a fixed amount of REP benefits rather than benefits determined using the ASC framework established in section 5(c) of the Northwest Power Act. Alcoa Br., REP-12-B-A1-02, at 4, 9.

Alcoa is wrong on all fronts. First, as noted above, the fact that the REP benefit values are "fixed" in the Settlement does not make those payments inherently illegal. *See* Issue 4.5.1. What matters is whether the payments under the Settlement are consistent with sections 5(c) and 7(b). BPA has shown that they are consistent, so they are lawful. Evaluation Study, REP-12-FS-BPA-01, Chapter 11; Gendron *et al.*, REP-12-E-BPA-04, at 26-37.

Second, the ASC framework Alcoa allegedly is concerned about is alive and well under the Settlement. The Settlement continues to provide REP benefits to the settling IOUs in conformance with section 5(c) of the Northwest Power Act. Gendron *et al.*, REP-12-E-BPA-04, at 28. That is, BPA will continue to "purchase" power pursuant to section 5(c) at the average system cost of the IOUs, and BPA will continue to "sell" power pursuant to section 5(c) at rates established pursuant to sections 7(b)(1), 7(b)(3), and 7(g) of the Northwest Power Act. *Id.*; *see also* Forman *et al.*, REP-12-E-BPA-10, at 18; Bliven *et al.*, REP-12-E-BPA-12, at 41-42; REPSIA, REP-12-A-02A, Exhibit A, §§ 5-6. The amount of REP benefits BPA pays to the settling IOUs continues to be the difference between the amount BPA pays for the purchase and the amount BPA receives for the sale. Gendron *et al.*, REP-12-E-BPA-04, at 28.

Moreover, the Settlement continues to distribute the REP benefits among the settling IOUs in a manner consistent with ASCs established under BPA's 2008 ASC Methodology and rates established under section 7 of the Northwest Power Act. *Id.* The Settlement requires no changes to the 2008 ASC Methodology, and no changes have been proposed or are contemplated. *Id.* Rates continue to be established using a method similar to that used to set rates without the Settlement. *Id.* The majority of the cost of rate protection continues to be allocated to the PF Exchange rate, thereby reducing REP benefits, as is done today in BPA ratemaking. *Id.* If a utility's ASC is less than the applicable PF Exchange rate, it will not receive any REP benefits under the Settlement, just as it would not receive any REP benefits in absence of the Settlement. *Id.*; *see also* Bliven *et al.*, REP-12-E-BPA-12, at 47. The cost of rate protection is initially allocated among eligible REP participants in the same manner as would be done without the Settlement. *Id.* In short, the Settlement preserves the ASC framework that exists today under

the REP. Alcoa's claim that BPA has delegated these statutory issues to the settling parties is without merit.

Alcoa claims that BPA may not completely shift or delegate its statutory responsibilities to third parties and cites numerous cases for support. Alcoa Br., REP-12-B-AL-02, at 10, citing *Perot v. Fed. Election Comm'n*, 97 F.3d 553, 559 (D.C. Cir. 1996); *Nat'l Park & Conservation Ass'n v. Stanton*, 54 F. Supp.2d 7, 18 (D.D.C. 1999); *Ocean Conservancy v. Evans*, 260 F. Supp.2d 1162, 1183 (M.D. Fla. 2003). WPAG and APAC raise similar arguments, claiming that by agreeing to set its rates in accordance with the rate provisions of the REP Settlement, BPA is delegating its statutory duty to set rates to the customers that negotiated the REP Settlement. WPAG Br., REP-12-B-WG-01, at 14, n.9; APAC Br. Ex., REP-12-R-AP-01, at 9.

Alcoa's and WPAG's arguments are not persuasive. The cases these parties cite establish nothing more than the general proposition that an agency cannot completely shift or delegate its statutory responsibility to a third party. See *National Park and Conservation Ass'n*, 54 F. Supp.2d 7, 18 (D.D.C. Cir. 1999) (citing *Perot v. Federal Election Comm'n*, 97 F.3d 553, 559 (D.C. Cir. 1996)). As explained above, BPA has delegated nothing to the settling parties; BPA has retained its statutory responsibilities to determine whether the terms of the Northwest Power Act are being followed under the Settlement in the first instance. Moreover, BPA will continue to set future rates in each rate case consistent with its statutory duties in sections 5 and 7. Evaluation Study, REP-12-FS-BPA-01, section 5.1; Bliven *et al.*, REP-12-E-BPA-12, at 2-4, 47-55. The only issue being resolved here is one component of BPA's ratemaking: the implementation of the REP. See 75 Fed. Reg. 78694, at 78695 (2010). For this reason, none of the cases cited by Alcoa and WPAG supports their contention that BPA would be unlawfully delegating its statutory responsibilities to private parties if the Settlement is adopted.

For example, in *Perot v. Fed. Election Comm'n*, 97 F.3d 553 (D.C. Cir. 1996), candidates who were not invited to participate in televised presidential debates claimed the Federal Election Commission (FEC) had unlawfully delegated agency authority when the FEC promulgated regulations that permitted private organization to stage debates and determine who might participate based on "pre-established objective criteria." The candidates claimed that it was the duty of the FEC, not the private organizations, to establish such criteria. *Id.* at 559-560. The Court of Appeals held that the FEC did not delegate authority to private organizations under the regulation because the "authority to determine what the term 'objective criteria' means rests with the agency ...." *Id.* at 560.

In the instant case, BPA, just like the FEC in *Perot*, has retained the final authority to determine whether the Settlement's terms comport with BPA's statutes. The Settlement will not be adopted *unless* it is shown to comply with BPA's statutes, and BPA has shown that it does. Evaluation Study, REP-12-FS-BPA-01, Chapter 11. No delegation has thus occurred.

Furthermore, BPA's current evaluation of the Settlement stands in stark contrast to cases in which the Court has found an unlawful delegation. In *Nat'l Park & Conservation Ass'n v. Stanton*, 54 F. Supp.2d 7, 18 (D.D.C. 1999), another case cited by Alcoa, environmental groups

challenged the National Park Service's (NPS) delegation to a private entity of management authority over a national scenic river. The U.S. District Court held that the NPS's delegation to the private entity of its statutory duty to administer and manage the scenic river was unlawful because the NPS did not retain sufficient final reviewing authority: the NPS retained no oversight over the private entity or final reviewing authority over the entity's actions or inactions. *Id.* at 20-21. Instead, the NPS merely served as a liaison and provided technical support as needed, had only one voting member on the private entity, and retained only the authority to dissolve the entity. *Id.* at 19. The Court found the delegation unlawful because the entity was composed almost wholly of local commercial and land-owning interests that were likely to conflict with the national environmental interests that NPS is statutorily mandated to represent. *Id.* at 20.

In this proceeding, however, BPA *has* retained ultimate control over the decision whether the Settlement is consistent with law. BPA will adopt the Settlement only if it comports with the agency's statutory mandates, including sections 5(c) and 7(b)(2). Evaluation Study, REP-12-FS-BPA-01, section 11.2. BPA's role in this regard is not merely to provide an advisory decision or "technical support," but rather to make an independent determination in the first instance as to whether the Settlement comports with the Northwest Power Act and may be implemented under BPA's statutory authorities. Again, the Settlement does not continue without BPA making this independent determination in this proceeding. *See* Settlement, REP-12-A-02A, § 3.7.

Both Alcoa and WPAG rely on *Sierra Club v. Sigler*, 695 F.2d 957, 962 (5th Cir. 1983) for the proposition that delegations of administrative authority are particularly suspect when they are made to private parties that may be questioned as to their objectivity due to a conflict of interest. Alcoa Br., REP-12-B-AL-02, at 10; WPAG Br., REP-12-E-B-WG-01, at 14, n.9. But the situation in which the Court made these statements bears no resemblance to the Settlement or the analysis BPA has performed in this case. The Court in *Sierra Club*, in *dictum*, expresses concern over the objectivity of the Environmental Impact Statement (EIS) prepared by the Corps of Engineers because it relies heavily on the findings of private consultants hired by applicants for certain deepwater drilling permits. *Sierra Club*, 695 F.2d at 962, n.3. The Court warned that the Corps could not abdicate its statutory duty to prepare an EIS by rubberstamping an EIS prepared by a private consultant, particularly a consulting firm that was hired by the applicant and therefore had a financial interest in the outcome of the project it was evaluating. *Id.*

In this case, BPA has prepared its own analysis to determine the legal validity of the Settlement. While the negotiating parties may believe they have made a Settlement that comports with BPA's statutory duties, and have stated as much in the record of this case, Staff has not taken their word for it. Murphy and Kallstrom, REP-12-E-JP02-02, at 33. Instead, for the better part of eight months, BPA has expended significant resources and dedicated agency personnel with extensive experience with implementing the REP to determine whether the Settlement comports with the law. The extensive record and analysis presented in this case clearly shows that BPA has taken seriously its responsibility to test whether the Settlement follows the Northwest Power Act, and given this fact, this proceeding bears no resemblance to the complete abdication of statutory responsibilities addressed by the Court in *Sierra Club*.

Alcoa argues that the REP Settlement Benefits/Scheduled Amounts under the Settlement are even more suspect than the 2000 REP Settlements. Alcoa Br., REP-12-B-AL-02, at 15. Alcoa claims BPA was a party to, and helped negotiate, the 2000 REP Settlements. *Id.* Here, however, the REP Settlement Benefits/Scheduled Amounts are derived entirely from a settlement negotiated by certain COUs and IOUs. *Id.*

BPA does not see how a settlement negotiated by COUs and IOUs that represent more than 90 percent of the regional loads could be viewed as “even more suspect” than the 2000 REP Settlements. The previous 2000 REP Settlements were negotiated primarily by BPA and regional IOUs. While COUs were permitted to comment on the 2000 REP Settlements, they were not deeply involved in the negotiations and were widely opposed to the agreement once it was finalized. Here, however, representatives of the COUs were intimately involved in the negotiation of the 2012 REP Settlement. *See, generally*, Murphy and Kallstrom, REP-12-E-JP02-02, at 18-20. The Settlement has received broad support from most of BPA’s customers, and over 88.1 percent of BPA’s COU load has signed the Settlement. Not only that, but several of the original parties that filed petitions challenging the 2000 REP Settlements have signed the 2012 REP Settlement. For example, Snohomish PUD, Northwest Requirements Utilities, and the Public Power Council all opposed the original 2000 REP Settlements. These same parties now have signed the 2012 REP Settlement, which Alcoa claims is “even more suspect” than the 2000 REP Settlements. Alcoa’s hyperbole is not supported by the record in this case.

Alcoa argues that rather than using its own settlement authority to negotiate an “agreed ASC,” which Alcoa asserts the Court in *PGE* rejected, BPA is even one step further removed. *Id.* Alcoa asserts that BPA is proposing to adopt (as its own) a Settlement entered into by some (but not all) of its customers. *Id.* Alcoa then relies again on *Sierra Club* to assert that a Federal agency decision to adopt a proposal developed by third parties that stand to benefit from the decision is highly suspect. *Id.*

Alcoa’s arguments reveal that it lacks a basic understanding of what BPA did in the 2000 REP Settlements and what the Court held in *PGE*. BPA did not negotiate an “agreed ASC” under the 2000 REP Settlements. In the 2000 REP Settlements, ASCs played essentially no role in determining whether a utility received REP benefits or how much it received. *See* Residential Exchange Program Settlement ROD at 36 (“the issue of IOUs’ eligibility to receive REP benefits cannot be based on ASC forecasts alone.”). At the time, BPA took the position that ASCs were not necessary for determining a utility’s right to participate in a settlement of the REP, *id.*, and instead, BPA could look to a number of other considerations, such as “the amount of residential and small farm load eligible for the REP, the historical provision of REP benefits, the REP benefits received in the last five-year period ending June 30, 2001, rate impacts on qualifying customers, and the individual needs and objectives of each state.” *Id.* at 81. It was this complete disregard for the use of ASCs in determining REP benefits and BPA’s heavy reliance on its section 2(f) settlement authority that the Court ultimately rejected in *PGE*:

According to BPA, its legal obligations were different, depending on which of those two options its non-preference customers pursued. In BPA’s view, in a

traditional REP agreement with a non-preference customer, such as an IOU, § 5(c) (and, by extension, § 7(b)) would apply. By contrast, with regard to a non-preference customer who chose to enter into a settlement agreement and settle out of any future power claims, BPA took the position that the agreement was governed by § 2(f) only, and it expressly denied that the settlement agreement would be subject to §§ 5(c) and 7(b).

\* \* \* \*

BPA's broad reading of its settlement authority is contrary to a plain reading of the Bonneville Project Act and the [Northwest Power Act], and it is inconsistent with general principles of administrative law.

*PGE*, 501 F.3d 1009, 1027-1028 (9th Cir. 2007).

The 2012 REP Settlement, in contrast, does not repeat these errors. In this case, BPA has not taken the position that its settlement authority can trump other provisions of the Northwest Power Act. Quite to the contrary; BPA has made compliance with section 5(c) and section 7(b) central criteria to determining whether the Settlement could be signed by the Administrator. 75 Fed. Reg. 78694, at 78695 (2010); *see also* Gendron *et al.*, REP-12-E-BPA-04, at 26. To test whether the Settlement complies with these provisions, Staff performs the 7(b)(2) rate test for each year (and the ensuing four years) of the Settlement, using ASCs developed from the existing ASC Methodology. Bliven *et al.*, REP-12-E-BPA-12, at 51. Staff tests the total amount of REP benefits under the Settlement to determine whether recovering this amount of REP benefits in rates comports with the protections afforded by the 7(b)(2) rate test. *Id.* In this way, Staff's analysis in this case goes far beyond simply determining whether a particular IOU would be "eligible" for REP benefits under the Settlement; it is a test of whether the REP benefits provided in the Settlement are permissible under the law. *Id.*

Finally, the fact that a set of private parties makes a recommendation to an agency that the agency adopts as its own does not make the agency's decision an unlawful delegation. Courts *routinely* affirm agency decisions that are based on settlements developed by private parties. For example, in *Mobil Oil Corp. v. Federal Power Comm'n*, 417 U.S. 283, 297 (1974), the United States Supreme Court found that it was appropriate for the Federal Power Commission to adopt a settlement proposal that was submitted by a private party in litigation over the FPC's establishment of an area rate structure for interstate sales of natural gas produced in Southern Louisiana. The settlement was admitted into the record, and the Commission "weighed its terms by reference to the entire record in the Southern Louisiana area proceeding since 1961, and further supplemented that record with extensive testimony and exhibits directed at the proposal's terms." *Id.* at 312-313. The Commission then adopted the terms of the settlement. *Id.* One of the parties to the proceeding objected, claiming that the Commission was without power to adopt as a rate order a settlement proposal that "lacks unanimous agreement of the parties to the proceeding." The Supreme Court responded that such a contention "has no merit." *Id.* at 312.

The Supreme Court then quoted with approval the appellate court's finding that "if there is a lack of unanimity, it may be adopted as a resolution on the merits, if FPC makes an independent

finding supported by ‘substantial evidence on the record as a whole’ that the proposal will establish ‘just and reasonable’ rates for the area.” *Id.* 314. The Court concluded that “[t]he choice of an *appropriate structure* for the *rate order* is a matter of *Commission discretion*, to be tested *by its effects*. The choice is not the less appropriate because the Commission did not conceive of the structure independently.” *Id.* at 314 (emphasis added).

The administrative law principles recognized by the Court in *Mobil Oil* are instructive to the issues in this case. Parties to this proceeding have presented into the record a Settlement that would resolve longstanding and contentious litigation. BPA did not simply accept these parties’ recommendations, but rather “weighed its terms” by reference to the extensive record developed in this case and BPA’s statutory duties under the Northwest Power Act. *Gendron et al.*, REP-12-E-BPA-04, at 26-38; *see also* Evaluation Study, REP-12-FS-BPA-01, Chapter 10. Based on this evaluation, BPA finds that the “substantial evidence on the record as a whole” supports a finding that the Settlement complies with all relevant sections of the Northwest Power Act and the Court’s holdings in *PGE* and *Golden NW*. *Gendron et al.*, REP-12-E-BPA-04, at 26-38. BPA’s adoption of the Settlement, then, is in no way unlawful simply because BPA “did not conceive of the structure independently.” *Mobil Oil*, 417 U.S. at 314.

In conclusion, no unlawful delegation has occurred in this case. The key legal issue with agency delegation concerns whether the agency retains ultimate authority to depart from or ignore the recommendation. *See Riverbend Farms, Inc. v. Madigan*, 958 F.2d 1479, 1488 (9th Cir. 1992). BPA, in this case, has clearly retained the ultimate authority to choose whether or not to adopt the Settlement. This choice has not been ethereal or hypothetical, but real and present at all times through this case in that BPA has been evaluating two proposals for implementing the REP for the FY 2012–2013 rate period: the proposed Settlement, and a traditional implementation of the REP. The parties did not ask BPA to present an alternative to the Settlement, but BPA nonetheless entered into the record of this case the traditional implementation of the REP that all parties contest. BPA did so to position itself throughout this case to implement either answer, depending upon (1) achievement of the signing threshold and (2) the Administrator’s specific findings on the legality of the Settlement’s terms. In short, BPA has not only retained unto itself the ultimate authority to determine whether the Settlement complies with the Northwest Power Act, but BPA has done so in such a way as to ensure that the Administrator had a true choice: either adopt the Settlement and implement its terms in rates, or decline the settling parties’ recommendation and return to the traditional REP. BPA has delegated no statutory responsibilities to the negotiating parties.

### **Decision**

*BPA has not unlawfully delegated to the negotiating parties its statutory authority to determine REP benefits.*

### **Issue 4.5.3**

*Whether the Settlement properly retains the features of the REP required by section 5(c) and resembles the REP envisioned by Congress in all material respects.*

#### **Parties' Positions**

Alcoa, APAC, and WPAG contend that the Settlement departs from the REP construct created by Congress in section 5(c). Alcoa Br., REP-12-B-AL-02, at 10-15; APAC Br., REP-12-B-AP-01, at 8-9; APAC Br. Ex., REP-12-R-AP-01, at 8; WPAG Br., REP-12-B-WG-01, at 10; WPAG Br. Ex., REP-12-R-WG-01, at 20-21. These parties, in various ways, argue that the REP benefits provided under the Settlement will not be determined by application of the traditional comparison of the IOUs' ASCs and BPA's PF Exchange rates, with the difference being multiplied by the utilities' exchange load. *Id.*

#### **BPA Staff's Position**

The Settlement retains all of the essential features of the REP required by section 5(c). Bliven *et al.*, REP-12-E-BPA-12, at 41-47. The REP will continue to be implemented as a power exchange between BPA and IOUs. *Id.* The IOUs will continue to file ASCs with BPA pursuant to the 2008 ASC Methodology and will sell power to BPA at the IOUs' ASCs. *Id.* BPA will continue to establish PF Exchange rates and sell power to the IOUs at BPA's PF Exchange rate. *Id.* REP benefits for each individual IOU will also be established based on a comparison of the utility's ASC and BPA's PF Exchange rate. *Id.*

#### **Evaluation of Positions**

Alcoa contends that the Settlement is patently inconsistent with the administrative structure Congress enacted. Alcoa Br., REP-12-B-AL-02, at 10. Alcoa asserts that the Northwest Power Act obligates BPA to determine REP benefits based on qualifying utilities' ASCs, but the proposed Settlement displaces that statutory standard. *Id.* Alcoa further states that BPA is not following the plain language of section 5(c) by not determining each utility's REP benefits on a case-by-case basis by comparing a utility's ASC with the PF Exchange rate and multiplying the difference by qualifying loads. *Id.* at 12. Instead, Alcoa asserts, total REP benefits are fixed pursuant to the Settlement. *Id.*

APAC raises a similar argument, claiming that the Settlement violates the Northwest Power Act by setting a REP benefit without regard to the IOUs' ASCs or the difference between the ASCs and the PF Exchange rate. APAC Br., REP-12-B-AP-01, at 8. APAC contends that the Settlement sets the REP benefit without regard to the comparative level of ASCs and the Exchange rate. *Id.* WPAG raises similar arguments. WPAG Br., REP-12-B-WG-01, at 10. In its brief on exceptions, however, APAC concedes that the Settlement "nominally follows" the statutory construct. APAC Br. Ex., REP-12-R-AP-01, at 8-9.

BPA fundamentally disagrees with these parties' views of the Settlement. First, Alcoa is simply wrong to assert that the Settlement is "patently inconsistent with the administrative structure

Congress enacted” or does not follow the “plain language” of section 5(c). Section 5(c) of the Northwest Power Act provides as follows:

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

16 U.S.C. § 839c(c)(1). Section 5(c)(7) further states that the “average system cost” for electric power sold to the Administrator under section 5(c)(1) must be “determined by the Administrator on the basis of a methodology developed for this purpose in consultation with the Council, the Administrator’s customers, and appropriate State regulatory bodies in the region.” *Id.* § 839c(c)(7).

Following the plain language of section 5(c), three things are needed to determine an individual utility’s REP benefits: (1) the utility’s ASC as determined by BPA’s ASC Methodology; (2) the rate BPA establishes pursuant to section 7 for the sale of power to the IOUs under the REP (referred to as the PF Exchange rate); and (3) the amount of the individual utility’s exchange load. As explained throughout Staff’s direct and rebuttal cases, these three features of the REP are alive and well under the Settlement. Bliven *et al.*, REP-12-E-BPA-17, at 19; Forman *et al.*, REP-12-E-BPA-10, at 5-6, 18; Bliven *et al.*, REP-12-E-BPA-12, at 41-47.

First, BPA will continue to pay each IOU at the rate established by its ASC. *Id.*; *see also* REPSIA, REP-12-A-02A, Exhibit A. Section 5 of the REPSIA provides:

5.1 Subject to the limitations set forth below in section 5.2, «Customer Name» shall offer and BPA shall purchase each month of each Fiscal Year an amount of electric power equal to the Residential Load of «Customer Name» beginning with the first month of the initial Exchange Period established under section 4 above.

5.2 The rate for such power sale to BPA shall be equal to «Customer Name»’s ASC, as determined by BPA using the ASC Methodology. «Customer Name» may sell only an amount of electric power under this section 5 that is equal to the Residential Load of «Customer Name».

*Id.* § 5. Each IOU is also required to make ASC filings with BPA pursuant to BPA’s ASC Methodology. *Id.* Section 4 of the REPSIA states:

Once «Customer Name» files an initial Appendix 1, «Customer Name» shall continue to file a new Appendix 1 as required by the ASC Methodology, unless and until «Customer Name» elects to suspend this Agreement pursuant to section 11 below[.]

*Id.* § 4. BPA will continue to establish ASCs for utilities that file an Appendix 1 every two years.

Second, BPA will continue to sell power to the IOUs at BPA's specified exchange rate. Forman *et al.*, REP-12-E-BPA-10, at 18. Section 6 of the REPSIA states:

6.1 Simultaneous with the offer by «Customer Name» and purchase by BPA pursuant to section 5 above, subject to the suspensions provisions set forth in section 11 below, BPA shall offer and «Customer Name» shall purchase each month an amount of electric power equal to the Residential Load that «Customer Name» offers and BPA purchases each month pursuant to section 5.

6.2 The rate for such power sale to «Customer Name» shall be the Utility-Specific Exchange Rate applicable to «Customer Name» as established pursuant to section 3 above.

REPSIA, REP-12-A-02A, Exhibit A, § 6. The PF Exchange rates that BPA establishes to “sell” power to the IOUs under section 6 will be, for the most part, calculated in the same manner as previous PF Exchange rates prior to the Settlement. Bliven *et al.*, REP-12-E-BPA-05, at 6. The PF Exchange rate will also be calculated in each rate case and will be used to compute the amount of REP benefits each IOU will receive under the REP. Bliven *et al.*, REP-12-E-BPA-12, at 41, 45. BPA discusses elsewhere in this ROD the basis for the development of the PF Exchange rate. *See* Chapter 5.

APAC claims that the Settlement violates section 5(c) because REP benefits are determined by the difference between ASCs and a PF Exchange rate that is “fixed” by the amount of REP benefits from the Settlement. APAC Br. Ex., REP-12-R-AP-01, at 8. BPA disagrees. The PF Exchange rate, as noted above, will not be “fixed” under the Settlement. Rather, the PF Exchange rate will be revised in each rate proceeding as required by section 7(b) and will continue to be used to establish each IOU's REP benefits. To the extent APAC means to argue that it is improper for BPA to set the PF Exchange rate to ensure the amount of REP benefits included in rates is actually paid, its argument lacks merit. As noted in Issue 4.5.1, BPA *must* set the PF Exchange rate to ensure the amount included in rates is paid, regardless of whether the Settlement is adopted or not. Adjusting the PF Exchange rate to the level of REP benefits (and rate protection) is the only way BPA can ensure that the rate protection of section 7(b)(2) is being afforded to COUs. If the PF Exchange rate were set in a manner *indifferent* to the results of the forecast of REP benefits, then section 7(b)(2) would be meaningless. The Settlement retains the requirement that the PF Exchange rate be adjusted to pay out no more than the amount of REP benefits included in rates. Provided that those aggregate REP benefits comply with the protections afforded by the Northwest Power Act (which BPA believes they do), there is no statutory violation.

Third, BPA will continue to purchase an amount of exchange power from each eligible IOU in the amount of its qualified residential and small farm load and sell an equal amount of power to each eligible IOU. Bliven *et al.*, REP-12-E-BPA-12, at 41-42. As noted above, section 5 of the REPSIA provides that BPA “shall purchase each month of each Fiscal Year an amount of electric power equal to the Residential Load of” the utility. *Id.* Section 6 of the REPSIA further provides that the utility, in turn, must purchase “each month an amount of electric power equal to the Residential Load that” the utility offers to BPA. *Id.* Under these provisions, if the

exchanging IOU has no Residential Load, then there is no exchange, and the utility receives no REP benefits. *Id.*

Thus, the Settlement in no way displaces the administrative structure put in place by Congress for paying REP benefits to individual IOUs as prescribed by section 5(c). Every step of the process is in place, just as under the “traditional” implementation of the REP. The IOUs will continue to file ASCs with BPA pursuant to BPA’s ASC Methodology, BPA will continue to calculate PF Exchange rates, and REP benefits will continue to be paid based on a comparison of the utilities’ ASCs and BPA’s PF Exchange rate with the difference multiplied by the utilities’ qualified exchange loads. BPA will explain in more detail the Settlement’s compliance with the 2008 ASC Methodology in Issue 4.5.7. Alcoa’s contention that the Settlement violates the plain language of section 5(c) is without merit.

Alcoa contends that REP benefits will not be determined in each rate case or on a “case-by-case” basis. Alcoa Br., REP-12-B-AL-02, at 10-15. This assertion is misguided. Under the Settlement, each individual IOU’s REP benefits will in fact be determined on a “case-by-case” basis each rate period. The Scheduled Amounts will not be allocated based on a utility’s ASC relative to other utilities’ ASCs. Bliven *et al.*, REP-12-E-BPA-12, at 47. Rather, the utility’s ASC must, in the first instance, exceed BPA’s applicable PF Exchange rate to qualify for REP benefits, as is the case under the no-Settlement implementation of the REP. *Id.* If the utility’s ASC does not exceed the applicable PF Exchange rate, then that utility will receive no REP benefits. *Id.*; *see also* Bliven *et al.*, REP-12-E-BPA-12, at 42 (“If an IOU’s ASC is less than the applicable PF Exchange rate, then under either the Settlement or no-Settlement, such IOU receives no REP benefits.”). Furthermore, the amount of REP benefits the IOU receives is also based on a comparison of the utility’s ASC with BPA’s PF Exchange rate. The higher the utility’s ASC is compared to BPA’s PF Exchange rate, the larger the share of the REP benefits the utility gets. Bliven *et al.*, REP-12-E-BPA-17, at 20. This is the same evaluation BPA performs under the traditional implementation of the REP to determine eligibility and distribution of REP benefits. *Id.* at 19-20. Under the Settlement, BPA will continue to compare the IOUs’ ASCs with BPA’s PF Exchange rates every rate period to determine (1) which IOUs are entitled to REP benefits; and (2) how much each of them gets.

Alcoa claims that the payments are “fixed” under the Settlement, but Alcoa misreads the Settlement. Alcoa Br., REP-12-B-AL-02, at 12. While the Settlement establishes a total REP benefit to include in rates, it in no way determines what each IOU receives. There can be little dispute that the settling parties retained section 5(c) as the means and method for determining individual IOUs’ REP benefits under the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 28. As stated above, the three criteria Alcoa identifies as necessary for determining REP benefits (ASCs, PF Exchange, and exchange load) will continue to be used to determine each IOU’s respective amount of REP benefits. *Id.* BPA has already responded to Alcoa’s concern that the “plain language” of section 5(c) requires BPA to establish aggregate REP benefits for all IOUs and Alcoa’s arguments against the “fixed” nature of the REP benefits. *See* Issue 4.5.1.

Alcoa argues that “in direct conflict with *PGE*, BPA would not calculate its revenue requirements for REP benefits consistent with the express terms of Section 5(c) because it is not basing its revenue requirements on the difference between ASCs and the PF Exchange rate.” Alcoa Br., REP-12-B-AL-02, at 14. But this is not so. As explained by Staff in the record of this case, BPA will continue to determine the total cost of the REP in its rates:

rates would continue to be set in a manner reflecting the purchase and sale of exchange power. The Power Rates Study in the BP-12 docket sets forth the manner in which REP costs are included in ratesetting. As shown on Table 2.1.3, ASCs are multiplied by exchange loads to derive exchange resource costs for each year of the rate period. Power Rates Study Documentation, BP-12-E-BPA-01A, at 24. The *total exchange resource costs are included in the revenue requirement (which amounts also include REP Support costs)*. *Id.* at 36, Table 2.3.2, line 30. These costs are then allocated to the rate pools. *Id.* at 42, Table 2.3.4.4, lines 46-49. The amounts of exchange resource costs allocated to the PF rate are a portion of the total costs used to set the [PF Exchange] rates to determine base exchange benefits, otherwise called Unconstrained Benefits. *Id.* at 64, Table 2.4.10. The [PF Exchange] rate is then allocated a share of the costs of rate protection. *Id.* at 67, Table 2.4.13, line 28. The rate protection costs allocated to the [PF Exchange] rate are then allocated to each REP participating utility to determine the 7(b)(3) surcharge for each utility. *Id.* at 65, Table 2.4.11. Finally, once the [PF Exchange] rates have been determined, the REP benefits payable to each utility can be determined. *Id.* at 66, Table 2.4.12.

Bliven *et al.*, REP-12-E-BPA-12, at 42. Staff further explains that from a ratemaking perspective, BPA would continue to reflect the REP as an exchange in rates under the Settlement. Bliven *et al.*, REP-12-E-BPA-17, at 21, *citing* FY 2012–2013 Section 7(b)(2) Rate Test Study, REP-12-E-BPA-02, sections 2.1.1.1 and 2.1.1.2. Thus, BPA would still consider the IOUs’ sale to BPA of power at their ASCs as an exchange resource, and BPA would continue to treat the IOUs’ residential and small farm load as a load on BPA. *Id.*, *citing* FY 2012–2013 Section 7(b)(2) Rate Test Study Documentation, REP-12-E-BPA-02A, Table 1.1.3, and Table 1.2.2.1, lines 15 and 60. Insofar as the REP has ever been a purchase and sale, it remains one under the Settlement. *Id.*

Alcoa argues that ASCs will be calculated solely for purposes of determining each participating utility’s share of the total REP benefits/Scheduled Amounts fixed under the Settlement. Alcoa Br., REP-12-B-AL-02, at 14. Alcoa claims that contrary to section 5(c) of the Northwest Power Act, the Settlement decides the amount of the revenue requirement pie, while BPA merely decides how large a slice each exchanging utility will get. *Id.* APAC echoes this theme, contending that, although the total REP benefits are allocated among the individual IOUs using their respective ASCs, limited use of the ASCs only allocates the proportion of REP benefits between IOUs. APAC Br., REP-12-B-AP-01, at 8. APAC asserts the Settlement does not determine whether the actual level of REP benefits assigned to a particular IOU is permissible under the Northwest Power Act. *Id.*

Alcoa and APAC ignore the record in this case. As described above, in terms of ratemaking, the IOUs' ASCs will still be treated "in a manner reflecting the purchase and sale of exchange power." Bliven *et al.*, REP-12-E-BPA-12, at 42. Thus, contrary to Alcoa's claims that ASCs will be used only as a means of "divvying up the pie," ASCs will continue to play the same role in BPA ratemaking as they do today. Power Rates Study, BP-12-FS-BPA-01, Chapter 8. Furthermore, nowhere in section 5(c) is there any instruction on how BPA should calculate its revenue requirement. As explained above, section 5(c) directs BPA how to conduct an exchange with a REP participant. Aggregate REP costs are determined pursuant to sections 7(b)(1) and 7(b)(2) of the Northwest Power Act. Once the size of the aggregate REP is determined, BPA will use ASCs, PF Exchange rates, and qualifying exchange load to determine each utility's REP benefits, whether under the Settlement or under no settlement.

APAC is correct that the Settlement does not determine whether the actual level of REP benefits assigned to a particular IOU is permissible under the Northwest Power Act, because that is BPA's responsibility, not the settling parties'. In this case, BPA determines that the aggregate level of REP benefits provided under the Settlement comports with BPA's statutes. *See* Chapters 4, 5, and 6. Moreover, BPA finds here that the distribution of those payments is being administered in a manner that closely resembles the REP envisioned by Congress in section 5(c). In this way, the Settlement is consistent with BPA's statutory authority and is consistent with law.

Alcoa attempts to draw comparisons between the proposed Settlement being evaluated in this case and the 2000 REP Settlements struck down by the Court in *PGE*. Alcoa Br., REP-12-B-AL-02, at 10, 15. Such comparisons are inapposite. *See* Chapter 7 for a complete discussion of the comparison of the Settlement to *PGE* and *Golden NW*.

First, Alcoa claims that the Settlement fails the Court's requirement that a settlement of the REP "resemble the REP program created in §§ 5(c) and 7(b) that it purports to be settling." Alcoa Br., REP-12-B-AL-02, at 10. BPA is frankly at a loss as to how the Settlement, or any other arrangement including the current REP, could be closer to these statutory requirements. As already described, BPA will continue to purchase and sell exchange energy under the Settlement; the IOUs must continue to file ASCs pursuant to BPA's ASC Methodology; REP benefit payments will be based on a comparison of the utility's ASC and BPA's PF Exchange rate, which will be determined each rate period; and IOUs with ASCs below BPA's applicable PF Exchange rate will receive no REP benefits. In all these features, the Settlement not only resembles the REP, the Settlement is identical to the REP. The only place where the REP and the Settlement are different is in determining the total amount of REP benefits to provide the IOUs as a *class*. In this respect, Alcoa is correct to the extent that it means the Settlement "substitutes" a lower amount of REP benefits for the term of the Settlement for the greater amount of REP benefits that (under BPA's Reference Case) would be paid to the IOUs this rate period and that would likely be paid in future rate periods. Bliven *et al.*, REP-12-E-BPA-12, at 43. But such substitution is not unlawful, because the IOUs may waive their right to such higher payments. *See* Issue 4.5.1. For these reasons, the Settlement resembles the REP in every substantive way and protects the position of the COUs consistent with section 7(b)(2) and the

Court's decision in *PGE*. What the Settlement bears no resemblance to is the 2000 REP Settlements struck down by the Court.

Second, Alcoa claims that the flaws in the 2000 REP Settlements also plague the Settlement here. Alcoa Br., REP-12-B-AL-02, at 15. Specifically, Alcoa alleges that BPA is not calculating REP benefits consistent with section 5(c) because BPA is not basing aggregate REP benefits on the participating utilities' ASCs.

BPA disagrees. The fact that the aggregate REP benefits were negotiated does not render them unlawful in the first instance. *See* Issue 4.5.1. As noted in the previous issue, the IOUs may waive their rights to greater REP benefits. The critical question, then, is whether the aggregate REP benefits provided under the Settlement exceed what the Northwest Power Act permits. As explained throughout this ROD, BPA's analysis demonstrates that no such violation has occurred. *See* Chapters 3, 4, and 5.

Alcoa's claim that BPA has not calculated aggregate REP benefits consistent with section 5(c) is also incorrect. BPA has not simply taken the settling parties' word that the Settlement provides the necessary protection from REP costs afforded by the statute. Instead, in the analysis phase of this case, Staff calculates aggregate REP benefits multiple times in a manner consistent with section 5(c) to test whether these payments comply with the Northwest Power Act. Evaluation Study, REP-12-FS-BPA-01, chapter 11. As explained more thoroughly in the next issue, Staff's long-term forecast of ASCs relies on the IOUs' most recent ASC filings and uses the FERC-approved 2008 ASC Methodology to forecast future REP benefits. Staff also performs an extensive analysis on future resource acquisitions to ensure that BPA's long-term ASC forecast model reflects as closely as technically possible the potential future growth of ASCs. This technical analysis, which takes up almost 3,000 pages of the record in this case, has not been refuted by any party, including Alcoa.

APAC argues BPA's disregard of actual ASC levels is also demonstrated by section 6.1.2 of the Settlement, pursuant to which BPA would adjust unconstrained benefits if ASCs are too low to pay the entire settlement amount. APAC Br., REP-12-B-AP-01, at 8. APAC claims that if an exchanging utility would not have been entitled to REP benefits because its ASC is lower than BPA's PF Exchange rate, this provision may permit manipulation of the benefit calculation such that that utility could receive benefits solely to preserve the payment of the Scheduled Amounts. *Id.* at 8-9. APAC states that under the proposed Settlement, the re-determined settlement amounts drive the rate determinations in this case, not the IOUs' actual costs. *Id.* at 9.

APAC misreads section 6.1.2. The purpose of section 6.1.2 is to ensure that the total amount of REP benefits provided for under the Settlement is paid out to the IOUs consistent with the analysis being performed in this case. It does not, as APAC appears to believe, ensure that any one IOU receives REP benefits. During the later phase of the negotiations on the Settlement, Staff worked with the parties to test the formulas in the Settlement to ensure they would function over time. As part of this testing process, Staff identified a potential anomalous rate result that could potentially affect the IOUs' right (as a class) to the total Scheduled Amounts under the

formulas developed in the Settlement. This anomalous scenario was predicated on BPA experiencing near catastrophic rate increases while regional IOUs were experiencing unprecedented reductions in the cost of their resources, with the end result being that BPA's cost of power was higher than *all* of the *IOUs'* cost of power. Staff determined that under this extremely unlikely and anomalous situation, the formulas in the Settlement would not function. To address this highly improbable scenario (a scenario that BPA could not reproduce in its long-term analysis) the parties developed section 6.1.2 to provide instructions to BPA on how to develop rates to ensure that the parties' original bargain would be preserved.

APAC claims that this provision might permit manipulation of the benefit calculation such that a utility could receive benefits solely to preserve the payment of the Scheduled Amounts. Section 6.1.2 does no such thing. APAC Br., REP-12-B-AP-01, at 8. Instead, section 6.1.2 simply preserves the parties' original bargain that the IOUs, as a class, receive REP benefits consistent with Table 3.1. When distributing these benefits, BPA will continue to calculate a PF Exchange rate and a utility's ASC even under section 6.1.2. Only utilities with ASCs in excess of the PF Exchange rate calculated under section 6.1.2 will be entitled to REP benefits.

APAC acknowledges that the Settlement "nominally" complies with the requirements of section 5(c). APAC Br. Ex., REP-12-R-AP-01, at 10. However, APAC complains that section 6.1.2. may permit IOUs to become eligible for the REP that had not been so initially. *Id.* APAC argues that section 6.1.2 demonstrates that the Settlement substitutes total REP benefits for the REP benefits to be determined under section 7(b)(2). *Id.*

BPA disagrees with APAC's assessment of section 6.1.2. As noted above, section 6.1.2. is intended to address anomalies in BPA's ratemaking that would prevent the formulas in the Settlement from functioning properly. If section 6.1.2 were implemented, BPA would still set a PF Exchange rate and would still compare the IOUs' ASCs to this rate to determine which utilities were and were not eligible. Those IOUs with the highest ASCs and largest exchange loads would continue to receive most of the REP benefits, and those IOUs with ASCs below BPA's PF Exchange rate would receive none. The only difference in this scenario is that the PF Exchange rate would be reduced to ensure that the total REP benefits to be paid that year would be distributed. Section 6.1.2 does nothing more than provide some certainty to the IOUs that the deal they have agreed to provides them with the agreed-upon Settlement value in what can only be described as a worst-case scenario. Considering that the IOUs are agreeing to take far less REP benefits than BPA forecasts they would be entitled to had the Settlement not been adopted for this rate period and every rate period until FY 2028, BPA does not see the harm in providing them a measure of security that the value they give up today for the certainty of tomorrow will, in fact, come true.

APAC claims that section 6.1.2 demonstrates that the Settlement substitutes total REP benefits for the REP benefits to be determined under section 7(b)(2). APAC Br. Ex., REP-12-R-AP-01, at 10. APAC is mistaken. This proceeding is determining whether the Settlement's schedule of REP benefits is permitted by the Northwest Power Act. BPA's long-term forecast analysis shows that, using BPA's Reference Case and under most litigation scenarios evaluated

(excepting where multiple COU positions are combined), the Settlement provides superior rate protection. That being the case, the Settlement's stream of payments is permissible under the Northwest Power Act.

Moreover, even if section 6.1.2. were triggered, it would not violate section 5(c). Again, section 6.1.2 simply revises the Reference Rate used under the Settlement to ensure that it pays out the entire amount of REP benefits that BPA includes in rates. ASCs and PF Exchange rates still play their statutory role in distributing these REP benefits in this instance.

Finally, APAC's challenge to a contract provision that BPA has not, and will likely never, implement is not ripe at this time. The only way section 6.1.2 becomes operative is if, essentially, BPA's cost of power exceeds all of the IOUs' respective costs of power. The chances of this event occurring are remote. BPA produced numerous scenarios in its analysis, and even stress-tested the Reference Case, to see what would happen if there were a precipitous decline in the IOUs' ASCs while BPA's costs continually increased. BPA was unable to produce any results that would have triggered section 6.1.2. Moreover, even if such an event did occur, section 6.1.2 does not describe the ratemaking steps BPA would take to implement it. In fact, at this point, BPA does not know what ratemaking actions it would take to implement section 6.1.2. BPA has never in its 30-year history of setting rates under the Northwest Power Act faced a situation of the kind that would trigger section 6.1.2, and BPA does not believe that there is any likelihood of having to face it over the next 17 years. If section 6.1.2. were triggered, BPA would have to evaluate its ratemaking to determine how best to implement this provision based on the facts at the time.

WPAG argues that the underlying purpose of the REP is to provide monetary benefits to utilities with high wholesale power costs. WPAG Br. Ex., REP-12-R-WG-01, at 20. WPAG contends that the statutory REP benefit calculation and distribution method is designed to ensure that the retail customers facing the highest wholesale power costs (those utilities with the highest ASCs) receive the bulk of the REP benefits available to help offset those costs, subject to the limits of the 7(b)(2) rate test. *Id.* at 20-21. Conversely, WPAG asserts the REP operates to ensure that the REP benefits are paid to only the IOUs, and charged to preference customers, when there is a legally sufficient need to do so. *Id.* at 21. WPAG then claims the Settlement operates contrary to these basic policy objectives in a number of ways. *Id.*

First, WPAG claims that by fixing contractually the amount of the REP benefits to be paid the Settlement disconnects the amount of the REP benefits paid from any measure of the need for such payment, which the statute measures as the difference between the ASCs and the PF Exchange Rate. *Id.* WPAG's claim that the REP benefits under the Settlement are not being paid based on the difference between the IOUs' ASCs and BPA's PF Exchange rate is refuted by the record in this case and the plain language of the Settlement. As stated above, the Settlement retains the exchange-based relationship between BPA and the IOUs, with the IOUs selling power at their ASCs (which will be established in accordance with the 2008 ASC Methodology) and BPA selling power to the IOUs at BPA's PF Exchange rate. It is indisputable that the amount of REP benefits each IOU receives under the Settlement will be determined in direct relation to the

comparison between such IOU's ASC and the applicable PF Exchange rate. IOUs with higher ASCs and larger exchange loads will receive more REP benefits than IOUs with low ASCs or low exchange loads. Indeed, IOUs with no exchange loads or ASCs below BPA's PF Exchange rate will receive no REP benefits under the Settlement. Bliven *et al.*, REP-12-E-BPA-12, at 42 ("If an IOU's ASC is less than the applicable PF Exchange rate, then under either the Settlement or no-Settlement, such IOU receives no REP benefits."). This is exactly the way the REP works today in the no-settlement alternative. WPAG need look no further than to the REP payments for FY 2012–2013 to see that the IOUs with the highest ASCs and largest exchange loads receive the most under the Settlement.

For example, Puget Sound Energy has the second highest ASC of over \$66/MWh and the largest forecast total exchange load of 1,371 aMW in FY 2012–2013. Power Rates Study Documentation, BP-12-FS-BPA-01A, Table 2.4.12. Under the Settlement, Puget will be receiving the bulk of the REP benefits, or approximately \$75 million (net of Refund Amounts), in FY 2012–2013. *Id.* Contrast Puget's payment with that of Idaho Power. Idaho Power is fourth in terms of size of overall exchange load, but has the lowest ASC at \$47/MWh. *Id.* Under the Settlement, it receives the least amount of REP benefits, at \$2.5 million. *Id.*

As the foregoing discussion makes clear, WPAG's claim that the Settlement "disconnects" the payment of REP benefits from the statutorily required comparison of ASCs and the PF Exchange rate is incorrect.

WPAG claims that the "fixed" nature of the REP benefits under the Settlement will "diverge" during the 17 years of the settlement, both in amount and by utility, from the need for such payment. WPAG Br. Ex., REP-12-R-WG-01, at 21. WPAG claims that this is bad for BPA, the IOUs, and the preference customers. *Id.* WPAG's argument is not persuasive. The "fixed" nature of the aggregate REP benefits under the Settlement has no bearing on which IOUs receive these payments. As noted above, ASCs will continue to be filed and PF Exchange rates set every rate period. Thus, throughout the entire term of the Settlement, the IOUs with the highest ASCs and largest exchange loads will receive the largest share of REP benefits under the Settlement. WPAG has cited no evidence in the record of this case demonstrating otherwise. As to WPAG's concern that the IOUs may be giving up more than they would otherwise receive under the traditional REP, that is the IOUs' prerogative. As noted in Issue 4.5.1, the Ninth Circuit has expressly held that utilities may waive their statutory rights under section 5(c). This is what the IOUs have done in this case. It is unclear why WPAG believes allowing the IOUs to waive their statutory rights to full REP benefits (as calculated by BPA) is "bad," particularly considering that such waiver results in lower rates for all COU ratepayers, including WPAG's members.

WPAG next asserts that the Settlement frustrates the basic objectives of the statutory REP by permitting the IOUs to reallocate amongst themselves, and in a manner that is inconsistent with their relative ASCs, the REP benefits provided to them under the Settlement. WPAG Br. Ex., REP-12-R-WG-01, at 21, *citing* Settlement, REP-12-A-02A, § 6.2. WPAG claims that section 6.2 of the Settlement virtually ensures that the retail customers most in need of the power cost relief provided by the REP will not receive it, thereby defeating the underlying purpose of

the REP. *Id.* WPAG argues that while the Settlement-sanctioned reallocation may serve a worthwhile purpose from the viewpoint of the IOUs, it is contrary to the underlying purpose of the REP. *Id.*

This argument is faulty for two reasons. First, WPAG is raising this issue for the first time in its brief on exceptions. BPA's procedural rules do not permit parties to raise, for the first time, new arguments in their briefs on exceptions. *See Procedures Governing BPA Rate Hearings*, § 1010.13(b), (c).

Second, even if WPAG's argument were properly before BPA, it is without merit. To understand the genesis of section 6.2 of the Settlement, some background is necessary.

Under BPA's previous Lookback construct, IOUs made different levels of progress in repaying their Lookback Amounts. Gendron *et al.*, REP-12-E-BPA-04, at 15. Although each of the IOUs disputes the existence and level of its Lookback Amount, all have recognized that between FY 2009 and FY 2011 BPA has withheld differing amounts of REP benefits from each IOU in order to make refund payments to the COUs. *Id.* at 15-16. During this period, IOUs with larger REP benefits relative to their Lookback Amounts have repaid a larger fraction of their Lookback obligations. *Id.* at 16. By the end of FY 2011, some IOUs will have paid off as much as 55 percent of their Lookback Amounts, while another will have paid off none. *Id.* Indeed, one IOU has completely repaid its Lookback Amount.

Section 6 of the Settlement recognizes these differences. To reflect these differences, the IOUs have requested BPA to redistribute among the IOUs the amount of rate protection dollars allocated under the Settlement to reflect the reallocation established in the IOUs' agreed-upon method to equalize such differential effects. *Id.* In addition, the IOU reallocation recognizes that the benefits that Idaho Power gains from the Settlement are much greater than those of the other IOUs because of the settlement of Idaho's deemer balance and the fact that its Lookback Amount would have been discharged without any reductions in Idaho Power's REP benefits. *Id.* Thus, Idaho Power has agreed to a downward adjustment of its REP benefits by accepting a greater allocation of rate protection to its PF Exchange rate. *Id.*

WPAG argues that the Settlement distributes REP benefits in a manner that is inconsistent with the IOUs' relative ASCs, and cites section 6.2 of the Settlement. WPAG Br. Ex., REP-12-R-WG-01, at 21, *citing* Settlement, REP-12-E-BPA-11, § 6. WPAG, however, is incorrect because REP benefits will continue to be paid based on the relative comparison between the IOUs' ASCs and BPA's established PF Exchange rates. The PF Exchange rates in this instance will reflect the adjustments identified in section 6.2 through a reallocation of rate protection among each IOU's respective PF Exchange rate. Gendron *et al.*, REP-12-E-BPA-04, at 16; *see also* Evaluation Study, REP-12-FS-BPA-01, section 4.3.9. That is, the IOU reallocation is treated as an adjustment to the allocation of the cost of rate protection assigned to each IOU. Gendron *et al.*, REP-12-E-BPA-04, at 16. Thus, some IOUs' allocation of rate protection would be increased, and others' would be decreased. *Id.* No unlawful allocation has occurred, however, because the total rate protection assignable to the PF Exchange rate class is still being allocated

consistent with the directives of section 7(b), and no other class of BPA ratepayers is affected by the reallocation among the IOUs' PF Exchange rates:

The IOUs' reallocations have been agreed to among them and can be implemented in a way that does not introduce any change to the section 5(c) procedures or any change in the section 7 ratemaking directives. It does not change the costs borne by any other customer group.

Evaluation Study, REP-12-FS-BPA-01, section 11.3. The resulting PF Exchange rates will then be compared to the IOUs' ASCs to determine each IOU's respective level of REP benefits.

Moreover, as discussed in Issue 4.5.1, the Northwest Power Act does not prohibit the IOUs from waiving their right to effectuate the purposes of section 6.2. BPA would normally allocate the rate protection dollars among the IOUs' PF Exchange rates on a pro rata load share basis. *Id.* at 42. Section 6.2 effectively operates as a waiver of the IOUs' right to have rate protection dollars allocated to their PF Exchange rates on a pro rata basis. Instead, pursuant to their own agreement in section 6.2, some have agreed to take a larger amount of rate protection in the calculation of their PF Exchange rate, while others have agreed to take less. BPA has determined that it can honor this arrangement among the IOUs because it does not require altering BPA's ratemaking methodology and still ensures that the PF Exchange rates collect, in total, all of the rate protection dollars allocated to the PF Exchange rate as required by section 7(b)(3). *Id.* Nothing in section 5(c), section 7(b)(2), or section 7(b)(3) prohibits the IOUs from waiving their right to have rate protection dollars allocated on a pro rata basis among the PF Exchange rates.

WPAG next claims that section 6 "virtually ensures" that the retail customers most in need of the power cost relief provided by the REP will not receive it, thereby defeating the underlying purpose of the REP. WPAG Br. Ex., REP-12-R-WG-01, at 21. WPAG claims that while this Settlement-sanctioned reallocation may serve a worthwhile purpose from the viewpoint of the IOUs, it is contrary to the underlying purpose of the REP. *Id.*

BPA disagrees. The basic construct of comparing ASCs to PF Exchange rates will continue under the Settlement, even with section 6.2. The IOUs with the highest ASCs and largest exchange loads will receive the largest share of the REP benefits. Thus, contrary to WPAG's unfounded assertions, those "most in need" of REP benefits will not be denied appropriate relief. Moreover, if anything, section 6.2 recognizes that those "most in need" of the REP benefits have, in fact, received less to date than other members of the IOU class. As noted above, since FY 2009, BPA has been withholding REP benefits to fund Lookback Amounts to the COUs. *See* FY 2012–2013 Lookback Recovery and Return Study, REP-12-E-BPA-03, at 5. By the end of FY 2011, the total withheld REP benefits will be approximately \$240.6 million. *See* WP-10 Lookback Recovery and Return Study, WP-10-FS-BPA-07, at 9, 14. The funding of these refunds fell primarily on the IOUs with the highest ASCs and largest exchange loads.

For example, Puget has historically been one of the largest recipients of REP benefits due to its high ASCs and large exchange loads. During the FY 2009–2011 period, Puget's REP benefits

were reduced by \$75 million in order to fund the Lookback refund payments. *Id.* Similarly, Portland General Electric (PGE) also has received a substantial portion of REP payments due to its high ASC and large exchange load, but it too saw its REP benefits reduced by over \$50 million over this same period. *Id.* Together, the retail ratepayers of Puget and PGE funded the majority of the Lookback Amount payments BPA made through reduced REP benefits. It is because of this disproportionate effect on the retail ratepayers of the highest-cost utilities that the IOUs included section 6.2. Otherwise, had no adjustment been included, the very “retail customers most in need of the power cost relief provided by the REP” that WPAG claims it is concerned about would not have received any recognition that they, for the better part of three years, have been providing the majority of the funds for repaying the disputed Lookback obligations.

Finally, BPA notes that the entities tasked with representing the interest of the IOUs’ retail customers, namely the public utility commissions for Oregon, Washington, and Idaho, and the Citizens’ Utility Board (CUB) (a ratepayer advocacy group for Oregon’s IOU retail ratepayers) have signed the Settlement. BPA assumes that if section 6.2 did not appropriately ensure that the benefits of the Settlement were being distributed to the retail customers “most in need of the power costs relief provided by the REP,” these entities would not have endorsed the Settlement. As the record in this case shows, they clearly have.

The Settlement resembles BPA’s traditional REP in every material way. The exchange-based relationship envisioned by Congress under section 5(c) will continue under the Settlement, with the IOUs selling power at their ASCs and BPA selling power to the IOUs at BPA’s PF Exchange rates. The IOUs will continue to submit ASC filings to BPA, and BPA will continue to review and evaluate these ASCs in accordance with BPA’s 2008 ASC Methodology. REP benefits under the Settlement will continue to be paid based on a comparison of the utilities’ ASCs and BPA’s respective PF Exchange rates. Under this construct, no individual IOU is guaranteed any REP benefits under the Settlement. The IOUs with the highest ASCs and the largest exchange loads will continue to receive the most in REP benefits, as is the case today, while the IOUs with the lowest ASCs and the lowest exchange loads will receive little, if any, REP benefits. REP benefits under the Settlement will also be distributed to the residential and small farm customers of each IOU. For these reasons, BPA finds that the Settlement properly retains the features of the REP required by section 5(c) and resembles the REP envisioned by Congress in all material respects.

### **Decision**

*The Settlement properly retains the features of the REP required by section 5(c) and resembles the REP envisioned by Congress in all material respects.*

### **Issue 4.5.4**

*Whether BPA’s calculation of aggregate REP benefits in the Long-Term Rate Model is consistent with section 5(c) and the Court’s decision in PGE.*

### **Parties' Positions**

Alcoa, APAC, and WPAG generally contend that BPA has failed to comply with section 5(c) by not calculating the aggregate amount of REP benefits to include in rates. Alcoa Br., REP-12-AL-02, at 10-14; APAC Br., REP-12-B-AP-01, at 8; WPAG Br., REP-12-B-WG-01, at 10. Instead, these parties contend, BPA will include in rates the Scheduled Amounts without regard to the utility's ASCs and PF Exchange rates. *Id.*

Alcoa also argues that BPA's analysis is faulty because the Court in *PGE* previously rejected BPA's attempt to rely on forecast ASCs as a basis for supporting a settlement of the REP. Alcoa Br., REP-12-B-AL-02, at 15.

### **BPA Staff's Position**

Staff calculates the aggregate amount of REP benefits permitted by section 5(c) under a variety of scenarios. These aggregate amounts of REP benefits are calculated in accordance with section 5(c) by comparing forecasts of utility ASCs with forecasts of BPA's PF Exchange rates. Russell *et al.*, REP-12-E-BPA-06, at 14. The Settlement, in almost all cases, provides REP benefits well below the amount of REP benefits the IOUs would have received under the traditional REP, even if BPA were to assume the COUs were to prevail on certain issues in Court. Gendron *et al.*, REP-12-E-BPA-04, at 27. Furthermore, over the next two-year rate period, it is indisputable that the IOUs will receive less in REP benefits under the Settlement than BPA would have paid the IOUs under the traditional implementation of the REP. Bliven *et al.*, REP-12-E-BPA-12, at 33.

Alcoa's reading of *PGE* is a legal issue; Staff made no response.

### **Evaluation of Positions**

A number of the parties in this case have accused BPA of not "calculating" the aggregate amount of REP benefits to include in rates. Alcoa Br., REP-12-AL-02, at 10-14; APAC Br., REP-12-B-AP-01, at 8; WPAG Br., REP-12-B-WG-01, at 10. These parties contend, in a variety of ways, that BPA has shirked its statutory responsibilities by adopting the REP benefits under the Settlement without regard to specific applications of the utility's ASCs with the PF Exchange rates. *Id.*

What these parties miss, however, is that BPA has not simply accepted the REP benefits provided under the Settlement as permissible under the Northwest Power Act without review. Rather, BPA has independently calculated the aggregate REP benefits available to the IOUs for this next rate period (FY 2012–2013) and every year of the Settlement thereafter to test whether the Settlement's aggregate REP benefits are consistent with sections 5(c) and 7(b). BPA has done so, following the dictates of section 5(c), through a comparison of long-term projections of the utilities' ASCs, BPA's PF Exchange rates, and the utilities' exchange loads, in the Long-Term Rate Model (LTRM). As noted above in the discussion in section 3.3, the LTRM uses ASCs, PF Exchange rates, and exchange loads to project future REP benefits. *See* section 3.3.

As a result of this comparison, Staff finds that (1) the Settlement provides far fewer REP benefits than under BPA's Reference Case and cost scenarios, and (2) the Settlement provides fewer REP benefits in almost all expected outcomes of the parties' litigation positions. Evaluation Study, REP-12-FS-BPA-01, Table 10.4. Based on this analysis, the COUs are being protected under the Settlement consistent with the Northwest Power Act. Gendron *et al.*, REP-12-E-BPA-04, at 28. The fact that the IOUs may be receiving less than they would receive under BPA's Reference Case or under most of the litigation scenarios is also not problematic because, as noted before, the IOUs may waive their right to greater REP benefits. *See* Issue 4.5.1.

No party has seriously argued that BPA's projections of ASCs, exchange loads, or PF Exchange rates are faulty in any material way. There is good reason for the parties' silence on these issues. Staff thoroughly explains the basis for the ASCs, PF Exchange rates, and exchange loads in the Initial Proposal of this case. The parties' primary argument against BPA's long-term projection of REP benefits and rate protection amount is that BPA simply cannot implement the REP this way. BPA discusses in Chapters 3 and 5 the parties' claims that BPA cannot perform a long-term projection of rate protection under section 7(b)(2). Here, however, BPA considers whether the projections of ASCs and exchange loads that were used to calculate aggregate REP benefits in the LTRM are consistent with section 5(c). The record in this case clearly shows that they are.

First, Staff's projections of ASCs are consistent with section 5(c). Section 5(c) provides that BPA purchase power from an exchanging utility at that utility's "average system cost." 16 U.S.C. § 839c(c)(1). Section 5(c)(7) further provides that:

The "average system cost" for electric power sold to the Administrator under this subsection shall be determined by the Administrator on the basis of a methodology developed for this purpose ....

*Id.* § 839c(c)(7). BPA's current ASC methodology is the 2008 ASC Methodology.

When developing the ASCs used in the long-term projections developed in this case, Staff is careful to ensure that the projected ASCs conform to the ASC calculations required by the 2008 ASC Methodology. Evaluation Study, REP-12-FS-BPA-01, section 7.1. Staff explains that to calculate long-term ASCs, it developed a Long-Term ASC Forecast Model, or LTAFM. Russell *et al.*, REP-12-E-BPA-06, at 11. The LTAFM relies on the ASCs filed by the IOUs in the FY 2012–2013 ASC Review Process, the most recent ASCs filed under the 2008 ASC Methodology available, to project future ASCs. *Id.* The LTAFM then projects future ASCs using the very same forecast model and escalators required by the 2008 ASC Methodology. *Id.* at 12 ("The LTAFM uses the same escalators described in the 2008 ASCM"). Staff then performs an exhaustive analysis to ensure that the projected ASCs are as accurate as possible. A total of 72 pages of the Evaluation Study is dedicated to explaining and considering all aspects of the forecast ASCs. Evaluation Study, REP-12-FS-BPA-01, Chapter 7. An additional 700 pages of documentation and support for BPA's calculation are provided in the Evaluation Study Documentation, REP-12-FS-BPA-01A, Chapter 7 and Attachment A. After considering all relevant factors, Staff concludes that "[t]he ASCs discussed in this section were determined pursuant to BPA's 2008 Average System Cost Methodology (2008 ASCM), as approved by

FERC in September of 2009.” Evaluation Study, REP-12-FS-BPA-01, section 7.1. No evidence has been presented on the record of this case stating otherwise.

Second, Staff’s calculation of the IOUs’ load is similarly well documented and left undisturbed on the record. For the FY 2014–2017 period, Staff uses the load forecasts that the utilities submitted with their June 2010 ASC Filing pursuant to the 2008 ASC Methodology, as adjusted in the ASC Review Process. Russell *et al.*, REP-12-E-BPA-06, at 14. To escalate each utility’s load to FY 2032, Staff uses the load growth percentage presented in the utility’s most recent Integrated Resource Plan (IRP). *Id.* Next, Staff adjusts each utility’s total retail sales for distribution losses to arrive at the forecast of Contract System Load. *Id.* For COUs, Staff uses BPA’s forecast through FY 2029 and escalates it through FY 2032. *Id.* To determine what share of the IOUs’ Contract System Load constitutes exchange load, Staff uses two methods. First, Staff uses the exchange load data submitted by the IOUs with their FY 2012–2013 ASC filings to determine exchange loads for the FY 2012–2017 period. *Id.* Thereafter, Staff determines the ratio of REP Exchange Load to Contract System Load for FY 2017 and then applies that same ratio to the utility’s forecast Contract System Load for FY 2018–2032. *Id.*

Once the utility ASCs and exchange loads have been established, Staff explains how REP benefits are calculated under the settlement analysis: “The REP Exchange Load is used to forecast a utility’s REP benefits by *comparing* the utility’s ASC with BPA’s PF Exchange rate, and then multiplying the difference by the utility’s REP Exchange Load to arrive at net benefits.” *Id.* (emphasis added). As this discussion makes clear, aggregate REP benefits have been calculated consistent with section 5(c) by comparing ASCs with BPA’s PF Exchange rates. Parties’ arguments contending that BPA has not done so are not persuasive.

WPAG argues that under the “statutory” REP benefit calculation, the difference between the ASC for a specific utility and the applicable PF Exchange rate, multiplied by its qualifying load, establishes the amount of REP benefits it can receive. WPAG Br. Ex., REP-12-R-WG-01, at 20. WPAG argues that the sum of these individual calculations for all participating utilities establishes the total REP benefits available. *Id.* WPAG contends that under the Settlement, ASCs are prepared and used for the limited purpose of gaining access to the available REP benefits, but they play no role in determining the total amount of REP benefits available to the IOUs as a class. *Id.* WPAG thus ignores the analysis BPA has prepared in this case to test whether the aggregate REP benefits provided under the Settlement comport with the statutory limitations set forth in the Northwest Power Act. As just noted, Staff calculated *aggregate* REP benefits following the “statutory” calculation WPAG identifies: “[t]he REP Exchange Load is used to forecast a utility’s REP benefits by *comparing* the utility’s ASC with BPA’s PF Exchange rate, and then multiplying the difference by the utility’s REP Exchange Load to arrive at net benefits.” Russell *et al.*, REP-12-E-BPA-06, at 14 (emphasis added). The fact that the aggregate REP benefit level included in the Settlement does not reflect one precise run of ASCs and PF Exchange rates is immaterial. What matters is whether the aggregate REP benefits provided under the Settlement *exceed* what the law permits, because the IOUs may always agree to take less. *See* Issue 4.5.1. As demonstrated by the analysis developed in this case, the REP benefits provided under the Settlement are well below those calculated in BPA’s Reference Case

and most of the litigation scenarios considered in BPA’s analysis (excepting combined issues scenarios where the COUs prevail on two or more litigated issues, and assuming the IOUs win none of their contested issues). Based on this evidence, BPA can see no basis to conclude that the Settlement’s fixed stream of REP benefits is unlawful or otherwise inconsistent with section 5(c).

Alcoa contends that BPA’s method of projecting future REP benefits was rejected by the Ninth Circuit previously, and that the Court will likely do so again here in the absence of an amendment to the Northwest Power Act. Alcoa Br., REP-12-B-AL-02, at 15. Alcoa’s attempt to compare the Settlement in this case to the 2000 REP Settlements is without merit. As noted in the discussion in Chapter 7, the 2012 REP Settlement in this case bears no resemblance to the 2000 REP Settlements struck down by the Court. In the 2000 REP Settlements, ASCs played essentially no role in determining whether a utility received REP benefits or how much it received. Bliven *et al.*, REP-12-E-BPA-12, at 52, *citing* Residential Exchange Program Settlement Record of Decision (2000 REP ROD) at 36 (“the issue of IOUs’ eligibility to receive REP benefits cannot be based on ASC forecasts alone.”). In the context of the 2000 REP Settlements, BPA took the position that ASCs were not necessary for determining a utility’s right to participate in a settlement of the REP, *id.*, and instead, BPA could look to a number of other considerations such as “the amount of residential and small farm load eligible for the REP, the historical provision of REP benefits, the REP benefits received in the last five-year period ending June 30, 2001, rate impacts on qualifying customers, and the individual needs and objectives of each state.” *Id.* at 52-53, *citing* 2000 REP ROD at 81.

Here, however, BPA is making compliance with section 5(c) and the ASC Methodology a central component of its criteria for evaluating the Settlement. 75 Fed. Reg. 78694, at 78695 (2010); *see also* Evaluation Study, REP-12-FS-BPA-01, section 11.2; Gendron *et al.*, REP-12-E-BPA-04, at 26. As noted before, BPA includes as its second evaluation criterion for the review of the Settlement the following standard:

- (2) the settlement would provide REP benefits in a manner consistent with section 5(c) of the Northwest Power Act and distribute such REP benefits among the settling IOUs in a manner consistent with BPA’s current ASC Methodology and with rates that are consistent with section 7 of the Northwest Power Act[.]

Evaluation Study, REP-12-FS-BPA-01, section 11.2; *see also* Gendron *et al.*, REP-12-E-BPA-04, at 26. Consistent with this criterion, Staff carefully evaluates the Settlement terms to ensure that the Settlement observes the requirements of section 5(c). Staff concludes that it does. Most importantly, the Settlement retains the requirement that the IOUs file ASCs with BPA pursuant to the 2008 ASC Methodology every rate period before receiving REP benefits. Bliven *et al.*, REP-12-E-BPA-12, at 53, *citing* REPSIA, REP-12-E-BPA-11, Exhibit A, § 4. Moreover, no one IOU is guaranteed any REP benefits under the Settlement. *Id.* IOUs will have to “compete” with BPA’s rates to receive REP benefits, and only IOUs that have ASCs that exceed BPA’s applicable PF Exchange rate will receive any payments under the Settlement. *Id.*

Alcoa next argues that in 2000, BPA proposed to globally settle its future REP obligations to qualifying IOUs based on forecast ASC calculations. Alcoa Br., REP-12-B-AL-02, at 15. Alcoa asserts that the Ninth Circuit rejected BPA’s settlement approach on the grounds that BPA did not strictly comply with Northwest Power Act section 5(c). *Id.* Specifically, Alcoa claims, the court “held that BPA did not base its REP settlement payments on utilities’ actual ASCs (as opposed to forecast ASCs).” *Id.*

Alcoa seriously misreads *PGE*. The Court in *PGE* did not opine on whether BPA could or could not use forecast ASCs as a basis for establishing a settlement of the REP. Instead, the Court found that in the case of the 2000 REP Settlements, BPA’s reliance on ASCs that were not based on the existing ASC Methodology was unreasonable. *PGE*, 501 F.3d at 1036. Had the Court’s holding in *PGE* been simply “BPA cannot rely on forecast ASCs,” one would have expected the Court to have said as much. It did not. Alcoa’s citation to *PGE*, which in other places in its brief is very precise, broadly cites to three pages of the opinion for support to this alleged holding. Alcoa Br., REP-12-B-AL-02, at 15. BPA has read and reread these pages and has been unable to find such a holding.

If anything, the pages cited by Alcoa *support* BPA’s proposal in this case to compare REP benefits based on forecast ASCs with REP benefits provided under the Settlement. In the very pages cited by Alcoa, the Court describes BPA’s method of forecasting ASCs and REP benefits in the WP-02 rate proceeding:

When determining traditional REP benefits—as it did in the WP-02 rate case—BPA calculated the cost of the traditional REP benefit and made a determination of the IOUs’ eligibility. *Based largely on forecasted ASCs*, BPA estimated that the REP benefit would cost \$240.6 million for the 2002–2006 rate period, or \$48 million per year. 2000 REP Settlement Agreement ROD at 78. This figure was based on § 5(c) calculations, as capped by the § 7(b)(2) ceiling.

*PGE*, 501 F.3d at 1033 (emphasis added).

The Court then contrasts the *forecast method* BPA used in the WP-02 rate proceeding, which generated a \$240 million forecast of REP benefits, with the *forecast method* BPA used to justify the level of REP benefits that would have been provided under the 2000 REP Settlements:

BPA estimated the cost of REP settlement at \$736 million for the 2002–06 period—\$496 million more than its WP-02 estimate of the cost of the REP benefit over the same rate period. *See id.* at 49, 78. BPA explained the striking difference between BPA’s two estimates: BPA had used a different methodology to determine who would be eligible for the REP settlement.

*Id.* at 1033. The Court then found that the flaw in BPA’s analysis was that instead of “relying exclusively on ASCs, as it had done when it *estimated the costs of the REP program*, BPA had factored in three other variables: (1) a possible legal challenge to the 1984 methodology; (2) a possible challenge to the PF Exchange Rate; and (3) future fluctuations in the energy market.” *Id.* at 1033 (emphasis added). The Court then proceeded to consider the reasonableness of

BPA's decision to settle the REP based on hypothetical challenges to the 1984 ASC Methodology, which the Court described as the "most significant of the assumptions" BPA considered. *Id.* In its review, the Court found that BPA had no basis for assuming the 1984 ASC Methodology would not have been in effect. *Id.* at 1034-1035. The Court concluded that the fault in BPA's analysis was that "BPA settled the REP program as if it had changed its regulations, which it had not." *Id.* at 1036.

As the foregoing discussion makes clear, the Court in no way found that BPA's analysis in the 2000 REP Settlements were faulty simply because BPA had relied on forecast ASCs rather than "actual ASCs," as Alcoa contends. Instead, the flaw the Court addressed in *PGE* was the use of a different ASC Methodology to calculate ASCs to justify a particular level of forecasted REP benefits provided under the 2000 REP Settlements.

In this case, BPA is not repeating that error. As described above, the analysis in this case relies on ASCs that are calculated using contemporary ASC filings submitted by the IOUs in the concurrent FY 2012–2013 ASC Review Processes, which is the most recent ASC data available (and possible). Russell *et al.*, REP-12-E-BPA-06, at 11. From these ASCs, Staff develops forecasts of ASCs for its analysis using the parameters established by the 2008 ASC Methodology. *Id.* at 11-12. Staff thereafter tests and tests again these ASCs to ensure that they are accurate and reasonable. Staff concludes in the record of this case that these ASCs are "determined pursuant to BPA's 2008 Average System Cost Methodology (2008 ASCM), as approved by FERC in September of 2009," and no party has contested otherwise. Evaluation Study, REP-12-FS-BPA-01, section 7.1. Clearly, Staff's analysis in this case stands a world apart from the analysis criticized by the Court in *PGE*.

Moreover, the results of Staff's analysis in this case are starkly different from the facts presented to the Court in *PGE*. As opposed to providing \$496 million more in REP benefits than projected in the no-settlement case, *PGE*, 501 F.3d at 1033, BPA's analysis reveals that under the Settlement the IOUs will be giving up \$24 million in REP benefits over the FY 2012–2013 rate period alone. As Staff states, this trend is expected to grow over time. Bliven *et al.*, REP-12-E-BPA-12, at 48. The analysis Staff performs in this case bears no resemblance to the analysis BPA performed in the 2000 REP Settlements, and any comparison to such analysis is inapposite.

In summary, BPA is not shirking its responsibility to determine aggregate REP benefits. Staff makes those calculations as part of its evaluation of the Settlement through the LTRM. Those calculations are generated by comparing projections of ASCs and exchange loads, all calculated in a manner consistent with section 5(c) and the 2008 ASC Methodology, with projections of BPA's PF Exchange rate used to forecast aggregate REP benefits. Based on these projections of future REP benefits, BPA finds that the Settlement protects the position of the COUs by providing them superior rate protection under a vast majority of the litigation outcomes. This superior rate protection begins in this rate period and is likely to grow over time. In addition, the REP benefits would be distributed among the IOUs in a manner consistent with section 5(c). For these reasons, BPA's decision to adopt the Settlement does not violate section 5(c) and is consistent with the Court's direction in *PGE*.

## **Decision**

*BPA's calculation of aggregate REP benefits in the Long-Term Rate Model comports with the requirements of section 5(c) and the Court's decision in PGE.*

## **Issue 4.5.5**

*Whether the Settlement's limitation on BPA's discretion to engage in "in lieu" transactions under section 5(c)(5) of the Northwest Power Act is improper.*

## **Parties' Positions**

APAC argues that the Settlement prohibits BPA from utilizing the *in lieu* provisions of section 5(c)(5) of the Northwest Power Act. APAC Br., REP-12-B-AP-01, at 9. APAC contends that under the proposed Settlement, preference customers are forced to pay the Scheduled Amounts under the Settlement regardless of how those amounts compare with market prices. *Id.*

Alcoa raises a similar argument for the first time in its brief on exceptions. Alcoa Br. Ex., REP-12-R-AL-01, at 37.

## **BPA Staff's Position**

Staff believes that it is reasonable to agree to withhold the use of the discretionary cost saving features of *in lieu* transactions in order to achieve the substantial cost protections afforded by the Settlement. Forman *et al.*, REP-12-E-BPA-10, at 19. The savings to be achieved through limiting REP costs to the amounts in the Settlement will likely far outweigh the savings that *may* occur by implementing *in lieu* transactions under a no-Settlement situation. Bliven *et al.*, REP-12-E-BPA-12, at 12.

## **Evaluation of Positions**

Under section 5(c)(5) of the Northwest Power Act, the Administrator *may*, in lieu of buying power at the utility's ASC, acquire power from another source to sell to the utility if the cost of acquiring the power is less than the cost of purchasing power directly from the utility. Forman *et al.*, REP-12-E-BPA-10, at 19. Section 5(c)(5) of the Act provides:

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

16 U.S.C. § 839c(c)(5).

If the Administrator exercises his discretion to acquire *in lieu* power, the REP turns into an actual power sale rather than an exchange: BPA acquires power from a third party and then sells that power to the exchanging utility at BPA's PF Exchange rate. Forman *et al.*, REP-12-E-BPA-10, at 19. *In lieu* transactions are one way the Administrator may reduce the costs of the REP. *Id.*

The final version of the Settlement includes the REPSIA. *Id.* at 17. As the name implies, the REPSIA contains the terms and conditions necessary to implement the Settlement during its 17-year term. *Id.* Unlike the broader Settlement, which all settling COUs, IOUs, and other parties will sign, the REPSIA will be executed only by BPA and the individual IOUs. *Id.* In this respect, the REPSIA is in many ways similar to the Residential Purchase and Sale Agreement (RPSA) that is currently used to implement the REP between BPA and the IOUs. *Id.* The REPSIA retains certain elements of the RPSA but also adds a number of new features in order to implement the provisions of the Settlement. *Id.* at 17-18.

One of the new features included in the REPSIA is a limitation on the use of *in lieu* transactions during the term of the Settlement. See REPSIA, REP-12-A-02A, Exhibit A, § 7. Section 7 of the REPSIA provides:

In consideration of the mutual benefits afforded by this Agreement and the Settlement Agreement, BPA shall not acquire or make arrangements to acquire In Lieu Power for sale to «Customer Name» during the Payment Period.

*Id.*

In evaluating this provision, Staff explains that it viewed this provision as reasonable because the *in lieu* provisions of the Act are designed to permit the Administrator to reduce the cost of the REP if he believed the facts and circumstances of the particular rate period warranted such a reduction. Forman *et al.*, REP-12-E-BPA-10, at 19. In a world where the IOUs' REP payments are determined rate case by rate case, it makes sense for the Administrator to retain his right to engage in *in lieu* transactions to dampen otherwise unknown REP costs. *Id.*

Under the Settlement, however, the aggregate IOU REP payments will not be unknown or at risk of increasing. *Id.* Far from it: the aggregate IOU REP payments will be set and fixed by a rigid schedule that must be rounded to the nearest \$1000. *Id.* These payments, as Staff's analysis shows, will likely be substantially below what the IOUs may be entitled to under most of the scenarios analyzed in the REP-12 proceeding. *Id.* Under these circumstances, it is reasonable for BPA to agree to withhold the use of a discretionary cost-saving feature for the term of the Settlement in order to achieve the substantial cost protections afforded by the Settlement. *Id.*

APAC objects to the inclusion of section 7 in the REPSIA, claiming that the *in lieu* provision allows BPA to control REP costs when utility ASCs are higher than resources available in the market. APAC Br., REP-12-B-AP-01, at 9. APAC contends that under the proposed Settlement, COUs will be forced to pay the Scheduled Amounts under the Settlement regardless of how those amounts compare with market prices. *Id.*

APAC's arguments are not persuasive. First, it must be emphasized that *in lieu* transactions are discretionary actions under the Northwest Power Act. Section 5(c)(5) is clear that the Administrator has a choice as to whether to exercise his discretion to engage in *in lieu* purchases: "in lieu of purchasing any amount of electric power offered by a utility under paragraph (1) of this subsection, the Administrator *may* acquire an equivalent amount of electric power from other sources ...." 16 U.S.C. § 839c(c)(5) (emphasis added). Thus, provided that BPA has a reasoned decision for withholding that discretion under the Settlement, there is no statutory impediment to BPA agreeing to section 7.

In this case, BPA believes that the greater cost savings to BPA's ratepayers and the region comes through the Settlement. As Staff's analysis clearly demonstrates, the IOUs are willing to give up potential substantial increases in future REP payments for a more certain steady stream of benefits over the next 17 years. Forman *et al.*, REP-12-E-BPA-10, at 20. Yet, if BPA reserved to itself the option of reducing the IOUs' future REP payments at will and at any time under the *in lieu* terms of the Northwest Power Act, BPA would be undermining one of the central components of the Settlement for the IOUs: certainty in the aggregate level of IOU REP benefits and predictability of individual IOU REP benefits based on relative ASCs, PF Exchange rates, and eligible exchange loads. *Id.* On balance, greater REP-related cost-savings certainty can be achieved by agreeing to the Settlement with its limitation on *in lieu* transactions when compared to retaining this discretionary right, but then having no Settlement, and concomitantly, no fixed limitation on future REP costs. *Id.*

Second, preserving the right to engage in *in lieu* transactions is necessary in a context where there are no other means of reducing the costs of the REP as REP costs fluctuate from rate period to rate period. Bliven *et al.*, REP-12-E-BPA-12, at 60. Here, however, BPA is faced with the opportunity of limiting, for 17 years, the costs of the REP to BPA and COUs. *Id.* Provided that these payments do not exceed the limitations placed on REP costs by section 7(b)(2) and are distributed to the IOUs in a manner consistent with section 5(c), BPA sees no reason why it must retain the right to further reduce the IOUs' REP benefits through *in lieu* power sales. *Id.* The savings to be achieved through limiting REP costs to the amounts in the Settlement will likely far outweigh the savings that may occur by implementing *in lieu* transactions under a no-settlement situation. *Id.*

Third, from a practical standpoint, retaining the right to engage in *in lieu* transactions under the Settlement would not produce the impact APAC contends. By signing the Settlement, BPA is contractually committing to make the REP payments in the amounts set forth in the Settlement. Forman *et al.*, REP-12-E-BPA-10, at 19-20. Therefore, an *in lieu* application to a utility would not reduce the total payments, but would simply adjust the amounts paid to each IOU. *Id.* If this implementation prevails, there would be no cost savings to BPA or any other ratepayers, which is the generally recognized purpose of the statutory *in lieu* provision. *Id.* Thus, the suspension of BPA's ability to engage *in lieu* exchange transactions under the Settlement is without consequence to BPA or other ratepayers. *Id.*

Fourth, even if BPA retained its ability to engage in *in lieu* transactions, there remain a number of very complicated and daunting issues with acquiring power on the scale necessary to effectuate an *in lieu* transaction for the IOUs. Again, the *in lieu* provision would require BPA to arrange for the *purchase* of actual power to serve the IOUs' residential loads. The IOUs' residential loads are approximately 5,000 aMW. See Evaluation Study Documentation, REP-12-FS-BPA-01A, Table 10.4.1.3. Obtaining a power source to supply even 20 percent of this load, or 1,000 aMW, would be a daunting administrative and logistical task. See Bliven *et al.*, REP-12-E-BPA-12, at 62.

APAC argues that the *in lieu* provision is a statutory safeguard that benefits all BPA customers that must share in the cost of supporting the REP. APAC Br., REP-12-B-AP-01, at 9. APAC claims that with the potential that 20 percent or more of COU load may not accept the Settlement, the effect of that protection in controlling prices and REP benefits would be significant. *Id.*

APAC overstates the importance of *in lieu* transactions in controlling REP costs. As Staff mentions, BPA has never implemented an *in lieu* transaction under the REP. Bliven *et al.*, REP-12-E-BPA-12, at 61. This is due in large part to the many complicated and difficult issues that must be addressed before BPA can begin to sell power directly to the utility. Bliven *et al.*, REP-12-E-BPA-12, at 62. Moreover, as explained by Staff, the presence of the 7(b)(2) rate test limitations on REP costs makes the efficacy of the *in lieu* provision uncertain. Bliven *et al.*, REP-12-E-BPA-17, at 17. This is because if there is no rate test trigger, the value of the *in lieu* provision is more certain. *Id.* For every dollar that the alternative purchase is cheaper than the ASC purchase, a dollar is saved. *Id.* However, when the rate test triggers, it is uncertain whether the dollar saved due to the alternative purchase results in a dollar saved, or whether it results in a dollar of REP benefit transferring from one REP participant to another. *Id.* Staff analyzes two hypothetical scenarios, one where no *in lieu* occurred, and one where BPA engaged in an *in lieu* transaction. *Id.* at 17-18. In Staff's simplified analysis, Staff shows that depending upon how BPA treats *in lieu* transactions in the 7(b)(2) rate test, *in lieu* may result in no net cost savings to other ratepayers. *Id.* In light of the complexity of engaging in an *in lieu* transaction, and the fact that its treatment in the section 7(b)(2) rate test may diminish its value to other ratepayers even further, BPA does not view withholding the use of the discretionary *in lieu* feature of the Act, which has not been a proven mechanism for reducing REP costs over the past 30 years, a critical loss. Bliven *et al.*, REP-12-E-BPA-12, at 61.

APAC claims that the *in lieu* provisions of the statute are designed to be "safeguards" that benefit all customers that must share in the cost of the REP and that the effect of the *in lieu* in controlling prices for non-settling parties will be significant. APAC Br., REP-12-B-AP-01, at 9. But what APAC misses is that the Settlement already is controlling the costs of the REP. Again, to BPA the critical question as to whether to withhold its discretionary right to engage in *in lieu* transactions is whether the Settlement provides greater REP cost savings for BPA ratepayers overall. As Staff's analysis demonstrates, the IOUs are willing to give up potentially substantial increases in future REP payments for a more certain steady stream of benefits over the next 17 years. *Id.* at 61. When comparing and weighing these issues, BPA believes that overall

greater REP-related cost-savings certainty can be achieved by agreeing to the Settlement, with its limitation on REP benefits, than by retaining the discretionary right to engage in *in lieu* transactions, but then having no Settlement, and concomitantly, no fixed limitation on future REP costs. *Id.*

APAC conflates the discretionary nature of *in lieu* transactions to a form of “rate protection” that the COUs are statutorily entitled to. APAC Br. Ex., REP-12-R-AL-01, at 8. APAC contends that “[b]eyond the formal rate protection provided by the section 7(b)(2) rate test, COUs are also provided rate protection by the *in lieu* provisions of § 5(c)(5).” *Id.* APAC argues that the Settlement requires the COUs to “forfeit” this rate protection. *Id.*

APAC’s argument is not persuasive. The concept of “rate protection” is associated with the rate test established in section 7(b)(2). Section 7(b)(2) is intended to provide the COUs “rate protection” by comparing the COUs’ rates under the Act with rates calculated when certain features of the Act are removed. *See* Chapter 5. Nowhere in section 7(b)(2) or in the legislative history of the Act does Congress indicate that BPA’s *discretionary* decision to engage in *in lieu* transactions forms part of BPA’s *obligation* to protect the rates of the COUs under section 7(b)(2). While section 5(c)(5) certainly permits BPA to use its discretion to limit REP costs in rates, BPA does not believe that the Northwest Power Act directs BPA to exercise that discretion in a context where significant reductions in projected REP benefits have already been achieved as part of a Settlement.

In its brief on exceptions, Alcoa raises for the first time concerns with BPA’s decision to restrict its ability to engage in *in lieu* transactions. Alcoa Br. Ex., REP-12-R-AL-01, at 37. Specifically, Alcoa claims BPA is locking itself into providing lump-sum payments to the participating utilities, losing its ability to respond to real-time market factors, and shackling itself to a program that may interfere with its ability to respond to market conditions consistent with sound business principles. *Id.*

As noted above, under the Settlement BPA will achieve greater cost certainty through a fixed stream of payments when compared to the unknown (and untested) *in lieu* provisions of the Northwest Power Act. Alcoa claims that not retaining this discretion may result in BPA acting in a manner not consistent with “sound business principles.” *Id.* This argument is being raised for the first time in Alcoa’s brief on exceptions, and consequently has been waived. *See Procedures Governing BPA Rate Hearings*, § 1010.13(b), (c). But even if Alcoa’s argument were properly raised, it is without merit.

First, BPA’s decision to limit its use of *in lieu* transactions is consonant with “sound business principles” for all the reasons already discussed above. That is, by limiting its use of the discretionary *in lieu* provision of the Act, BPA can settle the REP, end contentious and uncertain litigation, and fix REP benefits in a way benefitting *all* ratepayers (including Alcoa) by reducing REP costs below BPA’s Reference Case and most of the litigation outcomes. In contrast, as discussed earlier in this ROD, a great deal of uncertainties and business risks exist that would

attend with any attempt by BPA to implement on a broad scale *in lieu* transactions with the IOUs.

Second, even if the soundness of BPA’s decision to settle the REP in the manner prescribed by the Settlement were not apparent, the concept of “sound business principles” would still not prohibit BPA’s action to limit its discretionary use of *in lieu* purchases. There are some functions BPA must perform under the Northwest Power Act that, on their face, do not comport with the notion of “sound business principles.” The Ninth Circuit has specifically recognized that BPA’s implementation of the REP is one such provision. As noted by the Court in *Pac. NW. Gen. Coop. v. Bonneville Power Admin.*, 580 F.3d 792, 822 (9th Cir. 2009) (“*PNGC I*”):

But the exchange program is a specific exception that proves a general rule—and the rule is that Congress intended BPA “to operate with a business-oriented philosophy.” As the Supreme Court has observed, “[b]ecause th[e] exchange program essentially requires BPA to trade its cheap power for more expensive power, it is obviously a money-losing program for BPA.” In the case of the exchange program, Congress specifically directed BPA to conduct its operations in a manner that does not conform with the “sound business principles” that the agency is generally required to follow.

*Id.* (internal citations omitted). Thus, the “sound business principles” standard does not preclude BPA from limiting its *in lieu* discretion in the context of the Settlement.

### **Decision**

*The Settlement’s limitation on BPA’s use of its discretionary right to engage in in lieu transactions is proper.*

### **Issue 4.5.6**

*Whether the Settlement is unreasonable because it does not permit the IOUs’ REP benefits to be adjusted by a cost recovery adjustment mechanism.*

### **Parties’ Positions**

APAC contends that under the Settlement, the level of REP benefits is protected from the operation of a Cost Recovery Adjustment Clause (CRAC). APAC Br., REP-12-B-AP-01, at 9. As a result, APAC concludes, the responsibility for ensuring full recovery of BPA’s costs will fall more heavily on other customer classes. *Id.* APAC also claims this provision of the Settlement denies the COUs additional rate protection. APAC Br. Ex., REP-12-R-AP-01, at 8-9.

### **BPA Staff’s Position**

Application of a CRAC to the Settlement is not required because the Settlement’s value will be fixed. Bliven *et al.*, REP-12-E-BPA-12, at 55-59. The IOUs will receive no increase in REP benefits within the rate period even if BPA’s secondary sales exceed forecasts and BPA issues a

Dividend Distribution Clause. *Id.* Because the IOUs will not receive any upside benefits during a rate period, BPA believes it makes sense not to expose the IOUs to the downside risk of a CRAC if BPA fails to meet its revenue targets. *Id.* Moreover, because the REP benefits are fixed, the IOUs' REP benefit payments will never be a contributing factor to a CRAC, so applying a CRAC to their rates would be inequitable. *Id.*

### **Evaluation of Positions**

APAC contends that under the Settlement, the level of REP benefits is protected from the operation of a Cost Recovery Adjustment Clause. APAC Br., REP-12-B-AP-01, at 9. APAC asserts that since their creation, CRACs have been applicable to all rates. *Id.* In APAC's view, CRACs provide BPA with a mechanism to ensure recovery of costs if the established rates prove inadequate. *Id.* APAC cites the Load-Based CRAC as an example of a CRAC that BPA has designed to recover costs that cannot be recovered in base rates. *Id.* APAC argues that the Settlement excuses IOU Exchange customers from sharing in the responsibility for ensuring full recovery of BPA's costs. *Id.* As a result, APAC concludes, the responsibility for ensuring full recovery of BPA's costs will fall more heavily on other customer classes. *Id.*

APAC's objections are unfounded. First, a few preliminary matters must be addressed before responding to APAC's arguments. The first preliminary matter is to recognize that CRACs are not a statutory mechanism prescribed by the Northwest Power Act. Section 7(a) provides that BPA must

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. Such rates shall be established and, as appropriate, revised to recover, in accordance with sound business principles, the cost associated with the acquisition, conservation, and transmission of electric power, including the amortization of the Federal investment in the Federal Columbia River Power System (including irrigation costs required to be repaid out of power revenues) over a reasonable period of years and the other costs and expenses incurred by the Administrator pursuant to this chapter and other provisions of law.

16 U.S.C. § 839e(a)(1). As noted by the express terms of section 7(a)(1), there is no ratemaking requirement that BPA apply a CRAC or any other within-rate-period mechanism to adjust the rates of any class of BPA's customers. Instead, the Northwest Power Act grants BPA broad discretion to establish rates to "recover ... the cost associated with acquisition, conservation, and transmission of electric power ... over a reasonable period of years and the other costs and expenses incurred by the Administrator pursuant to this chapter and other provisions of law." *Id.* Other provisions of the Northwest Power Act confirm that BPA has broad discretion to design and develop rates. *See id.* § 839e(e) ("Nothing in this chapter 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."); *see also City of Seattle v. Johnson*, 813 F.2d 1364, 1367 (9th Cir. 1987) ("In short, the statute does not require BPA to impose any particular type of rate on its customers. Rather it restricts BPA only to 'sound business principles' in setting rates to meet its revenue requirements."). CRACs,

therefore, are a form of rate design that BPA has discretion to apply to its rates in the appropriate circumstances. They are not, and have never been, required by the Northwest Power Act.

The second preliminary matter is to clear up a misstatement of fact in APAC's arguments. APAC asserts that since their creation, "CRACs have been applicable to all rates." APAC Br., REP-12-B-AP-01, at 9. That is not so. There are many rates and rate design methodologies that BPA has developed over the years that have not been adjustable by CRACs. APAC need look no further than BPA's existing rate schedules to see examples of rates exempted from the application of the CRAC. See 2010 Wholesale Power Rate Schedules (FY 2010–2011) and General Rate Schedule Provisions, WP-10-A-02-AP02, at 79 (WP-10 GRSPs). For instance, in the WP-10 GRSPs it states:

The CRAC does not apply to:

sales under the PF Slice Product

power sales under Pre-Subscription contracts to the extent prohibited by such contracts

demand sales (unless a trigger event under the NFB Adjustment increases the CRAC cap and the CRAC triggers for an amount greater than the original cap, in which case the amount of CRAC revenue in excess of the original cap will be collected through an increase to all demand, Energy, and Load Variance rates proportionately).

*Id.* Having made clear that (1) CRACs are not mandated by the Northwest Power Act, but are discretionary rate design features, and (2) not all BPA rates are currently subject to CRACs, BPA now turns to APAC's arguments.

APAC argues that CRACs provide BPA with a mechanism to ensure recovery of costs if the established rates prove inadequate. APAC Br., REP-12-B-AP-01, at 9. APAC cites the Load-Based CRAC as an example of a CRAC that BPA has designed to recover costs that cannot be recovered in base rates. *Id.* APAC argues that the Settlement excuses IOU Exchange customers from sharing in the responsibility of ensuring full recovery of BPA's costs. *Id.* As a result, APAC concludes, the responsibility for ensuring full recovery of BPA's costs will fall more heavily on other customer classes. *Id.*

Contrary to APAC's conclusion, BPA does not view the lack of a CRAC mechanism in the Settlement as a flaw, but rather as simply one of the trade-offs that must be made to achieve an agreement for a long-term duration. Bliven *et al.*, REP-12-E-BPA-12, at 56. The IOUs are agreeing to a fixed limited amount of REP benefits for the next 17 years. *Id.* In return for this fixed stream of benefits, the IOUs are trading away their future right to receive higher benefits (although no one IOU is assured of receiving any of these REP benefits). *Id.* Applying a CRAC to the fixed REP benefits would only serve to further degrade the certainty that the IOUs thought they had achieved through Settlement, which BPA finds neither required by the Northwest Power Act nor reasonable. *Id.*

This is not to say that BPA simply rejected out of hand applying a CRAC to the IOUs' REP benefits. BPA considered applying a CRAC to the Settlement but ultimately rejected the proposal for two reasons. First, applying a CRAC mechanism to the PF Exchange rate under the REP Settlement does not make sense in a situation such as this, where the IOUs will see no benefit of a within-rate-period adjustment to BPA's costs or revenues. Bliven *et al.*, REP-12-E-BPA-12, at 56. CRACs are designed to recover the costs of events that cause unexpected swings in BPA's costs and revenues. *Id.* COUs' ratepayers, as a general matter, will experience both the positives and negatives of these swings. *Id.* If BPA has particularly good secondary sales in a year, the COUs' rates will reflect this "unexpected" benefit through a Dividend Distribution Clause "refund" or lower future rates. *Id.* Conversely, if BPA has an unexpected drop in secondary sales, COUs' rates could also be affected by an increase resulting from a CRAC. *Id.* Either way, the COUs see the costs and benefits of the unexpected events that occur during BPA's rate periods. *Id.*

The IOUs, on the other hand, are agreeing under the Settlement to a fixed amount of REP benefits. Bliven *et al.*, REP-12-E-BPA-12, at 57. As a result, they will see no additional increases in REP benefits regardless of what events occur during BPA's rate periods. *Id.* Thus, for example, if a DDC is triggered during the rate period, the IOUs receive no additional REP benefit from this event, even though REP benefits would have (without the Settlement) increased. *Id.*; *see also* WP-10 GRSPs, WP-10-A-02-AP02, at 84, 86. If BPA experiences conditions wherein it can lower its rates, the IOUs will enjoy no benefits from the lower rates. If the IOUs cannot experience any upside from within-rate-period adjustments in BPA's costs and revenues (such as through a DDC or rate reduction), then it makes sense to similarly insulate them from the downsides of within-rate-period adjustments (such as through a CRAC). Bliven *et al.*, REP-12-E-BPA-12, at 57.

Second, the fixed nature of the REP benefits in the Settlement also means the IOUs will not be contributing to any costs that could cause a CRAC to trigger. *Id.* This would not be the case if the IOUs were participating in the traditional REP. *Id.* Under a no-settlement scenario, the IOUs would be entitled to receive REP benefits calculated based, in part, on their actual exchange loads. *Id.* These loads could vary widely from what BPA forecasts in its rate case, resulting in additional unexpected within-rate-period cost changes to BPA, either upward or downward. *Id.* In this instance, it makes sense to apply a CRAC to the IOUs' REP benefits because their loads contribute to the events that cause BPA to experience "unexpected" changes in its costs and revenues. *Id.* Under the Settlement, however, this will never happen with the IOUs' REP benefits. *Id.* The IOUs' REP benefits are fixed by the Settlement, so no matter how their loads fluctuate throughout the rate period, REP benefits under the Settlement will never be a contributing factor in the triggering of a within-rate-period CRAC. *Id.*

APAC contends that the Settlement further denies "rate protection" to COUs in shielding the REP benefits from any imposition of a Cost Recovery Adjustment Clause. APAC Br. Ex., REP-12-R-AP-01, at 8-9. APAC argues that the parties to the Settlement may have bargained this away in exchange for the certainty of future REP benefits, but the COUs exchanged that for

more uncertainty in the rates they will face in the future. *Id.* BPA has two responses to APAC’s argument.

First, CRACs do not provide “rate protection” to the PF Public rate. As noted above, CRACs are not required by the Northwest Power Act but, rather, are a rate design mechanism BPA uses to ensure cost recovery within a rate period. Significantly, CRACs are employed only when *real-time* changes in costs and revenues vary substantially from what BPA was projecting when setting rates. The concept of “rate protection,” in contrast, comes from section 7(b)(2), which discusses *only* projections. Section 7(b)(2) provides:

After July 1, 1985, *the projected amounts to be charged* for firm power for the combined general requirements of public body, cooperative and Federal agency customers, exclusive of amounts charged such customers under subsection (g) of this section for the costs of conservation, resource and conservation credits, experimental resources and uncontrollable events, may not exceed in total, as determined by the Administrator, during any year after July 1, 1985, plus the ensuing four years, an amount equal to the power costs for general requirements of such customers if, the Administrator assumes [five assumptions]...

16 U.S.C. § 839e(b)(2) (emphasis added).

As the plain language of section 7(b)(2) makes clear, COUs’ “rate protection” comes from comparing two different *projections*. BPA is not required to provide real-time rate protection by revising the rate test every month to “test” whether the amounts *actually charged* exceed the results of section 7(b)(2).

As to APAC’s second argument that the parties to the Settlement have bargained away the ability to adjust the IOUs’ REP benefits for CRACs for “more uncertainty in the rates they will face in the future,” BPA fundamentally disagrees. The record in this case shows the COUs have obtained a substantial amount of certainty by signing the Settlement. This certainty comes, first, in the form of ending disputes over the refunds paid, and the refunds to be received. *See* Issue 6.5.7. In addition, the Settlement provides certainty in the amount of REP costs BPA includes in rates, which, based on BPA’s projections, could vary tremendously. If BPA were to be sustained on all issues in the present litigation, BPA projects that REP benefits could have increased to as high as \$752 million in FY 2028. Evaluation Study, REP-12-FS-BPA-01, Table 10.3.2 (Scenario 0 – Reference Case). Conversely, if the IOUs had succeeded in their claims, REP benefits could have increased to over \$873 million. *Id.* (Scenario 22 – IOU Brief Case). Even if the COUs were to win their current claims in Court, BPA projects that REP benefits in FY 2028 would exceed \$330 million. *Id.* (noting that Scenario 21-COU Brief Case would produce \$339 million in FY 2028). To provide a glimpse of how these values could vary due to other *non-litigation* factors, BPA performed a sensitivity analysis on the Reference Case, combining various groupings of high and low ASCs with high and low BPA costs. The resulting spread in REP benefits ranged from a low of \$504 million to a high of nearly a \$1 billion (per year) in FY 2028. *Id.* All of this variability contrasts to the Settlement, which provides a fixed amount of REP benefits of \$286 million in FY 2028, hundreds of millions of

dollars below BPA's and the IOUs' litigation positions, and over \$50 million *below* the amount BPA projects the COUs would pay in rates if the COUs were to win on all their briefed issues in the litigation currently pending at the Court. *Id.* Clearly, the Settlement does not increase the uncertainty to the COUs' rates.

APAC argues that the responsibility for ensuring full recovery of BPA's costs will fall more heavily on other customer classes if no CRAC is included in the Settlement. APAC Br., REP-12-B-AP-01, at 9. While COU customers may feel the brunt of a CRAC in a future rate case, BPA does not agree that this means COUs will likely be, from a rates perspective, worse off under the Settlement. Bliven *et al.*, REP-12-E-BPA-12, at 58. This is because the discount the IOUs are taking in their REP benefits under the Settlement would, in BPA's view, more than make up for the small amount of CRAC contributions the IOUs would have provided under a no-settlement alternative. *Id.* An example will illustrate this situation.

BPA's Reference Case projects that in FY 2022, REP benefits would be \$515 million under a no-settlement situation. *Id.* Hypothetically, if BPA were to implement a CRAC to recover \$100 million in unexpected costs from PF Public and PF Exchange ratepayers, using BPA's existing (WP-10) CRAC construct, the IOUs' REP benefits would be reduced by a mere \$27.8 million. *Id.*; *see also* WP-10 GRSPs, WP-10-A-02-AP02, at 80-81. COU rates would be responsible for recovering the remaining \$73.2 million from the CRAC plus their share of the IOUs' REP benefits (*i.e.*, \$487 million). Bliven *et al.*, REP-12-E-BPA-12, at 58.

Compare this scenario with the Settlement values. *Id.* Using the same assumptions, the CRAC would apply to the rates charged to COUs, resulting in a \$100 million increase. *Id.* The fixed amount of REP benefits recovered in rates for the same year under the Settlement would be \$259 million. *Id.* While the IOUs' aggregate REP payments would not be reduced as a result of the CRAC, the COUs would see overall greater net savings of \$256 million (\$259 million under Settlement subtracted from \$515 million under no-settlement) under Settlement when compared to a no-settlement scenario because of the discount the IOUs are taking in their REP benefits. *Id.*

For these reasons, BPA finds that exempting from a CRAC the PF Exchange rates developed under the terms of the Settlement is reasonable, consistent with the law, beneficial to all BPA ratepayers, and supported by the record in this case.

### **Decision**

*The Settlement's limitation on the application of a cost recovery adjustment mechanism to the IOUs' REP benefits is reasonable.*

### **Issue 4.5.7**

*Whether the Settlement complies with BPA's 2008 ASC Methodology and the 2008 RPSA.*

## **Parties' Positions**

WPAG contends that the Settlement approach of offering the IOUs as a class a global settlement of predetermined REP benefits is contrary to BPA's 2008 ASC Methodology and the 2008 RPSA. WPAG Br., REP-12-B-01, at 10, n.4; WPAG Br. Ex., REP-12-R-WG-01, at 20, n.9.

Alcoa argues that ASCs as used under the Settlement violate the "intended use and purpose" of the 2008 ASCM. Alcoa Br. Ex., REP-12-R-AL-01, at 32-41. Alcoa claims that the Settlement violates the 2008 ASC Methodology by fixing REP benefits, which in Alcoa's view violates the traditional REP that was described in the 2008 ASCM ROD and in FERC's orders. *Id.*

## **BPA Staff's Position**

The Settlement complies with the 2008 ASC Methodology. Gendron *et al.*, REP-12-E-BPA-04, at 29. The Settlement retains the requirement that IOUs file ASCs consistent with BPA's 2008 ASC Methodology. Bliven *et al.*, REP-12-E-BPA-12, 41-42. ASCs will be reviewed and evaluated in ASC processes consistent with the procedural rules of the 2008 ASC Methodology. *Id.* Moreover, only IOUs with ASCs that exceed BPA's PF Exchange rate will receive REP benefits under the Settlement. *Id.* at 53. The 2008 ASC Methodology does not describe the method or manner in which total REP benefits are to be determined or collected in BPA ratemaking.

## **Evaluation of Positions**

WPAG contends that the Settlement approach of offering the IOUs as a class a global settlement of predetermined REP benefits is contrary to BPA's 2008 ASC Methodology and the 2008 RPSA. WPAG Br., REP-12-B-01, at 10, n.4; WPAG Br. Ex., REP-12-R-WG-01, at 20, n.9.

BPA disagrees. First, WPAG is wrong in claiming that the Settlement contravenes any provision of the 2008 ASC Methodology. As noted above, the Settlement requires no changes to the existing ASC Methodology. Gendron *et al.*, REP-12-E-BPA-04, at 29. The IOUs will continue to file, and BPA will continue to determine, ASCs based on the FERC-approved 2008 ASC Methodology. *See* REPSIA, REP-12-A-02A, Exhibit A, § 4 ("...«Customer Name» shall continue to file a new Appendix 1 as required by the ASC Methodology ..."); *see also* Gendron *et al.*, REP-12-E-BPA-04, at 28-29 ("the Settlement continues to distribute the REP benefits among the settling IOUs in a manner consistent with ASCs established under BPA's current ASC Methodology ....").

Furthermore, no provision of the ASC Methodology speaks to whether BPA may adopt "a global settlement of predetermined REP benefits" as WPAG contends. In fact, the ASC Methodology says nothing about the determination of REP benefits. Rather, the focus of the ASC Methodology is to determine utility ASCs in accordance with section 5(c)(7) of the Northwest Power Act. *See* 18 C.F.R. § 301.1 ("The regulations in this part apply to the sales of electric power by any Utility to the Bonneville Power Administration (Bonneville) under section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act).").

In light of that focus, the term “REP benefits” is mentioned only once in the ASC Methodology, in the definition of Exchange Period, where it is used descriptively to refer to the “period during which a Utility’s Bonneville-approved ASC is effective for the calculation of the Utility’s Residential Exchange Program benefits.” *Id.* § 301.2. Beyond this single reference, the 2008 ASC Methodology provides no further references to the term “REP benefits.” Not surprisingly, WPAG provides no specific citation to the ASC Methodology to support its assertions that the Settlement violates the 2008 ASC Methodology. *See* WPAG Br., REP-12-B-WG-01, at 10, n.4; WPAG Br. Ex., REP-12-R-WG-01, at 20, n.9.

WPAG’s second contention, that the Settlement contravenes the 2008 RPSA, is simply irrelevant. The 2008 RPSAs are being disputed by the IOUs in the *IPUC* litigation. The Settlement would end this litigation and replace the disputed 2008 RPSAs in their entirety with the REPSIA, the agreement containing the specific terms and conditions necessary to implement the Settlement during its 27-year term. Forman *et al.*, REP-12-E-BPA-10, at 17. Section 12 of the REPSIA expressly terminates the 2008 RPSA and replaces it with the Settlement:

As of October 1, 2011, «Customer Name»’s Residential Purchase and Sales Agreement, Contract No. [xxxx], is hereby terminated and replaced by this Agreement. Upon termination of such «Customer Name»’s Residential Purchase and Sale Agreement, Contract No. [xxxx], all obligations incurred thereunder shall be preserved until satisfied.

REPSIA, REP-12-A-02A, Exhibit A, § 12. BPA does not understand how it will be acting “contrary to applicable regulations” by adopting a Settlement that will terminate and replace a disputed agreement. WPAG fails to provide any citation or analysis to support its assertion.

Alcoa, like WPAG, also claims that the Settlement violates the 2008 ASC Methodology. Alcoa Br. Ex., REP-12-R-AL-01, at 32-41. Alcoa asserts that the Settlement requires BPA to deviate from the ASC Methodology, and therefore, does not comply with the law. *Id.* at 33. After providing an overview of its understanding of the ASC Methodology, Alcoa claims that the Settlement violates the ASC Methodology in four ways.

First, Alcoa claims that the 2008 ASC Methodology was designed and implemented solely to support BPA’s traditional REP. *Id.* at 35. Alcoa asserts that under its terms, the ASC Methodology may be implemented only to develop an ASC amount that correlates to an “actual amount” of REP benefits for individual utilities, not just to allocate percentages of REP benefits among utilities using an externally, third-party negotiated aggregate level of REP benefits. *Id.*

This argument is easily rebutted because the ASC Methodology in no way declares that it may be used only when establishing ASCs under the “BPA’s traditional REP.” Alcoa has cited no provision of the ASC Methodology which prohibits its use in a context of a Settlement. Alcoa’s contention is, therefore, without merit.

Second, Alcoa asserts that the ASC Methodology may be used only to determine ASCs that are used to determine the “actual amount” of REP benefits for individual utilities, rather than

“allocate percentages of REP benefits among utilities.” *Id.* ASCs, however, will continue to determine “the actual amount” of REP benefits for each IOU under the Settlement. As noted above in response to WPAG’s argument, individual ASCs will continue to be filed by utilities under the Settlement, BPA will review these ASCs in the ASC Review Process and issue final ASC Reports, the IOUs will file these ASCs with the Commission, and BPA and the utilities will exchange power based on a comparison of the utilities’ ASCs and BPA’s PF Exchange rates. Bliven *et al.*, REP-12-E-BPA-12, at 41-43. If a utility does not “file” an ASC, it will receive no REP benefits. Alcoa believes that ASCs will be used only to allocate REP benefits based on “percentages” under the Settlement, but that is incorrect. A utility with an ASC below BPA’s PF Exchange rate will receive no REP benefits, as is the case today. Thus, ASCs under the Settlement will continue to serve the same function as they do today: determining which individual IOUs are eligible for REP benefits and how much REP benefits these utilities should receive. Bliven *et al.*, REP-12-E-BPA-17, at 19-20. Alcoa has not shown otherwise.

Third, Alcoa contends that the Settlement does not use the 2008 ASC Methodology to develop an ASC “amount” that correlates to any actual dollar amount of benefits, but rather establishes a pre-determined level of aggregate benefits and allocates the negotiated settlement amount among participating utilities. Alcoa Br. Ex., REP-12-R-AL-01, at 35. Alcoa asserts that under the traditional implementation of the REP, the REP benefit calculation begins with (and is determined by) a utility’s ASC. *Id.* at 35-36. But under the Settlement, Alcoa contends, the REP benefit calculation ends with the use of ASCs to allocate shares of the fixed REP benefits negotiated by the parties. *Id.*

Alcoa is mistaken. ASCs calculated pursuant to the 2008 ASC Methodology are being used in both the “beginning” and the “end” of the REP benefits determinations under the Settlement. The aggregate amount of REP benefits provided for under the Settlement is being evaluated for compliance with sections 5(c) and 7(b) through this proceeding. To do this, BPA has developed long-term models that evaluate projected REP benefits under BPA’s Reference Case and under a host of other risk and litigation scenarios for the 17 years of the Settlement. *See* Chapter 3. The ASCs used in the long-term model were established in conformance with the 2008 ASC Methodology. *See* Issue 4.5.4. Based on these long-term projections, BPA has found that the Settlement likely produces fewer REP benefits, and greater rate protection, than without the Settlement, thereby satisfying sections 5(c) and 7(b). While Alcoa may believe there is only one answer for the REP benefit calculation, as noted in Issue 4.5.1, nothing in the Northwest Power Act prohibits the IOUs from accepting less in REP benefits. BPA’s analysis demonstrates the IOUs are doing just that. BPA could not have made this determination without “beginning with” ASCs calculated consistent with the 2008 ASC Methodology.

Fourth, Alcoa contends that the aggregate amount of REP benefits is fixed under the Settlement, and BPA is obligated to pay out the fixed annual amount regardless of any given utility’s ASC. Alcoa Br. Ex., REP-12-R-AL-01, at 36. Thus, Alcoa asserts the Settlement’s use of the 2008 ASC Methodology is contrary to the Methodology’s purpose and intended use. *Id.*

Alcoa's arguments are not persuasive. As discussed in Issue 4.5.3, section 5(c) and the ASC Methodology do not establish "aggregate" REP benefits. Instead, this is a function of BPA's ratemaking in section 7(b). While the ASC Methodology provides information that is used to determine the total REP benefits to include in rates, the ASC Methodology says nothing about how BPA is to perform those calculations. As discussed in Issue 4.5.4, Staff's scenario analysis uses ASCs that were developed in a manner consistent with the BPA's existing ASC Methodology. Thus, the fact that the Settlement includes a fixed amount of REP benefits does not violate any provision of the ASC Methodology.

Alcoa is also incorrect when it claims that the Settlement requires BPA to pay out the REP benefits "regardless of any given utility's ASC." Alcoa Br. Ex., REP-12-R-AL-01, at 36. In fact, the Settlement requires just the opposite: REP benefits will be paid out in direct relation to the utilities' ASCs. This fact could not be more apparent from the record in this case. The utilities with low ASCs compared to BPA's PF Exchange rate will receive fewer REP benefits (if any at all), when compared to the utilities with higher ASCs. Bliven *et al.*, REP-12-E-BPA-12, at 53. A utility that has an ASC below BPA's applicable PF Exchange rate will receive no REP benefits. Bliven *et al.*, REP-12-E-BPA-12, at 42 ("If an IOU's ASC is less than the applicable PF Exchange rate, then under either the Settlement or no-Settlement, such IOU receives no REP benefits."). As the record in this case makes clear, BPA will not be making payments to the IOUs "regardless of any given utility's ASC."

Alcoa next claims the Settlement's "use" of ASCs violates the "purpose and intended" use of the ASC Methodology. Alcoa Br. Ex., REP-12-R-AL-01, at 36. Alcoa's assertion as to the "intended" use and purpose of the 2008 ASC Methodology is not well founded. Notably, Alcoa did not participate in the development of the 2008 ASC Methodology, did not submit a comment in any of the comment processes associated with the 2008 ASC Methodology, made no filings at FERC regarding the ASC Methodology, and has not intervened in any of the ASC Review Processes for three rate periods. Nevertheless, Alcoa believes it holds a better understanding of the "purpose and intended" use of the 2008 ASC Methodology than Staff or BPA. As Alcoa's arguments reveal, it does not understand the intended "purpose" of the 2008 ASC Methodology.

Alcoa first points to some general statements made by FERC in its order approving the 2008 ASC Methodology that Alcoa asserts "endorsed" the traditional use of ASCs in the calculation of the REP. *Id.* at 36-37. Alcoa then cites to language in the Commission's order where FERC simply describes the exchange-based relationship between BPA and the REP participants; namely, BPA purchases power at the utility's ASC, and the utility purchases power from BPA at the PF Exchange rate. *Id.* As BPA has repeated many times above, this exchange-based relationship is retained under the Settlement. BPA does not see how FERC's general observation on the way the REP operates (which is being retained under the Settlement) demonstrates that the Settlement's "use" of ASCs violates the ASC Methodology.

Alcoa next claims BPA and FERC "obviously envisioned" that BPA would use the 2008 ASC Methodology to determine the amount of REP benefits available to an individual utility, as required by the Northwest Power Act. *Id.* at 37. Alcoa then argues "BPA's intent" to use the

ASC Methodology to determine an amount of REP benefits rather than what Alcoa asserts is “just ... an allocator, as applied under the Settlement” is evident throughout the many changes made to the methodology in the 2008 ASC Methodology. *Id.* at 37. Alcoa then proceeds to take various statements made by FERC in its order approving the ASC Methodology and BPA in the ASCM ROD to support its conclusion that the 2008 ASC Methodology “describes the methodology in terms of [BPA’s] traditional REP program, and nowhere in the ASCM ROD does BPA contemplate, or even speculate, that the ASCM would only be used to allocate an externally-derived and fixed aggregate REP benefit.” *Id.* at 40.

Alcoa is again conflating innocuous background statements made in the ASCM ROD and the Commission’s order into substantive findings by BPA and the Commission. As Alcoa admits, the only significance of the statements cited by Alcoa is the simple observation that the 2008 ASC Methodology “describes the methodology in terms of [BPA’s] traditional REP program.” Alcoa Br. Ex., REP-12-R-AL-01, at 40. Nowhere in any of these statements, however, does the ASC Methodology or FERC’s order support Alcoa’s inferential leap that these descriptions of the traditional REP somehow preclude BPA’s use of the ASC Methodology in the context of a Settlement of the REP. BPA did not describe any other method for the REP in the ASCM ROD for the simple reason that there were no other methods present when BPA was considering the ASC Methodology. The only “method” before BPA and the Commission at the time the 2008 ASC Methodology was being developed was BPA’s “traditional” implementation method. But the fact that BPA mentioned this approach in its development of the 2008 ASC Methodology does not mean that BPA and the Commission tacitly determined for all time that the only way to implement the REP was through BPA’s “traditional” method rather than through a settlement. Indeed, there is not a word in the ASC Methodology about whether the ASC Methodology may or may not be used to determine ASCs in a settlement where the aggregate level of REP benefits is fixed.

Alcoa seems to believe that because the Settlement was not contemplated at the time the 2008 ASC Methodology was developed, the ASC Methodology is incompatible with the construct in the Settlement. That is not so. Simply reviewing the record in this case demonstrates that the settling parties have structured the Settlement *to conform to* the existing 2008 ASC Methodology. As noted above, the Settlement requires no changes to the existing ASC Methodology. Gendron *et al.*, REP-12-E-BPA-04, at 29. The IOUs will continue to file, and BPA will continue to determine, ASCs based on the FERC-approved 2008 ASC Methodology. See REPSIA, REP-12-A-02A, Exhibit A, § 4 (“... «Customer Name» shall continue to file a new Appendix 1 as required by the ASC Methodology ....”); *see also* Gendron *et al.*, REP-12-E-BPA-04, at 28-29 (“the Settlement continues to distribute the REP benefits among the settling IOUs in a manner consistent with ASCs established under BPA’s current ASC Methodology ....”).

Moreover, Alcoa’s conclusion also reveals that it misunderstands the role the 2008 ASC Methodology plays in BPA’s ratemaking and the REP calculation. Contrary to Alcoa’s inculcations, the 2008 ASC Methodology does not dictate how aggregate REP benefits are determined. Rather, the ASC Methodology provides information that is used in the REP benefit

calculation; namely, a utility's ASC and exchange load. How this information is used in rates and BPA ratemaking to determine the ultimate level of REP benefits is a function of section 7(b) of the Northwest Power Act, not the ASC Methodology. Alcoa does not cite a single substantive provision of the ASC Methodology to support its conclusion that the ASC Methodology dictates how BPA is to calculate total REP benefits.

Alcoa claims BPA modified the ASC Methodology in 2008, for the first time in 24 years, to account for changes in the energy industry that had occurred over time. Alcoa Br. Ex., REP-12-R-AL-01, at 37. Alcoa asserts that under the Settlement, an individual utility's ASC is used as a "threshold for determining whether or not that utility receives, and if so its relative percentage of, the pre-determined and fixed REP benefits set forth in the Settlement." *Id.* BPA does not see how, from an individual utility perspective, the Settlement is any different from the no-Settlement alternative. The very same "threshold determination" of comparing ASCs to BPA's PF Exchange rate would occur under the no-settlement alternative. In addition, the allocation of the aggregate level of REP benefits based on the "relative percentages" of ASCs to BPA's PF Exchange would also occur under the no-settlement alternative. BPA has calculated individual REP benefits this way for two rate periods, without protest from Alcoa. *See Bliven et al.*, REP-12-E-BPA-17, at 22. As noted by Staff:

[A]djusting the PFX rate to permit the payment of the amount of REP benefits that BPA believes is appropriate under the law is not a new concept; it is the way BPA would set the PFX rates even without the Settlement. WPAG needs only to look to the manner in which the PFX rates were set in the WP-07 Supplemental rate case (FY 2009) or the WP-10 rate case (FY 2010–2011) to see precedent for this approach. In both cases, BPA developed specific PFX rates for each IOU such that they would receive the REP benefit amounts BPA determined they were entitled to under the law.

*Id.*

Alcoa next claims the ASC Methodology contemplates individualized determinations of REP benefits, which by their nature will change over time. Alcoa Br. Ex., REP-12-R-AL-01, at 36-37. Alcoa asserts the Settlement disregards this construct by fixing the aggregate amount of REP benefits for 17 years, and "the aggregate amount of REP benefits will not be adjusted to account for changes in the participating utilities' ASCs." *Id.* Again, Alcoa misunderstands the Settlement, the 2008 ASC Methodology, and BPA ratemaking. Individualized determinations of REP benefits will continue under the Settlement based on ASCs and BPA PF Exchange rates. The amount of REP benefits each IOU receives will change over time as ASCs change. The fact that the Settlement "fixes" the aggregate REP benefits to collect in rates does not violate any provision of the ASC Methodology because the ASC Methodology addresses only calculating individual utilities' ASCs; the 2008 ASC Methodology does not establish how BPA is to calculate REP benefits in rates. BPA calculates aggregate REP benefits pursuant to section 7(b). BPA explains in Issue 4.5.4 how the ASCs used in determining total aggregate REP benefits have been calculated in accordance with the ASC Methodology.

Alcoa next claims BPA's intended use of the ASC Methodology becomes even more apparent upon an examination of the ASCM ROD. Alcoa Br. Ex., REP-12-R-AL-01, at 40. Alcoa asserts the ASCM ROD is replete with BPA's explanations of the traditional REP and how the ASC Methodology complies with the program. *Id.*

Again, Alcoa is conflating BPA's description of the traditional REP into a substantive finding by BPA that ASCs cannot be used in the context of a settlement of the REP. BPA has already explained above that such an assertion is flatly incorrect. Moreover, Alcoa's attempt to tether BPA's implementation of the REP to a specific method in the ASC Methodology is patently inconsistent with the ASCM ROD. BPA could not have been more clear in the substantive discussions in the ASCM ROD that its "intended" purpose for developing the 2008 ASC Methodology was limited to calculating utility ASCs. How those ASCs would be used in rates and how BPA would develop its PF Exchange rate in relation to these ASCs to determine total REP benefits were matters outside of the scope of the ASCM consultation process. As explained in the 2008 ASCM ROD:

The purpose of the consultation is to establish the ASCM that will be used to calculate a Utility's average system cost pursuant to section 5(c) of the Northwest Power Act. Consequently, the issues that must be addressed in this Record of Decision *are limited to matters that directly relate to the determination of ASCs under the proposed ASCM.*

ASCM ROD at 64 (internal citation omitted and emphasis added). This limited focus of the 2008 ASC Methodology is consistent with the scope BPA set for the 2008 ASCM consultation process:

[BPA] proposes a revised methodology for determining the average system cost (ASC) of resources for regional electric utilities that participate in the ... [REP] authorized by section 5(c) of the [Northwest Power Act].... This consultation proceeding is intended to facilitate the compilation of a full record upon which the Administrator will base his decision for a final ASCM.

73 Fed. Reg. 7270 (2008).

Thus, contrary to Alcoa's repeated assertions, BPA had no "intent" of establishing in the 2008 ASC Methodology a particular method or manner of calculating "aggregate" or individualized REP benefits. The point and purpose of the 2008 ASC Methodology was simply to determine how to calculate the utility's ASC; that is all the 2008 ASC Methodology does. And, as noted above, the 2008 ASC Methodology will continue to serve this role under the Settlement.

Alcoa raises a new argument in its brief on exceptions. Alcoa claims that the Settlement "does away with" the traditional RPSA, which Alcoa claims was "expressly contemplated" in the 2008 ASC Methodology. Alcoa Br. Ex., REP-12-R-AL-01, at 40. Alcoa then asserts that BPA is removing the "deemer mechanism" under the Settlement. *Id.* Alcoa explains that under the deemer mechanism, if a utility's ASC falls below BPA's PF Exchange rate, the utility can "deem" its ASC equal to the PF Exchange rate and can pay off the amount it owes BPA in its

deemer account by accepting a reduction in future positive REP benefits. *Id.* Under the Settlement, if a utility's ASC fails to exceed BPA's PF Exchange rate, Alcoa claims the utility simply will not receive REP benefits, but BPA does not indicate that it will be forced to pay the difference through a reduction in future benefits. *Id.*

Alcoa's arguments are faulty for two reasons. First, Alcoa's objection to the removal of the deemer mechanism from the REPSIA (the new form of RPSA) is barred because it is being raised for the first time in its brief on exceptions. BPA's rules of procedure do not permit parties to raise new arguments in brief on exceptions. *See Procedures Governing BPA Rate Hearings*, § 1010.13(b), (c). Neither Alcoa nor any other party argued in initial briefs that removal of the deemer provision from the REPSIA was improper. Alcoa cannot now raise that argument.

Second, even if Alcoa has not waived this argument, it is without merit. BPA does not know what point Alcoa is attempting to make in its argument. If Alcoa is asserting that the 2008 ASC Methodology restricts BPA's ability to modify the RPSA, then Alcoa's argument is clearly without merit for the reasons already articulated above. The 2008 ASC Methodology addresses how to calculate a utility's ASC, not what provisions to include in the RPSA. If Alcoa is asserting that the 2008 ASC Methodology contemplates that there would be a deemer clause in the RPSA used in the REP, then Alcoa's argument is again faulty. Had Alcoa participated in the 2008 ASC Methodology consultation process or the FERC proceedings involving the 2008 ASC Methodology, Alcoa would have realized that BPA has studiously objected to including RPSA contract issues (such as whether to include a deemer provision in the RPSA) within the scope of the 2008 ASC Methodology. *See BPA's Reply Comments on BPA's Proposed 2008 ASC Methodology*, FERC Docket Nos. EF08-2011-000, RM08-20-000, dated December 22, 2008, at 40-41. Idaho Power and the Idaho Public Utilities Commission attempted to argue to FERC (on a number of occasions) the merits of the deemer mechanism, but FERC agreed with BPA that issues regarding the RPSA were not within the scope of FERC's rulemaking:

We also decline Idaho PUC's request that we reject use of the deemer mechanism. We find that Idaho PUC's challenge represents a collateral attack on Bonneville's Residential Purchase and Sales Agreements between Bonneville and its customers, where that mechanism is found. Those agreements are not the subject of this rulemaking proceeding.

*Sales of Electric Power to the Bonneville Power Administration; Revisions to Average System Cost Methodology*, 74 Fed. Reg. 47052, at 47054 (2009).

Third, if Alcoa is attempting to suggest that the Northwest Power Act directs BPA to include a deemer mechanism, then again, Alcoa's argument is without merit. BPA's position is that it is permissible to include this provision in order to address a statutory "gap" in section 5(c). *See Evaluation Study Documentation*, REP-12-E-BPA-01A, at 1692-1706 (noting BPA's position in the *IPUC* litigation on the deemer provision). BPA has in no way said that section 5(c) directs that such a provision be included in every conceivable agreement involving the REP. In this case, BPA is considering a settlement of the REP. One of the issues being settled is the litigation over BPA's decision to include a deemer provision in the RPSA. While BPA believes a deemer

provision is permissible, BPA finds that substantially greater REP benefit savings can be achieved through the Settlement. The evidence submitted into the record of this case squarely supports BPA's position on this issue. *See Bliven et al.*, REP-12-E-BPA-17, at 23. BPA forecasts that significant cost savings will be achieved under the fixed REP benefits when compared to the traditional approach to the REP, which would include a deemer mechanism. *Id.* This is due to the basic fact that the utilities that receive the bulk of payments under the traditional REP, and hence the primary drivers of increasing REP costs, are generally the utilities least likely to go into deemer status because of high ASCs. The utilities with the lowest ASCs, and hence the lowest cost to the REP, would be more likely to deem their ASCs equal to the PF Exchange rate. In other words, retention of the deemer mechanism would do little else than protect BPA ratepayers from the costs of REP associated with the lowest-cost IOUs, which in most instances will be receiving very few REP benefits to begin with. Alcoa's arguments cannot overcome the clear evidence provided in the record of this case.

Alcoa concludes that BPA's only course for implementing the Settlement is to change the 2008 ASC Methodology, which BPA has not proposed to do. Alcoa Br. Ex., REP-12-R-AL-01, at 41. Alcoa's argument is baseless. The sum total of Alcoa's contention that the Settlement violates the 2008 ASC Methodology is the insignificant observation that BPA and FERC were thinking of the traditional REP when the 2008 ASC Methodology was approved in 2008. As repeatedly stated above, BPA's and FERC's descriptions of the traditional REP were just that: descriptions. Unless Alcoa can cite to a specific portion of BPA's regulation that prohibits the use of ASCs as contemplated by the Settlement, BPA can see no basis for concluding that the Settlement violates the 2008 ASC Methodology. Alas, Alcoa's brief on exceptions fails to fulfill this most basic charge. Having found nothing in the ASC Methodology that prohibits BPA from using ASCs under a settlement of the REP, BPA finds no merit in Alcoa's conclusion that the Settlement violates either the 2008 ASC Methodology or section 5(c) of the Northwest Power Act.

### **Decision**

*The Settlement complies with the 2008 ASC Methodology and does not violate the 2008 RPSA.*

## 5.0 THE 2012 REP SETTLEMENT AGREEMENT'S COMPLIANCE WITH NORTHWEST POWER ACT SECTIONS 7(b) AND 7(c)

### 5.1 Introduction

Section 7 of the Northwest Power Act governs the establishment of BPA's rates. 16 U.S.C. § 839e. Section 7(b) provides specific directives in setting rates for public agency customers (the PF Public rate) and for REP participants (the PF Exchange rate). 16 U.S.C. § 839e(b). Notably, section 7(b)(1) of the Northwest Power Act prescribes the manner in which BPA will allocate costs to the rate that applies to sales to preference customers and the loads of utilities (primarily IOUs) participating in the REP. Section 7(b)(2) creates a "rate test" that compares the PF Public rate established under the Northwest Power Act with a PF Public rate established using five assumptions specified in section 7(b)(2). The result of the test is a "rate ceiling" on the rate charged to preference customers.

### 5.2 Ratesetting Steps Occurring Before the 7(b)(2) Rate Test

Although the REP is generally a paper transaction with no real power being exchanged between BPA and the participating utility, as described in section 1.2.1, BPA's ratemaking assumes that the REP comprises an actual exchange of power. Evaluation Study, REP-12-FS-BPA-01, section 3.1; 16 U.S.C. § 839e(b). BPA's forecast 7(b)(1) loads are increased by the forecast sales of exchange power, and BPA's forecast of resource generation is equally increased by the forecast purchase of exchange power. Evaluation Study, REP-12-FS-BPA-01, section 3.1. BPA's ratemaking calculates the cost of exchange purchases using the ASCs of participating utilities. *Id.* An equal amount of power is sold to the participating utilities using the same rate, with some adjustments, as used for sales to BPA's preference customers—the PF Exchange rate. *Id.* However, despite this treatment as an actual power sale, when the ratemaking sequence is complete, the results reflecting the inclusion of the exchange loads and resources are the same as if those exchange loads and resources had been removed (along with the attendant costs and revenues) and replaced with the costs of providing REP benefits. *Id.* The importance of including the exchange loads and resources in the ratemaking sequence is to determine the proper level of REP benefits and the appropriate cost allocations to all rate classes. *Id.*

BPA's ratemaking methodology begins with a Cost of Service Analysis (COSA), then implements a series of rate directive adjustments, and finishes with the application of BPA's rate design. *Id.*; see Power Rates Study, BP-12-FS-BPA-01, Section 2. The COSA divides BPA's power revenue requirement into resource-based cost pools and assigns cost pool responsibility to several load-based rate pools in accordance with generally accepted ratemaking principles and in compliance with statutory directives governing BPA's ratemaking. Evaluation Study, REP-12-FS-BPA-01, section 3.1. The rate directive adjustments, including the section 7(b)(2) rate test, modify the costs allocated to rate pools as necessary to ensure that BPA recovers its rate period revenue requirement while following its statutory rate directives. *Id.*, section 3.1. The application of rate design does not change the costs allocated to a rate pool, but defines the

parameters used to recover the costs allocated to the rate pool. *Id.* This ratemaking sequence is programmed into a Microsoft Excel spreadsheet model called the Rate Analysis Model (RAM2012) for purposes of calculating BPA’s requirements power rates. *Id.*

Rate pools are groupings of customer classes for cost allocation purposes. *Id.* The Northwest Power Act established three rate pools. *Id.* The 7(b) rate pool includes public body, cooperative, and Federal agency sales authorized by section 5(b) of the Northwest Power Act and sales to utilities participating in the REP established in section 5(c). *Id.* The 7(c) rate pool includes sales to BPA’s DSI customers under contracts authorized by section 5(d). *Id.* The 7(f) rate pool includes all other power BPA sells in the Pacific Northwest (PNW) and outside of the PNW, including sales pursuant to section 5(f). *Id.*

The COSA first groups parts of the power revenue requirement into cost pools specified by section 7 of the Northwest Power Act. *Id.* The cost pools are associated with resource pools (Federal base system (FBS) resources, exchange resources, and new resources) and costs allocated according to section 7(g) of the Northwest Power Act. *Id.* The COSA then apportions or “allocates” the cost pools among the rate pools based on the priorities of service from resource pools to rate pools provided in section 7 and the principle of cost causation when section 7 does not provide guidance. *Id.*

Rate directive adjustments are made to recognize sections 7(a)(1), 7(c)(2), 7(b)(2), and 7(b)(3) of the Northwest Power Act. *Id.* The first adjustment ensures cost recovery by reassigning costs allocated to surplus sales that are not recoverable due to contract provisions setting the rates for the surplus sales. *Id.* The second adjustment implements section 7(c)(2) by adjusting the costs allocated to the IP rate pool to ensure the IP rate is set at the level specified in section 7(c)(2). *Id.* At this point in the sequence of ratemaking, the PF Public rate and the PF Exchange rate are equal except for a transmission wheeling adder to accomplish delivery to the PF Exchange rate purchaser. *Id.* In addition, pursuant to section 7(c)(1), the IP rate is equal to the PF Public rate plus adjustments for the typical margin specified in section 7(c)(2) and a section 7(c)(3) adjustment for the value of power reserves provided by IP rate purchasers pursuant to section 5(d)(1)(A). *Id.* At this point, the PF Public rate is tested through the 7(b)(2) rate test. The final rate directive adjustments result from the section 7(b)(2) rate test. *Id.*

### **5.3 Overview of Section 7(b)(2) Rate Test**

#### **5.3.1 Description of the Rate Test**

Section 7(b)(2) of the Northwest Power Act directs BPA to conduct a comparison (called the rate test) of the projected amounts to be charged for general requirements power sold to its public body, cooperative, and Federal agency customers, over the rate period plus the ensuing four years, with the power costs (as measured by rates) to such customers for the same time period if certain assumptions are made. Evaluation Study, REP-12-FS-BPA-01, section 3.2. The effect of this rate test is to partially protect BPA’s preference and Federal agency customers’ wholesale firm power rates from costs resulting from certain provisions of the Northwest Power Act. *Id.*

The rate test can result in a reallocation of costs from the rates of PF Public customers to other BPA power rates. *Id.* BPA has codified the procedures used to conduct the rate test in the *Implementation Methodology of Section 7(b)(2) of the Pacific Northwest Power Planning and Conservation Act (Implementation Methodology)*, WP-07-A-07, which, in turn, relies on BPA’s legal interpretation of section 7(b)(2), as set forth in the *Legal Interpretation of Section 7(b)(2) of the Pacific Northwest Power Planning and Conservation Act (Legal Interpretation)*, WP-07-A-06. *Id.*

The rate test ensures that preference customers’ firm power rates applied to their requirements loads are no higher than rates calculated using specific assumptions that may remove certain effects of the Northwest Power Act. *Id.* If the 7(b)(2) rate test indicates that rate protection is to be accorded to the preference customers, the rate test is said to “trigger.” *Id.*, section 3.3. Pursuant to section 7(b)(3), the cost of this rate protection is borne by all other BPA power sales. *Id.* Some PF purchasers, the preference customers, receive rate protection, while other PF purchasers, the REP participants, pay a portion of the cost of the rate protection. *Id.* Thus, to allow the cost reallocations due to the rate protection, the PF rate is bifurcated into the PF Public rate, which receives the rate protection, and the PF Exchange rate, which does not receive rate protection and bears its allocated share of the rate protection reallocation. *Id.* Forecast sales under the IP rate, the NR rate, and the FPS rate are also allocated a share of the cost of the rate protection. *Id.*

As noted above, the rate test involves the projection and comparison of two sets of wholesale power rates for the general requirements of BPA’s preference customers. *Id.* Under BPA’s traditional approach to the rate test, the two sets of rates are (1) a set for the rate period plus the ensuing four years assuming that section 7(b)(2) is not in effect (*i.e.*, the “projected amounts to be charged for firm power,” known as Program Case rates); and (2) a set of rates for the same period taking into account the five assumptions listed in section 7(b)(2) (*i.e.*, the “the power costs for general requirements,” known as 7(b)(2) Case rates). *Id.* Certain specified costs allocated pursuant to section 7(g) of the Northwest Power Act are subtracted from the Program Case rates prior to the rate comparison. *Id.* Next, each nominal rate is discounted to the beginning of the test period of the relevant rate case. The discounted Program Case rates are averaged, as are the 7(b)(2) Case rates. *Id.* Both averages are rounded to the nearest hundredth of a mill per kilowatthour for comparison. *Id.* If the simple average of the discounted Program Case rates is greater than the simple average of the discounted 7(b)(2) Case rates, the rate test triggers. *Id.* The difference between the average of the discounted Program Case rates and the average of the discounted 7(b)(2) Case rates is used to determine the amount of costs to be reallocated from the PF Public rate to other BPA power rates for the rate period. *Id.*

### **5.3.2 Reallocation of Rate Protection Costs**

In the event the rate test triggers to provide rate protection to BPA’s preference customers, the difference between the average of the Program Case rates and the average of the 7(b)(2) Case rates is multiplied by the preference customer loads. *Id.* The resulting dollar amount, the rate

protection amount, is allocated as a credit to the PF Public rate pool to reduce the PF Public rate to the level allowed by the rate test. *Id.*

The rate protection amount is allocated as a cost to all other BPA power sales pursuant to section 7(b)(3). *Id.* The rate protection amount is allocated on a pro rata energy basis to sales in the PF Exchange rate pool, the IP rate pool, the NR rate pool, and firm surplus and secondary energy sales under the FPS rate. *Id.* As a result of this additional cost allocation, these other rates, except for the market-determined FPS rate, will increase as the PF Public rate decreases. *Id.*

As a result of the decrease in the PF Public rate and section 7(c)(2)'s direction to set the IP rate equal to the PF Public rate, the IP rate (exclusive of its allocation of rate protection costs) is lowered to the PF Public rate. *Id.* The cost of this linking the IP rate to the PF Public rate is a direct result of the rate test and, therefore, none of the costs of this linking can be allocated to the PF Public rate, as was the case with the linking of the IP rate to the PF rate prior to the rate test. *Id.* Instead, the cost of linking the two rates is allocated to the PF Exchange rate pool and the NR rate pool. *Id.* The rate protection cost allocated to the IP rate pool is then reinstated to the IP rate to finalize the costs in the IP rate pool. *Id.*

In the WP-07 Supplemental proceeding, BPA implemented a new method of allocating rate protection costs within the PF Exchange rate pool. *Id.* Prior to the WP-07 Supplemental proceeding, BPA allocated rate protection costs to the PF Exchange rate pool based on energy loads. *Id.* This had the effect of increasing the single PF Exchange rate, which would often result in disqualifying REP participants whose ASCs would now be less than the modified PF Exchange rate. *Id.* In the WP-07 Supplemental proceeding, BPA changed the allocator from energy loads to pre-rate test REP benefits, sometimes called Unconstrained Benefits. *Id.* This change in allocation has the effect of retaining all participants that qualified for the REP prior to the rate test as participants after the rate test. *Id.* Therefore, BPA was able to spread the REP benefits more broadly across the region without increasing the costs of the REP borne by preference customers. *Id.* The total costs of the REP remain the same under this revised allocation methodology as under the prior allocation methodology, but the amounts paid to each REP participant are different, and each REP participant has a different PF Exchange rate. *Id.*

With these final reallocations resulting from the rate test completed, all costs are finally allocated and rate designs can be applied to each rate pool to determine the manner in which its allocated costs will be recovered. *Id.*

### **5.3.3 The Effect of the Rate Test**

As mentioned above, the inclusion of exchange purchases and sales is used to determine the proper level of REP benefits. *Id.*, section 3.4. The 7(b)(2) rate test changes only one of BPA's costs, the cost of the REP. *Id.* All other BPA costs remain as stated prior to the rate test. *Id.* In the ratemaking view of the REP, the proper level of benefits is determined by changing the amount of revenue requirement recoverable from the PF Exchange rate pool, which changes the

level of the PF Exchange rate and, as a result, the amount of revenue from the PF Exchange rates. *Id.* The cost of exchange purchases included in rates is not changed by the rate test. *Id.*

The proper level of REP benefits is determined by comparing each participant's ASC with its PF Exchange rate and multiplying the difference by each participant's qualified exchange load. *Id.* Because BPA's rates are set using forecasts of qualified exchange load, the variance between forecast and actual exchange loads can result in a different amount of REP benefits being paid during each rate period compared to the amount expected in the rate proceeding. *Id.*

Because the REP is the only BPA cost that changes as a result of the rate test, any change in the outcome of the rate test and the subsequent cost reallocations affect only REP benefits and which rate pools pay for the REP. *Id.* Thus, the purpose of the rate test is confined solely to defining the amount of REP benefits expected to be paid and the sharing of the costs of the REP by the different rate pools. *Id.*

#### **5.4 Parties' Disagreements on 7(b)(2) Issues**

It is difficult to overstate the contentiousness over BPA's implementation of the 7(b)(2) rate test in BPA's rate development. The 7(b)(2) rate test trigger (and the extent of that trigger) directly affects the level of the PF Public rate for power sales to preference customers and the PF Exchange rate used to calculate REP benefits for exchanging utilities. The issues that need to be resolved in order to implement the rate test have been contested since the first implementation of the rate test in 1985. *See* 1985 Implementation Methodology ROD, b2-84-F-02. Numerous 7(b)(2) issues came into sharper focus during BPA's WP-07 Supplemental and WP-10 rate cases. BPA's WP-07 Supplemental proceeding was conducted to respond to the Ninth Circuit's decisions in *PGE* and *Golden NW*, where the Court found BPA's 2000 REP Settlements unlawful and held that BPA had improperly treated the REP settlement costs as section 7(g) costs. BPA's response was, in simple terms, to compare the IOUs' benefits under the settlement with the benefits they would have received under the traditional implementation of the REP during the settlement period (FY 2002–2008). BPA then took the difference and, with certain adjustments, earmarked it for refunds to the preference customers through payments and prospective rate credits. BPA is recovering the refunds by reducing each IOU's REP benefits until the IOU has fully repaid its past overpayments. BPA conducted three 7(b)(2) rate tests in the WP-07 Supplemental proceeding: one for the FY 2002–2006 rate period; one for FY 2007–2008; and one for FY 2009.

BPA's decisions on 7(b)(2) rate test issues in recent rate cases are being contested by both COUs and IOUs. These issues include:

- (1) the COUs' contention that the loads in the 7(b)(2) Case should not be adjusted for acquired conservation (*see* Evaluation Study, section 9.3.1.1);
- (2) the IOU exchange customers' contention that the loads in the 7(b)(2) Case should not be adjusted for acquired conservation, but Program Case

- conservation costs should be included in the 7(b)(2) Case (Evaluation Study, section 9.3.1.1);
- (3) the COUs' contention that inclusion of different repayment costs from the Program Case revenue requirement is not allowed in the 7(b)(2) Case (Evaluation Study, section 9.3.2);
  - (4) the COUs' contention that Mid-Columbia resources should be included in the resource stack pursuant to section 7(b)(2)(D) of the Northwest Power Act (Evaluation Study, section 9.3.3);
  - (5) the COUs' contention that the costs of rate protection should not be allocated to surplus and secondary sales (Evaluation Study, section 9.4.1);
  - (6) the IOUs' contention that the surplus sales to Slice customers should include a 7(b)(3) Supplemental Rate Charge and that BPA has not properly accounted for this allocation in the 7(b)(3) reallocations (Evaluation Study, section 9.4.2);
  - (7) the IOUs' contention that conservation resources should be expensed in the year that the resource is called upon (Evaluation Study, section 9.3.1.2);
  - (8) the COUs' contention that all conservation resource costs, if included in the resource stack, should be capitalized over the useful life of the resource (Evaluation Study, section 9.3.1.2);
  - (9) the IOUs' contention that all acquired conservation should be included in the resource stack rather than the smaller portion used in the Reference Case (Evaluation Study, section 9.5.2);
  - (10) APAC's contention that the projected rate of inflation should be used to discount projected rate streams for the Program Case and the 7(b)(2) Case rather than the forecast BPA borrowing rate (Evaluation Study, section 9.5.1); and
  - (11) the IOUs' alternative contention that the projected investment decision discount rate should be used to discount projected rate streams for the Program Case and the 7(b)(2) Case rather than the forecast BPA borrowing rate (Evaluation Study, section 9.5.1).

These issues are raised by the parties in pending litigation before the Ninth Circuit.

Each 7(b)(2) issue would have a significant impact on the PF Public and Exchange rates (and thus the IOUs' REP benefits). The COUs and IOUs believe that there is uncertainty in the way these issues would be resolved by the court. Once an issue is decided by the court, it would be binding on future ratemaking and REP implementation. The COUs and IOUs sought a way to resolve their 7(b)(2) (and related) disputes that would provide them with certainty on the level of the PF Public rate and REP benefits for an extended term. This would also resolve an enormous amount of litigation before the Ninth Circuit. When the COUs' and IOUs' initial discussions

were not fruitful, they asked BPA to consider a mediation process to try to determine whether a settlement could be reached. This mediation process is described in greater detail in section 1.5.3. The mediation process was followed by months of continued intensive negotiations. During the mediation and negotiations, the parties had available information regarding BPA's 7(b)(2) rate tests conducted in the WP-07 Supplemental case for FY 2002–2006, 2007–2008, and 2009. The parties also had information on BPA's most recent 7(b)(2) rate test conducted in the WP-10 proceeding. Thus, the parties' discussions of the settlement amount were grounded in knowledge of the manner in which BPA had resolved each 7(b)(2) issue in its most recent rate cases.

The COUs and IOUs, however, did not want to establish a settlement by assuming that each 7(b)(2) issue would be resolved in a particular way, that is, that either party's position would be used to calculate a settlement amount. This is because, after the settlement period ended, BPA would once again have to conduct the 7(b)(2) rate test and establish rates. The COUs and IOUs were concerned that, despite language stating that no precedent was established by the settlement, if a particular position on each 7(b)(2) issue were adopted in developing a settlement, it would create a suggestion that BPA should make the same decision on each issue in its first post-settlement rate case. The parties would then have to oppose such decisions before BPA and the Ninth Circuit while facing an argument that a particular position had been used for the previous 17 years, an argument that would not have existed in the absence of assuming specific positions on each issue. It was therefore critical to the parties that any settlement would take no position on the merits of any pending 7(b)(2) issue.

The parties are familiar with the Court's decision in *PGE*, which provided that BPA could enter a REP Settlement but that such settlements must respect the statutory protections provided to preference customers. The settling parties believe the Settlement complies with this requirement. Also, from the inception of BPA's review of the Settlement, BPA stated that it needs to determine whether the Settlement complies with sections 5(c) and 7(b) of the Northwest Power Act, and particularly with section 7(b)(2). *E.g.*, Evaluation Study, REP-12-FS-BPA-01, section 6.1. The manner of demonstrating compliance with section 7(b)(2) in a settlement, however, is necessarily somewhat different from demonstrating compliance with section 7(b)(2) in a typical rate case. Because BPA establishes power rates every two years, there is little need for a REP settlement for any two-year rate period because rates have been fixed for such periods and, therefore, benefits from implementing the REP during the rate period based on those rates are close to the REP benefits forecast in the rate case. A settlement therefore must last longer than a single rate period to have much value.

Furthermore, in order to have *any* REP settlement longer than a rate period, BPA must determine a manner in which to reflect section 7(b)(2) in the determination of the settlement benefits for the period following the first two years, because such period exceeds the period for which BPA has established rates. This is a critical point. The Court in *PGE* recognized that BPA can have REP settlements, noting that “[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” *PGE* at 1030 (emphasis added). Thus, the *PGE* Court recognized that establishing a REP

settlement longer than a two-year rate period (like the 10-year 2000 REP Settlements reviewed in *PGE*) would necessarily require BPA to find a way to recognize utilities' ASCs (pursuant to section 5(c)) and the 7(b)(2) rate test (pursuant to section 7(b)(2)) for a period that was *longer* than the (then five-year) rate period. BPA has considered this issue carefully and at great length in reviewing the Settlement.

## **5.5 Ratesetting Pursuant to the Settlement**

### **5.5.1 Overview of Ratesetting Under the Settlement**

Parties to the Settlement seek to resolve their REP disputes (including 7(b)(2) disputes) for a 27-year period. In order to have an effective settlement, the COUs and IOUs needed to establish the amount of REP costs that would be included in the PF Public rate and the amount of REP benefits that would be received by the IOUs. These elements of the Settlement were developed based on the parties' knowledge of BPA's previous resolution of 7(b)(2) issues (as reflected in BPA's WP-10 implementation of the 7(b)(2) rate test) and the respective parties' arguments in litigation on those issues. The COUs and IOUs were unable to construct a manner of settlement wherein BPA simply continued to determine rate protection and forecast REP benefits in each two-year rate proceeding. Although two-year rate cases are the most common manner in which to demonstrate compliance with section 7(b)(2), they resolve issues for only two years and provide parties no resolution of their disputes or any long-term certainty regarding their cost exposure or benefits. BPA has to determine whether the Settlement complies with BPA's statutory directives, including section 7. BPA adopted the following approach to ratesetting in the REP-12 proceeding.

BPA's ratesetting consists of three major steps: the COSA step, the rate directives step, and the rate design step. Evaluation Study, REP-12-FS-BPA-01, section 5.1. Ratesetting under the Settlement affects only a portion of the rate directives step. *Id.* The ratesetting process is unchanged prior to the 7(b)(2) rate test. *Id.*

The purpose of the rate test is to calculate the level of rate protection due to preference customers pursuant to section 7(b)(2) of the Northwest Power Act. *Id.* At the point in the rate modeling after the section 7(c) rate directives have been completed, the Settlement proposes a new solution to a limited portion of BPA's rate calculations. *Id.* This new set of rate calculations effectively implements the section 7(b)(2) rate test through calculations that provide preference customers with an amount of rate protection based on the amount of IOU REP benefits specified in the Settlement, any COU REP benefits for qualified REP participants, and section 7(b)(3) adjustments to the IP and NR rates as specified in the REP Settlement. *Id.*

The REP Settlement ratesetting begins with total IOU REP benefits as specified in the Settlement, called Scheduled Amounts. *Id.* Added to the Scheduled Amount for each year is an additional amount of REP benefits, also specified in the Agreement, known as the Refund Amount. *Id.* The Refund Amounts are considered REP benefits because they are subject to the amount of rate protection afforded to the PF Public rate. *Id.* The Refund Amounts are not paid

to the IOUs, however, but instead are credited back to preference customers in the form of a credit on their power bills. *Id.* Together, the Scheduled Amount plus the Refund Amount is called the REP Recovery Amount.

The REP Settlement rate modeling first calculates the Unconstrained Benefits, which are the REP benefits that would be paid if there was no 7(b)(2) rate protection, in the same manner as if there is no settlement. *Id.* In such circumstance, the REP benefits for each exchanging utility would be equal to its ASC minus its appropriate PF Exchange rate multiplied by its qualified exchange load. *Id.* These Unconstrained Benefits are then used to calculate total COU REP benefits under the REP Settlement. *Id.*

The total rate protection provided to preference customers under Settlement ratemaking is composed of two parts. With the Unconstrained Benefits and the total IOU and COU REP benefits determined, the first amount of rate protection due to preference customers is calculated as the sum of Unconstrained Benefits minus the sum of REP benefits. *Id.* The cost of this first part of rate protection is allocated entirely to the PF Exchange rate pool. The cost of the second part of rate protection to be allocated to the IP and NR rate pools is calculated later. *Id.* Settlement ratemaking allocates this first amount of rate protection to individual REP participants using the same process used in non-settlement ratemaking, a pro rata allocation based on each participant's Unconstrained Benefits. Settlement ratemaking next allocates the cost of providing Refund Amounts to COUs in the same pro rata manner. *Id.* Settlement ratemaking then calculates utility-specific REP Surcharges to be added to the appropriate Base PF Exchange rates to produce utility-specific PF Exchange rates. *Id.* After the utility-specific PF Exchange rates are calculated, the utility-specific REP benefits are calculated and summed. *Id.* At this point, the total annual utility-specific REP benefits for IOUs are equal to the Scheduled Amount for each year. *Id.*

The second part of rate protection is calculated and allocated to the IP and NR rate pools. *Id.* This second part of rate protection is equal to the REP Surcharge included in the IP and NR rates. *Id.* The REP Surcharge is determined by multiplying the total REP benefit costs determined above (REP Recovery Amounts plus COU REP benefits) by a scalar specified in the proposed REP Settlement. *Id.* The scalar is calculated by dividing the WP-10 7(b)(3) Supplemental Rate Charge included in the IP and NR rates by the total REP benefit costs included in WP-10 rates. *Id.* This REP Surcharge, when multiplied by the expected sales under the IP and NR rate schedules, will produce an amount of dollars comprising the second amount of rate protection. *Id.* The second amount of rate protection is subtracted from the total IOU and COU benefits to yield a residual amount of REP benefits that are allocated to the PF Public, IP, and NR rate pools on a pro rata load basis. *Id.*

After the IP and NR adjustment, the now-lower PF Public rate and the now-higher IP rate must again be adjusted to maintain the proper 7(c)(2) rate directive cost relationship. *Id.* For this second IP-PF Link calculation, monthly/diurnal PF Public energy rates are determined, and the IP rate is set equal to the flat PF Public rate plus the typical industrial margin minus the value of reserves credit plus the REP Surcharge. *Id.*

One further adjustment is made to recognize that each IOU currently has differing levels of setoffs in repaying its Lookback Amounts. *Id.* This adjustment is accomplished through reallocations of the cost of rate protection allocated to the IOUs. *Id.* The Agreement specifies a maximum annual adjustment amount for three IOUs and a separate adjustment for Idaho Power. *Id.* These adjustments reduce the initial amount of REP benefits that some IOU would receive and reallocate this reduction to other IOUs. *Id.* Once all of the adjustments are allocated, the cost of rate protection initially allocated to each IOU is recomputed to account for this adjustment. *Id.* The adjusted allocations of the cost of rate protection are added to the allocation of the cost of Refund Amounts to compute each IOU's final PF Exchange rate. *Id.*

Once these steps are complete, the ratemaking process continues to the traditional rate design step. *Id.* The Settlement does not affect the rate design step. *Id.*

### **5.5.2 Comparing the Rate Test with the Settlement**

A comparison of the development of rates under the Settlement and without a settlement reveals only a few changes. Evaluation Study, REP-12-FS-BPA-01, section 5.2. *Id.* Under the Settlement, the amount of rate protection included in the PF Public rate is calculated using specific formulas rather than relying on the disputed 7(b)(2) rate test. *Id.* The allocation of the cost of rate protection is also determined according to specific formulas. *Id.* Finally, the allocation of the 7(c)(2) adjustments after the rate protection has been applied is somewhat different. *Id.* Other aspects of ratemaking are unchanged by the Settlement. *Id.*

Under the Settlement, rate protection is afforded to preference customers. *Id.* The amount of rate protection is calculated in the manner prescribed by the REP Settlement. *Id.* In the same manner as with no settlement, the rate protection reduces the costs allocated to the PF Public rate applicable to preference customers. *Id.* The cost of this rate protection is reallocated to all other power sales, with the exception of surplus sales, which allocation is hard-wired into the Settlement calculations. *Id.* Two PF rates are the result of this : the PF Public rate, which receives the rate protection, and the PF Exchange rate, which does not receive rate protection and bears its allocated share of the rate protection reallocation. *Id.* The cost of rate protection continues to be collected through REP surcharges applied to non-PF Public sales. *Id.*

#### **5.5.2.1 Summarizing the PF Public Rate**

Under the Settlement, the PF Public rate is lowered from the level prior to the application of rate protection included in the PF Exchange rates. *Id.* It has also been lowered by the amount of REP benefits recoverable through the REP Surcharges in the IP and NR rates. *Id.*, section 5.3. After these adjustments, the final amount of costs allocated to the PF Public rate pool is complete, and the ratesetting process proceeds to setting rates pursuant to the Tiered Rate Methodology. *Id.*

### **5.5.2.2 Summarizing the PF Exchange Rate**

Under the Settlement, the PF Exchange rates are set to produce the Scheduled Amounts for the IOUs. *Id.*, section 5.4. This is accomplished through the allocation of the cost of rate protection provided to the PF Public rate and the cost of providing Refund Amounts. *Id.* The PF Exchange rates for COUs participating in the REP are set in the same manner except that the costs of the Refund Amounts are not allocated to the COU participants. *Id.* Finally, the rate protection costs already allocated to the IOUs are reallocated to provide a redistribution of REP benefits that recognizes that each IOU has differing current levels of setoffs in repaying its Lookback Amounts. *Id.*

### **5.5.2.3 Summarizing the IP and NR rates**

Under the Settlement, the IP and NR rates have been adjusted upward by application of the REP Surcharge, which is a section 7(b)(3) allocation of the cost of rate protection. The IP rate is then relinked with the PF Public rate pursuant to section 7(c)(2). *Id.*, section 5.5.

## **5.6 Evaluating the 2012 REP Settlement for Compliance with Section 7(b)(2)**

### **5.6.1 Overview of Staff's Evaluation Criteria**

In *PGE*, the Court held that BPA could settle the REP, but only on “terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” *PGE*, 501 F.3d at 1030. The Court also noted that a “settlement of BPA’s REP obligations must be grounded in the REP program authorized by § 7(b)(2) that governs the recovery of REP costs. A settlement agreement cannot be a means of bypassing congressionally mandated requirements.” *Id.* at 1031. In reviewing the 2000 REP Settlements, the Court found the settlement did not reflect the section 7(b)(2) rate protection Congress had intended. Rate protection served essentially no role under the 2000 REP Settlements. BPA performed a 7(b)(2) rate test in the WP-02 rates, then established REP settlement benefits in excess of that amount and included the REP settlement costs in the rates for COUs. This approach to providing rate protection was particularly troubling to the Court:

[Section 7(b)(2)] provides that preference customers are entitled to rates as if no REP program existed. 16 U.S.C. § 839e(b)(2)(C). The costs of the REP program must be charged in a supplemental rate against other BPA customers, and not against preference customers.<sup>[11]</sup> *Id.* § 839e(b)(3). Notwithstanding this clear instruction, BPA treated the REP settlement as though it were not a rate subject to §§ 7(b)(2) and 7(b)(3).

*Id.* at 1027-1028.

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<sup>11</sup> Section 7(b)(1) of the Northwest Power Act assigns REP costs to the PF rate. 16 U.S.C. § 839e(b)(1).

The Court concluded its opinion by reciting again that BPA has broad settlement authority. *Id.* However, the Court concluded, the 2000 REP Settlements were not a proper exercise of that authority because the “settlement does not resemble the REP program created in §§ 5(c) and 7(b) that it purports to be settling.” *Id.* at 1037.

As representatives of the COUs and IOUs approached BPA with the broadly supported Settlement, it was not lost on BPA that any settlement of the REP must have a clear and direct connection to the protections and requirements set forth in the Northwest Power Act. *See* Evaluation Study, REP-12-FS-BPA-01, section 11.1. As Staff considered what criteria to include in its evaluation of the Settlement, Staff returned to the Court’s clear directive in *PGE* that such settlement be “grounded” in section 7(b)(2) and “resemble the REP program created by §§ 5(c) and 7(b)[.]” *Id.* at 1031, 1037. To ensure that such an evaluation would be central to BPA’s decisions, BPA includes as its first evaluation criterion for the review of the Settlement the following standard:

- (1) the settlement would provide COUs with at least as much rate protection compared to the rate protection afforded under section 7(b)(2) of the Northwest Power Act[.]

Evaluation Study, REP-12-FS-BPA-01, section 11.2; *see also* Gendron *et al.*, REP-12-E-BPA-04, at 26. Staff committed to recommend the Settlement only if it met the requirements of section 7(b)(2).

### **5.6.2 Overview of Staff’s Evaluation Methodology**

The Settlement was developed in the context of three 7(b)(2) rate tests conducted in the WP-07 Supplemental rate proceeding (for FY 2002–2006; FY 2007–2008; and FY 2009) and a rate test conducted for the WP-10 rate proceeding. The settling parties were intimately aware of the rate protection and REP benefits produced by such tests. The Settlement would determine the amount of REP payments to the IOUs and, concomitantly, the amount of rate protection afforded to the COUs for the Settlement period. Evaluation Study, REP-12-FS-BPA-01, section 6.2. REP payments to IOUs under the proposed Settlement would begin in FY 2012 at approximately \$182 million per year and gradually increase over 17 years to about \$286 million by FY 2028. *Id.* In addition, Refund Amounts of \$76.5 million per year would start in FY 2012 and run for eight years. *Id.* Finally, it is expected that COUs may participate in the REP, when eligible, resulting in additional REP payments. All of these payments under the Settlement must be allowable under section 7(b)(2). *Id.*

The protection and payments under the proposed Settlement are well defined and can be computed without much interpretation. *Id.* The REP payments to the IOUs are defined by a schedule, as are the Refund Amounts paid to the COUs. *Id.* However, before the Administrator can make these payments and perform his obligations in the proposed Settlement, the Settlement must have a clear and direct connection to the protections and requirements set forth in the Northwest Power Act. *Id.* To that end, Staff approaches the analysis of the Settlement by

comparing the protections and requirements set forth in the Settlement with protections and requirements that would be reasonably expected in absence of the Settlement. *Id.*

To analyze the protections and requirements set forth in the Settlement, Staff develops a set of potential future streams of results based on an examination of the major variables that would affect the amount of rate protection and REP payments. *Id.* In addition, Staff develops a set of potential future streams of results based on an examination of the issues in litigation that would affect the amount of rate protection and REP payments. *Id.* To accomplish this analysis, Staff used two separate rate models. *Id.*

### **5.6.3 Rate Models Used to Analyze the Settlement**

Staff modified the existing RAM2012 to examine the effect of different resolutions of issues in litigation on the amount of rate protection provided by section 7(b)(2) and the amount of REP benefits that would be paid after application of the 7(b)(2) alternatives. *Id.*, section 6.3. RAM2012 is the detailed rate model being used to calculate rates in the concurrent BP-12 rate proceeding. *Id.* RAM2012 has the capability of developing rates based on either the proposed Settlement or the 7(b)(2) rate test. *Id.* In fact, RAM2012 is the model that would be used to set rates using the 7(b)(2) rate test had the Administrator decided not to adopt the Settlement. *Id.* However, RAM2012 in its current state cannot be used as the sole model for analyzing the Settlement, because RAM2012 is limited to calculating rates for only the FY 2012–2013 rate period. *Id.*

To address the need for a long-term analysis of the Settlement, Staff developed the Long-Term Rate Model to produce estimates of rate protection amounts and REP benefits in the absence of settlement. *Id.* The LTRM projects rates, including rate protection amounts and REP benefits, for the full 17 years of the proposed Settlement and is a scaled-down version of RAM2012. *Id.* It performs many of the same functions as RAM2012 in the portions of the ratesetting process necessary to analyze the Settlement. *Id.* The LTRM develops energy allocation factors in the same manner as RAM2012 and allocates costs and credits to rate pools in the same manner as RAM2012. *Id.* The LTRM links the IP rate to the PF rate in a simplified form as used in RAM2012 (the new model uses annual data only, so it cannot independently calculate a flat annual PF rate for use in the 7(c)(2) linking process). *Id.* Most important, the LTRM performs the 7(b)(2) rate test, and consequent 7(b)(3) reallocations, in essentially the same manner as RAM2012; different formulas are used to compress the rate-period-plus-four-year features of the rate test using the same data inputs as in RAM2012. *Id.*

There are a few notable differences between the LTRM and RAM2012. *Id.* The LTRM is an annual model; it does not calculate rates based on a two-year rate period as does RAM2012. *Id.* Thus, the rate test in the LTRM is based on each year plus the four subsequent years. *Id.* This will create only minor differences compared to RAM2012. *Id.* Also, the LTRM calculates only average energy rates for different rate classes; RAM2012 can calculate monthly and diurnal rates and apply the effects of the demand rate to the energy rates (RAM2012 performs the rate test using annual data also). *Id.* Finally, the LTRM does not calculate tiered rates, whereas RAM2012 implements the Tiered Rate Methodology. *Id.* The lack of tiered rates has only one

effect on this analysis, one that the LTRM can perform: the rate for COUs participating in the REP is based on Tier 1 costs and loads; the LTRM forecasts the costs and loads associated with expected service at Tier 2 rates and removes them from the PF Exchange rate for COUs. *Id.*

Once the LTRM was operational, Staff also incorporated the ability to compute REP benefits and rate protection amounts under a variety of different litigation scenarios. *Id.* Staff recognizes that the level of future REP benefits could be influenced by the outcome of the pending litigation. *Id.* To model these impacts on future REP benefits, Staff designed the LTRM to produce rate protection and REP benefits under differing section 7(b)(2) assumptions in the same manner as in RAM2012. *Id.*

#### **5.6.4 Overview of the Settlement Analysis**

RAM2012 is used in the analysis to produce near-term results and is used as the basis for calibrating the long-term model. Evaluation Study, REP-12-FS-BPA-01, section 6.4. From these scenarios, parties can see the projected near-term and long-term quantitative impacts on future REP benefits of a number of different litigation positions and cost projections. *Id.* The litigated issues Staff considers in this analysis are discussed in Evaluation Study Chapter 9, REP-12-FS-BPA-01. The issues in litigation that can affect 7(b)(2) rate protection and REP benefits and that are considered in Staff's analysis include Lookback issues from BPA's WP-07 Supplemental rate proceeding. Lookback issues contain (1) a no-Lookback proposition, which includes (a) the effect of an invalidity clause in the IOUs' 2000 REP Settlements and (b) retroactive rulemaking and ratemaking; (2) separate and unchallenged Load Reduction Agreements (LRA) with two IOUs; (3) the exclusion of power sales under the 2000 REP Settlements; and (4) a combined effect of the IOU positions.

Lookback issues also contain a large Lookback proposition, which includes: (1) using BPA's WP-02 determinations to set rates; (2) void LRAs; (3) the certainty of Lookback repayment; and (4) the combined effect of the COU positions. Staff's analysis also considers 7(b)(2) issues, including the treatment of conservation; the use of repayment studies; and the treatment of Mid-Columbia resources. Staff's analysis also considers section 7(b)(3) issues, including the allocation of rate protection to surplus power sales, and the treatment of the secondary energy credit. Staff also considers additional 7(b)(2) issues subject to litigation, including the 7(b)(2) accounting and financing treatment of conservation costs; discounting the stream of 7(b)(2) rate projections; and including all acquired conservation in the resource stack.

In addition to the analysis of the litigation positions, Staff's analysis considers other factors that could affect the future amounts of rate protection and REP benefits. *Id.* Both are affected by such things as changes in costs, loads, and other revenues. *Id.* The factors considered can affect the ASCs used as the price of BPA's purchases from REP participants. *Id.* The factors can likewise affect the PF rates used as the price of BPA's sales to REP participants. *Id.* While any factor that could affect rates could produce a change in rate protection and REP benefits, the factors can be grouped into those that would cause ASCs to grow faster than BPA's rates and those that would cause BPA's rates to grow faster than ASCs. *Id.*

If ASCs grow faster than BPA's rates, the increased spread between the two rates produces more rate protection and mitigates the increase in REP benefits that would otherwise occur as ASCs increase. *Id.* If BPA's rates grow faster than ASCs, the decreased spread between the two rates produces less rate protection and mitigates the decrease in REP benefits that would otherwise occur as BPA's rates increase. *Id.* Factors that tend to equally increase or decrease ASCs and BPA's rates produce offsetting effects on rate protection and REP benefits. *Id.* Thus, Staff's analysis focuses on factors that produce opposite or disproportionate effects between ASCs and BPA rates. *Id.* The analysis builds a high-ASC, low-BPA case and a low-ASC, high-BPA case to be representative of the variety of factors that can affect the two rates. *Id.* The factors that affect ASCs are addressed primarily in Evaluation Study Chapter 7; the factors that affect BPA rates are addressed in Evaluation Study Chapter 9. *Id.*

#### **5.6.5 Description of Scenarios Analyzed by Staff**

Staff's technical analysis examines the ratemaking provisions of the Settlement by constructing a variety of scenarios resulting in potential future streams of REP benefits based on differing implementations of the section 7(b)(2) rate test or other major drivers of REP benefits. Evaluation Study, REP-12-FS-BPA-01, section 10.1. Constructing these alternative results using the 7(b)(2) rate test allows evaluation of the Settlement through the comparison of the results specified in the Agreement with the results of the scenarios developed in the analysis. *Id.* The analysis is divided into two major groups of scenarios: those that examine the issues in litigation that are developed and discussed in section 7 of the Evaluation Study, and those that examine the two major "natural" drivers of REP benefits, ASC levels and BPA rate levels. *Id.*

The Reference Case (or Scenario 0) employs BPA's current 7(b)(2) implementation methodology and a base case, or best forecast, of inputs used in ratemaking. *Id.*, section 10.3. The Reference Case is built upon the updated results for the non-settlement section 7(b)(2) rate test results located in the Evaluation Study Documentation, BP-12-FS-BPA-01A, Tables 10.2 and 10.3. Performing Scenario 0 in RAM2012 produces the results shown in the Evaluation Study Documentation. *Id.*, Table 10.6. Performing Scenario 0 in the LTRM produces 17 years of results consistent with the Section 7(b)(2) Rate Test Study. *Id.*

Staff's analysis of the Settlement begins with examining the ratemaking effects that the issues in litigation could have on REP benefits. Evaluation Study, REP-12-FS-BPA-01, section 10.4. REP benefits are a good benchmark of comparison for analyzing the Settlement because of the interrelationship between rate protection and REP benefits. Gendron *et al.*, REP-12-E-BPA-04, section 5. Scenarios are developed to analytically assess the impact of each of the issues in litigation discussed in the Evaluation Study, REP-12-FS-BPA-01, Chapter 7. A scenario is developed for each issue, followed by several scenarios that combine several issues to represent the aggregate position of the COU parties or the IOU parties. *Id.* A listing of each of the scenarios follows.

Staff develops the following scenarios for its analysis:

- Scenario 1: No Lookback (an IOU position)
- Scenario 2: Large Lookback Without LRAs (a COU position)
- Scenario 3: Large Lookback with LRAs (a COU position)
- Scenario 4: Idaho Deemer Balance
- Scenario 5: Conservation = General Requirements without Conservation Costs (a COU position)
- Scenario 6: Conservation = General Requirements with Conservation Costs (an IOU position)
- Scenario 7: Same Repayment Study in Both Cases (a COU position)
- Scenario 8: Mid-C Resources Included in 7(b)(2)(D) Resource Stack (a COU position)
- Scenario 9: No 7(b)(3) Allocation to Surplus (a COU position)
- Scenario 10: Same Secondary Credit in 7(b)(2) Case (an IOU position)
- Scenario 11: Conservation Resource Expensed Costs Are Expensed in the year selected from the resource stack (an IOU position)
- Scenario 12: All Conservation Resource Costs Are Capitalized (a COU position)
- Scenario 13: Excluded Conservation Added to Resource Stack (an IOU position)
- Scenario 14: placeholder
- Scenario 15: Inflation Rate Used for Discount Rate (a COU position)
- Scenario 16: Investment Rate Used for Discount Rate (an IOU position)
- Scenario 17: placeholder
- Scenario 18: COU Best Case
- Scenario 19: IOU Best Case
- Scenario 20: IOU Alternative Case
- Scenario 21: COU Brief Case
- Scenario 22: IOU Brief Case

*Id.* at 154-164.

In addition to analyzing the effect of litigated issues on projected REP benefits and rates using the LTRM, high and low rate scenarios are developed with high and low ASC levels and high and low BPA rate levels. *Id.*, section 10.7. These rate level scenarios are divided into two types. First, scenarios with high IOU ASCs coupled with low PF rates (and vice versa) are examined. *Id.* These scenarios adjust the new resource cost assumptions for IOUs' ASCs and the revenue requirement assumptions for the PF Rate. *Id.* Second, Staff analyze the effect of market price

and generation cost risk. *Id.* These scenarios include variation in gas prices, embedded CO<sub>2</sub> price assumptions in the market price curve, nuclear fuel price assumptions, and risk of resource output levels. *Id.*

Having completed the analysis of the issues in litigation and other factors that could affect the levels of rate protection and REP benefits between FY 2102 and FY 2028, Staff evaluates the proposed Settlement. *Id.*, section 11.1 The protection and payments under the proposed Settlement are well-defined and can be computed without much interpretation. *Id.* The protection and payments under alternative views of 7(b)(2) and Lookback have been developed in the analysis. *Id.* Staff believes that the Settlement must have a clear and direct connection to the protections and requirements set forth in the Northwest Power Act. *Id.* Thus, Staff evaluates the proposed Settlement by comparing the protections and requirements set forth in the Settlement with protections and requirements that would be reasonably expected in absence of the Settlement. *Id.*

To evaluate the Settlement, Staff develops a set of criteria used to “test” the settlement. *Id.*, section 11.2. These criteria are comprised of three primary and two secondary criteria, which are:

- the settlement would provide COUs with at least as much rate protection compared to the rate protection afforded under section 7(b)(2) of the Northwest Power Act;
- the settlement would provide REP benefits in a manner consistent with section 5(c) of the Northwest Power Act and distribute such REP benefits among the settling IOUs in a manner consistent with BPA’s current ASC Methodology and with rates that are consistent with section 7 of the Northwest Power Act;
- the settlement would resolve, in a fair and equitable manner, all of the outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period;
- the settlement would recognize that not all COUs were equally harmed by the costs of the 2000 REP Settlement Agreements and that IOUs were differentially affected by BPA’s setting off REP benefits for Lookback Amounts; and
- the settlement would provide reasonable rates for non-settling parties and other classes of BPA’s customers.

*Id.* at 165-166. A settlement that satisfies the aforementioned criteria would be, from an analytical perspective, reasonable and consistent with the protections and requirements of the Northwest Power Act. *Id.* Most significantly, a settlement that meets the foregoing criteria would also avoid the key concerns expressed over previous settlements of the REP with BPA, the lack of connection with sections 5(c) and 7(b). *Id.*

To test whether the proposed Settlement satisfies the above criteria, Staff compares the projected rate protection amounts and REP benefits developed by the various litigation scenarios with the amounts provided under the Settlement. *Id.* Based on this comparison, Staff provides an assessment of whether the Settlement satisfies the criteria set forth above, in particular with regard to rate protection under section 7(b)(2) of the Northwest Power Act:

Under almost all outcomes of the analysis, the Settlement provides superior rate protection compared to the 7(b)(2) rate test scenarios. The analysis performs the rate test under a variety of potential future rate scenarios and litigation results and shows that except in the instance that COUs prevail on every contested issue, the rate protection is greater and REP benefits smaller under the Settlement. Under most possible future results of the rate test, rates for COUs would be higher than the rates under the Settlement, all other factors being the same in both futures.

\* \* \* \*

The Settlement provides superior rate protection than the 7(b)(2) rate test provides in almost all instances. To achieve higher rate protection, the non-settling COUs would have to prevail on five litigated issues. Although it is always risky to lay odds on the possible decisions of the Court, simply affixing a 50/50 probability to the outcome of each issue would mean that the likelihood of receiving greater rate protection is about 3 percent ( $= 0.5^5$ ). Given the unlikely probability of complete success before the Court, the Settlement would provide superior rate protection for non-settling COUs.

Evaluation Study, REP-12-E-BPA-01, at 180-182. After ensuring that the Settlement ensures full 7(b)(2) rate protection, Staff recommends that the Administrator adopt the proposed Settlement and set rates consistent with its terms. *Id.* at 183.

### **5.6.6 Staff's Conclusions and Recommendation**

The results of Staff's analysis show that the Settlement, when compared to BPA's traditional implementation of the REP, provides far less in aggregate REP benefits to the IOUs than otherwise would likely be permitted by the Northwest Power Act in the absence of the Settlement. BPA's Reference Case, which is built from BPA's current REP implementation, produces aggregate REP benefits of approximately \$3.071 billion (net present value or NPV) over the FY 2007–2028 period covered by the Settlement's REP benefits. Evaluation Study, REP-12-FS-BPA-01, Table 10.4. This is compared to the Settlement's aggregate REP benefits of \$2.05 billion (NPV) over the same period. *Id.* Thus, based on a comparison of BPA's view of the proper implementation of the REP, the Settlement presents a very reasonable and acceptable basis for settling the REP.

As expected, Staff's analysis of the parties' respective positions in litigation produces a wide array of aggregate REP benefits levels. On one extreme is the IOUs' position; if they were to succeed on most or all of their issues in litigation, Staff projects that REP benefits could increase to as high as \$5.9 billion (NPV). Evaluation Study, REP-12-FS-BPA-01, Table 10.4. On the

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other extreme is the COUs' position, which, if successful, would reduce REP benefits to \$759 million (NPV) over the FY 2007–2028 period. *Id.* In between these two extremes are multiple variations on these amounts. *Id.* Of the 22 litigation scenarios considered by Staff, 18 of them produce aggregate REP benefits in excess of the amounts provided by the Settlement. *Id.* From this, Staff concludes that the analysis shows that, except in the extreme instance where the COUs prevail on multiple major contested issues, rate protection is greater and REP benefits smaller under the proposed Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 27; *see also* Table 3.4.1 for the NPV of all scenarios analyzed.

It is based upon this expansive evaluation, alongside the stated evaluation criteria, that Staff recommends adoption of the Settlement.

First, Staff finds that under almost all outcomes of the analysis, the Settlement provides superior rate protection when compared to the 7(b)(2) rate test scenarios. The analysis performs the rate test under a variety of potential future rate scenarios and litigation results and shows that except in the instance that COUs prevail on multiple contested issues, the rate protection is greater and REP benefits smaller under the proposed Settlement. *Id.* at 27.

Second, Staff concludes that under most possible future results of the rate test, rates for COUs would be higher than the rates under the Settlement, all other factors being the same in both futures. *Id.*

Third, Staff concludes that the Settlement at least meets, and most likely will exceed, the first standard. *Id.*

On this last point, BPA wishes to emphasize that the lower projected costs of the REP that have been discussed in this case under Settlement are not mere ethereal guesswork. While some parties may argue that BPA cannot predict the future with certainty, there is no denying that the Settlement provides COUs immediate rate relief in the form of lower costs of near-term REP benefits. Without the Settlement, BPA would collect in rates for the FY 2012–2013 rate period an additional \$24 million under BPA's traditional (and disputed) implementation of the REP. Evaluation Study, REP-12-FS-BPA-01, section 11.3. Stated another way, the IOUs are giving up \$24 million in REP benefits that BPA would be prepared to pay to their residential and small farm customers over the next two years under the traditional REP. The IOUs have said they are willing to live with less in order to obtain certainty, and they mean it. In this way, the Settlement will result in real savings in REP costs that will be paid in the near-term by all of BPA's ratepayers. These savings, as described by Staff and supported by the analysis in this case, are expected to "grow over time[.]" Bliven *et al.*, REP-12-E-BPA-12, at 48.

Based on the fact that the Settlement retained the rate protection relationship between BPA and the COUs (that the limited REP benefit payments to IOUs did not exceed the amounts allowed by the 7(b)(2) rate test), Staff concludes that the first criterion for evaluating the Settlement has been met. Gendron *et al.*, REP-12-E-BPA-04, at 27.

## **5.7 Issues Regarding the Settlement’s Compliance with Section 7(b)(2) of the Northwest Power Act**

### **Issue 5.7.1**

*Whether the Settlement complies with section 7(b)(2) of the Northwest Power Act.*

#### **Parties Positions**

Alcoa, APAC, and WPAG argue that the Settlement is inconsistent with section 7(b) of the Northwest Power Act. Alcoa Br., REP-12-B-AL-02, at 8; APAC Br., REP-12-B-AP-01, at 5-7; WPAG Br., REP-12-B-WG-01, at 9-13.

Alcoa argues that BPA, as a Federal agency, is obligated to comply with congressional directives and that BPA’s exercise of its settlement authority must comport with the Northwest Power Act, *citing PGE*, 501 F.3d at 1028, 1030 (“Congress could not have made it any clearer that it intended for BPA to exercise its general settlement authority within the confines of the [Northwest Power Act] ... BPA may not provide power under the REP program on whatever terms—whether good business or not—that BPA likes.”). Alcoa Br., REP-12-B-AL-02, at 8-9. Alcoa argues that the Settlement would displace section 7(b)(2) of the Northwest Power Act because if BPA adopts the Settlement, BPA would not set COU rates “in accordance with [section 7].” *Id.* at 16. Alcoa states that BPA has performed a series of 7(b)(2) rate tests for the 17 years of the Settlement, but BPA has done so only for purposes of determining whether the amount of COU rate protection resulting from application of the Settlement’s ratesetting directives would be greater or less than would be provided by a strict application of the statutory section 7(b)(2) rate test. *Id.* at 17. Alcoa claims that the duration of the 2012 Settlement and BPA’s section 7(b)(2) “evaluation” is unprecedented. *Id.* Alcoa claims that the Bonneville Project Act requires BPA to set rates at least every five years, citing section 5(a) of the Bonneville Project Act, which provides that “[c]ontracts entered into under this subsection shall contain (1) such provisions as the administrator and purchaser agree upon for the *equitable adjustment of rates* at appropriate intervals, not less frequently than once every five years ....” *Id.* at 17-18. Alcoa argues that BPA’s section 7(b)(2) rate tests have always been tied to specific rates in a specific rate period. *Id.* at 18. Alcoa argues that BPA would effectively delegate its ratesetting obligations to the COUs and IOUs, and would ignore the specific manner that Congress established for the calculation of COU rate protection. *Id.* at 9.

APAC argues that a ratepayer’s voluntary offer to take a particular benefit does not release BPA from its statutory obligation under section 7(b)(2). APAC Br., REP-12-B-AP-01, at 5. APAC argues that testing the Settlement against many scenarios of projected economic factors and litigation outcomes is simply a semantic exercise because section 7(b)(2) states that “projected amounts” of costs may not exceed the costs under the assumptions of the 7(b)(2) Case. *Id.* APAC states that the Northwest Power Act requires BPA to perform the 7(b)(2) rate test to set a rate ceiling, and then the costs in excess of that ceiling are allocated to other rates, including the PF Exchange rate. *Id.* APAC argues that under the Settlement, the PF rate is set to support the REP benefits that have been predetermined by the Settlement, without any constraint by the

7(b)(2) rate test. *Id.* APAC argues that BPA’s section 7(b)(2) rate tests have always been tied to specific rates in a specific rate period. *Id.* at 6. APAC argues that the Northwest Power Act prohibits an exchanging IOU from receiving a benefit greater than the difference between its ASC and the PF Exchange rate. *Id.*

WPAG argues that contractual rate protection cannot be substituted for statutory rate directives. WPAG Br., REP-12-B-WG-01, at 26. WPAG argues that whether the Administrator thinks that the REP Settlement will provide more rate protection to preference customers than will the 7(b)(2) rate test is irrelevant. *Id.* at 27. WPAG states that there is no legal authority that empowers BPA to substitute its judgment for that of Congress regarding the manner in which rate protection will be provided to preference customers, and in particular those that have not executed the REP Settlement. *Id.* at 28. WPAG claims that the 7(b)(2) rate test was included in the Northwest Power Act by Congress to protect preference customers from the costs of the REP. *Id.* at 27. WPAG argues that the law is well settled with regard to BPA’s duty to provide to preference customers the rate protection established by Congress in the 7(b)(2) rate test. *Id.* at 28. WPAG argues that congressional intent is clear regarding the purpose of the rate directives in section 7 of the Northwest Power Act. *Id.* WPAG argues that, even if it were assumed *arguendo* that BPA has the authority to substitute contractually determined REP benefits for those that should be determined under the statutory rate directives in each rate proceeding, BPA has not demonstrated that the rate protection under the REP Settlement is the same as that which would be provided by the statutory rate directives in each rate proceeding. *Id.* at 29. WPAG argues that Staff’s analysis and its outcomes demonstrate that the annual REP benefits set out in the REP Settlement have virtually no chance of replicating the REP costs that the 7(b)(2) rate ceiling test will permit BPA to lawfully charge the preference customers in any specific future rate period. *Id.* at 33. WPAG claims there is only one lawful answer for each BPA rate period for rate protection and REP benefits. *Id.* WPAG argues the analysis performed by Staff is legally insufficient for two reasons.

First, for the out-years of the analysis, that is, those years not encompassed by the 7(b)(2) rate test performed for the FY 2012–2013 rate period, the forecasts of REP “amounts to be charged” preference customers are not based on costs that BPA will actually use to set rates in future rate cases. *Id.* at 30. Second, the analysis performed by BPA is being done in a proceeding (REP-12) in which no rates will be set. *Id.* WPAG claims Congress intended that the 7(b)(2) rate test be performed in each rate revision process to ensure that the REP costs and 7(b)(2) rate protection are determined based on the facts in hand when BPA is setting its rates in order to avoid setting BPA’s rates, and the 7(b)(2) rate protection, on forecast values that stretched far into the future. *Id.* at 31. These issues are addressed below.

### **BPA Staff’s Position**

The Settlement provides superior rate protection when compared to the 7(b)(2) rate test scenarios. The analysis performs the rate test under a variety of potential future rate scenarios and litigation results and shows that except in the instance that COUs prevail on multiple contested issues, the rate protection is greater and REP benefits smaller under the proposed Settlement. Bliven *et al.*, REP-12-E-BPA-12, at 27. Based on the fact that the Settlement retains

the rate protection relationship between BPA and the COUs (that the limited REP benefit payments to IOUs did not exceed the amounts allowed by the 7(b)(2) rate test), Staff concludes that the first criterion for evaluating the Settlement has been met. *Id.* at 28.

## **Evaluation of Positions**

### **A. Introduction**

Before explaining how BPA demonstrates compliance with section 7(b)(2), it is helpful to briefly review the facts leading to the REP-12 proceeding. In 2000, BPA developed a REP Settlement with its IOU customers for FY 2002 through FY 2011. The 2000 REP Settlements were challenged by numerous BPA customers. In *PGE*, the 2000 REP Settlements were found unlawful because they ignored the requirements of sections 5(c) and 7(b) of the Northwest Power Act. Upon remand, BPA conducted the WP-07 Supplemental rate proceeding. BPA's response to the court's remand was, in simple terms, to calculate the difference in the REP settlement benefits the IOUs received and the REP benefits the IOUs would have received under the REP in the absence of the settlement. This process was called the Lookback. The differences were classified as overpayments to the IOUs and overcharges to the COUs; the overcharges were then earmarked to be refunded to BPA's preference customers, and the cost of the refund was earmarked to be recovered through reductions in the IOUs' REP benefits. In calculating the Lookback, BPA conducted separate 7(b)(2) rate tests for FY 2002–2006; FY 2007–2008; and FY 2009.

After BPA issued its Final WP-07 Supplemental ROD, BPA's IOU and COU customers challenged BPA's Lookback decisions. *Assoc. of Pub. Agency Customers v. Bonneville Power Admin.*, Nos. 08-74725 *et al.* (APAC). These challenges include BPA's decisions on numerous 7(b)(2) issues. Once FERC granted final confirmation and approval to BPA's WP-07 rates, the parties filed additional petitions for review. *Avista Corp., et al. v. Bonneville Power Admin.*, Nos. 09-73160 *et al.* In addition, the IOUs filed petitions for review of BPA's offer of new Residential Purchase and Sale Agreements to implement the REP. *Idaho Pub. Utilities Comm'n v. Bonneville Power Admin.*, Nos. 08-74927 *et al.*

BPA then established new rates for FY 2010–2011 in its WP-10 rate proceeding, which continued BPA's Lookback decisions from the WP-07 Supplemental proceeding. BPA's IOU customers filed petitions challenging the Lookback issues contained in the WP-10 proceeding. *Portland General Electric Co., et al. v. Bonneville Power Admin.*, Nos. 09-73288 *et al.* (*PGE II*). Once FERC granted final confirmation and approval to BPA's WP-10 rates, the parties filed additional petitions for review. *PacifiCorp, et al. v. Bonneville Power Admin.*, Nos. 10-73348 *et al.*

Given the enormous costs and benefits pending in the litigation, and the tremendous risk posed by the litigation to both sides, the IOUs and COUs began discussing possible settlement. At the request of the IOUs and COUs, BPA engaged a former Federal district court judge as a mediator to establish a foundation for further settlement discussions between the COUs and IOUs. After the better part of a year of extraordinary efforts, the COUs and IOUs developed a Settlement.

The proposed settlement was developed in the context of disputed 7(b)(2) and other REP issues. The COUs and IOUs believe strongly in their respective positions on the issues and did not want either party's 7(b)(2) positions to be the basis of the settlement. Adopting the COUs' or IOUs' particular 7(b)(2) positions in the settlement was problematic because the parties were concerned that, despite provisions in the settlement that ensured no precedent would be established by the settlement, the use of a particular party's position in the settlement could suggest that if it had been used for 27 years as the basis for settlement, it would be appropriate to continue to reflect the position in future 7(b)(2) rate tests, and thus rates, after the settlement expired. For this reason, the Settlement does not take positions on the pending 7(b)(2) issues. This rationale for settlement was appreciated in *PGE*, where the court stated:

The ability to settle claims without resort to litigation or full-throated regulatory administrative proceedings is certainly an important aspect for making BPA an efficient agency and fulfilling the Administrator's charge to conduct BPA as a well-run business. The ability to compromise claims, by its nature, requires flexibility and discretion. *Regulatory claims are rarely capable of a sum-certain determination and an either/or assessment of the likelihood of success on the merits. It is thus implicit in the grant of settlement power that BPA have the flexibility to take into account a variety of considerations, including its litigation costs, differing damage assessments, and the risk of loss on the merits.*

501 F.3d at 1030 (emphasis added).

BPA cannot simply assume, however, that the proposed settlement complies with sections 5(c) and 7(b) of the Northwest Power Act. From the inception of Staff's review of the Settlement, Staff has stated that it must determine whether the Settlement complies with sections 5(c) and 7(b) of the Act, and particularly with section 7(b)(2). *E.g.*, Evaluation Study, REP-12-FS-BPA-01, sections 6.2 and 11.2. The manner of demonstrating compliance with section 7(b)(2) in a settlement, however, is necessarily somewhat different from demonstrating compliance with section 7(b)(2) in a typical rate case. *Id.* Because BPA establishes power rates every two years, there is little need for a REP settlement for any two-year rate period. *Id.* In the absence of a settlement, rates would be fixed for such rate periods and, therefore, REP benefits would also be fixed. *Id.* Establishing rates in the absence of a settlement requires final section 7(b)(2) decisions. Once BPA makes final decisions, they will necessarily be subject to challenge in Court. A settlement, therefore, must last longer than a single rate period to have much value. *Id.*

Furthermore, in order to have *any* REP settlement longer than a rate period, BPA must determine a manner in which to reflect section 7(b)(2) in the determination of the settlement benefits for the period following the first two years, because such settlement period exceeds the period for which BPA has established rates. *Id.* The Court in *PGE* recognized that BPA can have REP settlements, noting that “[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” 501 F.3d at 1030 (emphasis added). Thus, the *PGE* Court recognized that establishing a REP settlement longer than a two-year rate period (such as the 10-year 2000 REP Settlements reviewed in that litigation) would necessarily require BPA to find a way to recognize utilities’

ASCs (pursuant to section 5(c)) and the 7(b)(2) rate test (pursuant to section 7(b)(2)) for a period that was *longer* than the (then five-year) rate period. BPA is considering this issue carefully and at great length in reviewing the Settlement, as demonstrated by the issues addressed in this section 5.7.

**B. Sub-issue: Whether the Settlement Complies with Statutory Directives**

Alcoa argues that BPA, as a Federal agency, is obligated to comply with congressional directives and that BPA’s exercise of its settlement authority must comport with the Northwest Power Act, *citing PGE*, 501 F.3d at 1028, 1030 (“Congress could not have made it any clearer that it intended for BPA to exercise its general settlement authority within the confines of the [Northwest Power Act] ... BPA may not provide power under the REP program on whatever terms-whether good business or not-that BPA likes.”). Alcoa Br., REP-12-B-AP-01, 8-9. BPA agrees. Alcoa argues, however, that the proposed Settlement, and BPA’s FY 2012–2013 rates set pursuant to that Settlement, are inconsistent with the Northwest Power Act’s mandatory rate provisions. *Id.* BPA disagrees; Staff’s analysis clearly shows that the Settlement results in rates that are within the statutory ambit. That the PF Public and IP rates are not as high as they would be under the traditional implementation of the rate test does not constitute an inconsistency with the statute.

Alcoa argues that the Settlement would displace section 7(b)(2) of the Northwest Power Act because if BPA adopts the Settlement, BPA would not set COU rates “in accordance with [section 7].” Alcoa Br., REP-12-B-AP-01, at 16. Alcoa states that BPA would not perform a section 7(b)(2) rate test for each rate period during the FY 2012–2029 period of the Settlement but instead would adopt the 17-year rate protection construct set out in the Settlement. *Id.* When BPA began its review of the Settlement, it directly stated that the Settlement must comply with section 7(b)(2) and BPA’s other statutory directives. *Proposed Residential Exchange Program Settlement Agreement Proceeding (REP-12); Public Hearing and Opportunities for Public Review and Comment*, 75 Fed. Reg. 78694, at 78702 (2010). Section 7(b)(2) does not limit the rate test to any particular rate period (although in the absence of a settlement, BPA has traditionally implemented it for single rate periods). Instead, section 7(b)(2) requires that the rate test be conducted to determine whether “*projected amounts* to be charged for firm power” for preference customers’ general requirements loads exceed power costs for those general requirements if specified assumptions are made. 16 U.S.C. § 839e(b)(2) (emphasis added). Section 7(b)(2) provides:

After July 1, 1985, the projected amounts to be charged for firm power for the combined general requirements of public body, cooperative, and Federal agency customers, exclusive of amounts charged such customers under subsection (g) of this section for the costs of conservation, resource and conservation credits, experimental resources and uncontrollable events, may not exceed in total, as determined by the Administrator, during any year after July 1, 1985, plus the ensuing four years, an amount equal to the power costs for general requirements of such customers if, the Administrator assumes that...

*Id.* In a normal ratemaking context, where BPA revises its rates every two years in a contested environment, BPA conducts the 7(b)(2) rate test for the rate period plus four years to determine two-year rates. A REP settlement, however, resolves REP disputes for a longer term than a single rate period. Therefore, conducting the rate test in each contemporaneous rate period is insufficient to support a longer-term REP settlement when parties cannot agree on how the rate test should be conducted. Similarly, BPA does not generally establish rates for longer than five years. Therefore, a REP settlement must satisfy section 7(b)(2) in a different manner from the rate test used to establish rates for a single rate period. Despite the fact that a REP settlement is longer than a rate period, the Ninth Circuit concluded that BPA has the authority to settle REP disputes. In *PGE*, the court recognized that “[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” 501 F.3d at 1030. The issue, therefore, is how BPA can ensure that a REP settlement will provide rate protection to its preference customers under section 7(b)(2). Staff’s analysis clearly shows that the Settlement results provide preference customers at least as much rate protection as they would receive under all evaluated cost and risk scenarios and almost all litigation scenarios.

WPAG argues that contractual rate protection cannot be substituted for statutory rate directives. WPAG Br., REP-12-B-WG-01, at 26. WPAG argues that whether the Administrator thinks that the REP Settlement will provide more rate protection to preference customers than will the 7(b)(2) rate test is irrelevant. *Id.* WPAG states that there is no legal authority that empowers BPA to substitute its judgment for that of Congress regarding the manner in which rate protection will be provided to preference customers, and in particular those that have not executed the REP Settlement. *Id.* This argument fails, however, because BPA has not substituted its judgment for that of Congress in the manner in which rate protection is provided.

Conditional rate protection is provided to BPA’s preference customers by section 7(b)(2) of the Northwest Power Act. 16 U.S.C. § 839e(b)(2). Such protection depends on whether or not the rate test established in section 7(b)(2) triggers (*i.e.*, whether Program Case costs exceed 7(b)(2) Case costs). If the rate test does not trigger, no rate protection is afforded the preference customers. If the rate test triggers, the trigger amount is allocated to all non-PF Public power rates. Section 7(b)(2) is the basis upon which BPA, like Congress, has ensured that rate protection will be provided to preference customers under the Settlement. Traditionally, BPA has implemented section 7(b)(2) in rate cases where BPA established rates for two-year or five-year rate periods. In this REP-12 proceeding, however, BPA is reviewing whether a proposed 17-year REP Settlement complies with section 7(b)(2), among other statutory directives. Any REP Settlement that prescribes an amount of REP benefits for longer than a five-year rate period, which every REP settlement must do because otherwise there would be little need for a settlement, will not have 7(b)(2) protection demonstrated solely by the 7(b)(2) rate test run for the first rate period of the settlement. Additional 7(b)(2) runs are needed to demonstrate rate protection for the entire settlement term. This is the case with the Settlement.

WPAG argues that BPA’s rate directives should be implemented only in the manner in which BPA has previously implemented them in the absence of a REP settlement, including limiting

the rate test to a single (generally two-year) rate period. If WPAG were correct that BPA can conduct the rate test for only a single rate period, there could never be a meaningful REP settlement. WPAG has offered no example whatsoever of the manner in which BPA and its customers could ever have a REP settlement (which provides certainty for the term of the settlement and thereby allows the settlement of ongoing litigation) longer than a rate period without violating section 7(b)(2) of the Northwest Power Act. In contrast, approximately 84 percent of preference customers, and all of BPA's IOUs customers, three state utility commissions, and a retail ratepayer advocacy group have developed a REP settlement that can be thoroughly vetted for compliance with BPA's statutory directives, including section 7(b)(2).

Determining whether the Settlement complies with section 7(b)(2) is one of BPA's most important criteria for evaluating the settlement. In order to do so, Staff conducts a traditional 7(b)(2) rate test for the FY 2012–2013 rate period, just as BPA conducted a 7(b)(2) rate test in BPA's WP-10 rate case for the FY 2010–2011 rate period. This Reference Case is incorporated into the LTRM. The LTRM then conducts 17 section 7(b)(2) rate tests, one for each year of the Settlement. Each of these rate tests includes a year of the Settlement term and the following four years, as required by section 7(b)(2). In addition, BPA does not assume that the information included in the reference case is static, but conducts scenarios for each of the 17 rate tests that consider litigation outcomes for the 7(b)(2) issues currently pending in litigation. Staff also conducts scenarios that consider other factors that could affect the future amounts of rate protection and REP benefits, such as changes in costs, loads, and other revenues. Evaluation Study, REP-12-FS-BPA-01, section 6.4. Staff's section 7(b)(2) rate test results show that under almost all outcomes the Settlement provides superior rate protection compared to the 7(b)(2) rate test scenarios. *Id.*, section 11.3. This is not a surprising result, as over 88 percent of BPA's preference customers (by load), which are familiar with the implementation of section 7(b)(2) and its results in BPA's WP-07 Supplemental, WP-10, and REP-12 proceedings, support the Settlement and thus the rate protection it provides.

Further, WPAG's argument is at odds with the findings of the *PGE* Court, which recognized that “[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” 501 F.3d at 1030. The Court presumed that BPA could settle the implementation of 7(b)(2) in a fashion that protects the position of its preference customers. To argue that lawful contractual rate protection cannot be substituted for the traditional implementation of the statutory rate directives would mean that the only means to provide rate protection would be to perform the rate test in each and every rate proceeding. This would require all settling parties to agree how to conduct the rate test, something that has proven impossible in the entire history of the rate test. The practical effect of WPAG's argument would be that section 7(b)(2) would be the only portion of BPA's governing statutes that would be outside the reach of BPA's settlement authority. Congress did not circumscribe BPA's settlement authority to exclude section 7(b)(2); thus, section 7(b)(2) must be within BPA's settlement authority.

Settlements are frequently accomplished by contract. In the Northwest Power Act, Congress affirmed the BPA Administrator's broad authority to contract and settle claims according to

section 2(f) of the Bonneville Project Act. *See* section 9. Regarding BPA’s ability to settle disputes by contract, the Court has previously held that “unless the outcome is indisputably contrary to a clear statutory directive, a settlement agreement must be upheld without resolving the underlying complex legal issues, if it is reasonable under ‘the totality of circumstances’ and should be set aside ‘only for the strongest of reasons.’” *Util. Reform Project v. Bonneville Power Admin.*, 869 F.2d 437, 443 (9th Cir. 1989). Staff’s analysis demonstrates that the Settlement results are not contrary to a clear statutory directive.

WPAG claims that the 7(b)(2) rate test was included in the Northwest Power Act by Congress to protect preference customers from the costs of the REP. WPAG Br., REP-12-B-WG-01, at 27. This statement is only partially correct. As noted in BPA’s statutory analysis elsewhere in this ROD, section 7(b)(2) protects preference customers from only *excessive* REP costs. Section 7(b)(2) includes five assumptions, only one of which is the assumed absence of the REP in the 7(b)(2) Case. Thus, section 7(b)(2) does not directly protect preference customers from REP costs, but indirectly as part of the total costs of the five assumptions together.

WPAG argues that the law is well settled with regard to BPA’s duty to provide to preference customers the rate protection established by Congress in the 7(b)(2) rate test. WPAG Br., REP-12-B-WG-01, at 28. First, however, contrary to WPAG’s statement, BPA does not have an unconditional duty to provide 7(b)(2) rate protection in the sense that the 7(b)(2) rate test must always trigger. When the 7(b)(2) rate test does not trigger, preference customers receive no rate protection under section 7(b)(2). 16 U.S.C. § 839e(b)(2). Also, WPAG’s suggestion that the law regarding section 7(b)(2) is “well settled” is contrary to the facts. Section 7(b)(2) is the most complex provision of the Northwest Power Act. Parties have argued over its meaning since the inception of its implementation in 1985. Indeed, the Settlement arose in large part because of pending litigation in which the parties are presenting opposing arguments on 7(b)(2) issues. Such include, for example, the treatment of conservation in the rate test; the use of repayment studies; the treatment of Mid-Columbia resources; and discounting the stream of 7(b)(2) rate projections. The unsettled nature of section 7(b)(2), and its attendant risks, support the desirability of the Settlement.

WPAG argues that congressional intent is clear regarding the purpose of the rate directives in section 7 of the Northwest Power Act, citing *Golden NW*:

The [Northwest Power Act] requires that the IOUs’ exchange benefits not come at the expense of BPA’s preference customers. Under section 7(b)(2), preference customer rates must be calculated as if BPA made “no purchases or sales” under the REP. Any amounts not charged to preference customers as a result of section 7(b)(2)’s “rate ceiling test” must instead be “recovered through supplemental rate charges for all other power sold by [BPA] to all customers.”

WPAG Br., REP-12-B-WG-01, at 28, *citing Golden NW*, 501 F.3d at 1047. Contrary to WPAG’s claim, however, the Court’s description of section 7(b)(2) is not nearly as clear as WPAG would like it to be. As noted elsewhere in this ROD, section 7(b)(1) of the Northwest Power Act prescribes that REP costs are directly allocated to preference customers’ rates after

FBS resources are insufficient. 16 U.S.C. § 839e(b)(1). The 7(b)(2) rate test does not eliminate all REP costs from preference customers' rates because the rate test triggers based on five assumptions included in section 7(b), only one of which concerns the REP. The Court states that IOUs' exchange benefits do not come "at the expense" of BPA's preference customers. This conforms to statements made by Congress that the rates for COUs would be "no greater than would occur in the absence of the regional program established in [the Northwest Power Act]." S. Rep. No. 96-272, 96th Cong., 1st Sess. 20 (1979). This regional program is far more than the REP. WPAG conveniently omits the next sentence in *Golden NW*, which confirms this reading: "The practical effect of the rate ceiling is that once it is reached, qualifying IOUs must then pay for the costs of the additional benefit they receive, thereby reducing the overall value of their benefits." *Golden NW*, 501 F.3d at 1047, quoting *PGE*, 501 F.3d 1015. The Court understands that REP benefits are allowed in the rates of COUs until the rate ceiling is reached. Furthermore, when the Court states that preference customer rates must be calculated as if BPA made "no purchases or sales" under the REP, it cites section 7(b)(2) of the Northwest Power Act. *Golden NW* at 1047, 1048. The Court does not mean that no REP costs are allocated to preference customers' rates (indeed, the Court could not mean this given section 7(b)(1), which directly allocates REP costs to preference customers).

In reviewing section 7(b)(2), it is clear that the assumption of no REP in the 7(b)(2) Case of the rate test is one of *five* different assumptions that are made in conducting the test: if the section 7(b)(2) rate test triggers, the trigger is the result of all five assumptions and not simply the elimination of REP costs. The fact that no REP costs are included in the 7(b)(2) Case of the 7(b)(2) rate test does not mean that preference customers pay no REP costs in their rates, but that they can be included up to the rate ceiling. The complexity of section 7(b)(2) is another reason why the Settlement is desirable.

WPAG states that the question the Settlement presents is whether BPA's settlement authority is so expansive as to allow BPA to forgo the performance of the 7(b)(2) rate test in such a manner and for such a period or, similarly, whether Congress empowered BPA to divest itself of its obligations under the section 7 rate directives by entering into a settlement. WPAG Br. Ex., REP-12-R-WG-01, at 8. WPAG has misstated the issue. BPA is not arguing that its settlement authority allows it to forgo the performance of the 7(b)(2) rate test or to divest itself of its section 7 rate directives. Instead, the issue is whether the Settlement is consistent with section 7(b)(2) when BPA has established a Reference Case and has performed seventeen 7(b)(2) rate tests, one for each future year of the Settlement, with each of these rate tests demonstrating that the Settlement provides greater 7(b)(2) rate protection than in the absence of the Settlement. BPA also demonstrates that the Settlement provides greater 7(b)(2) rate protection under all risk scenarios and most litigation scenarios. BPA believes this is consistent with BPA's statutory rate directives, including section 7(b)(2).

WPAG states that BPA's rate directives are cast in mandatory language. WPAG Br. Ex., REP-12-R-WG-01, at 7-14. This, however, does not distinguish the rate directives from nearly every other provision of the Northwest Power Act. WPAG then notes that section 5(c) of the Northwest Power Act established the REP and that sections 7(a)(1), 7(b)(2), and 7(b)(3) provide

for the allocation and recovery of BPA's costs. *Id.* at 8-10. This is already noted in sections 4.1, 5.4, 5.5, and 5.6. WPAG asks whether, given the statutory language and the need to allocate and recover BPA's costs, BPA's settlement authority can be used to set rates in a manner different from the manner prescribed in the Act. *Id.* at 11. This statement of the issue mischaracterizes BPA's position regarding the Settlement. BPA has consistently acknowledged, as pinpointed in *PGE*, that its settlement authority must be exercised in a manner consistent with its statutory directives, including ratemaking directives. For this reason, BPA is not using its settlement authority to set rates in a manner different from that prescribed in the Act. Instead, BPA is developing rates in the same manner as prescribed in the Act, and establishing a methodology for determining the amount of rate protection for BPA's preference customers consistent with the Settlement. This is necessary because, as explained previously, BPA traditionally develops rates for a single rate period, but any meaningful settlement of the REP must be longer than a single rate period. WPAG argues that there can be no lawful REP settlement, but BPA, its IOU customers, and 84 percent of its preference customers believe that a REP settlement can comply with BPA's statutory directives.

WPAG argues that, even if it were assumed *arguendo* that BPA has the authority to substitute contractually determined REP benefits for those that should be determined under the statutory rate directives in each rate proceeding, BPA has not demonstrated that the rate protection under the REP Settlement is the same as would be provided by the statutory rate directives in each rate proceeding. WPAG Br., REP-12-B-WG-01, at 29. WPAG's argument errs on several counts. First, BPA is not substituting contractually determined benefits for 7(b)(2) rate protection. Rather, BPA is determining the rate protection required by section 7(b)(2) for the 17 years of the Settlement, and then ensuring that the contractually specified benefits do not exceed the amount allowed by the statutory protection. Second, as previously indicated, the law does not require that the 7(b)(2) rate test be performed in every rate case in cases such as this, where 7(b)(2) rate tests have been performed for every year (plus the ensuing four years) within the 17-year period. Finally, as indicated elsewhere, BPA Staff demonstrates that the Settlement provides WPAG and other preference customers greater protection than afforded under section 7(b)(2).

WPAG also argues that Staff's analysis and its outcomes demonstrate that the annual REP benefits set out in the REP Settlement have virtually no chance of replicating the REP costs that the 7(b)(2) rate ceiling test will permit BPA to lawfully charge the preference customers in any specific future rate period. *Id.* WPAG claims there is only one lawful answer for each BPA rate period for rate protection and REP benefits. *Id.* WPAG misstates the direction of section 7(b)(2). Section 7(b)(2) states that "the projected amounts to be charged ... *may not exceed* ... an amount equal to the power costs for general requirements ...." 16 U.S.C. § 839e(b)(2) (emphasis added). Thus, it is not whether the rates are "the same," but that they not exceed the 7(b)(2) rates. Staff's analysis clearly shows that the Settlement results would establish rates that do not exceed those allowed under section 7(b)(2). WPAG adds that attempts to model the future cannot capture the full range of possible future events that will materially impact the 7(b)(2) rate test. WPAG Br. Ex., REP-12-R-WG-01, at 26.

WPAG's argument establishes an impossible standard for any REP settlement, or virtually any other type of settlement for that matter, and a higher standard than applies to traditional ratemaking and REP implementation. As noted previously, rate protection has been traditionally determined in BPA's rate cases, where it is used to establish rates for a single rate period. Any REP settlement, however, has to be longer than a rate period to make any sense, because there is little reason for a settlement to exist when costs have already been fixed for that limited rate period. However, conducting the 7(b)(2) rate test for a single rate period is insufficient to demonstrate 7(b)(2) compliance for a longer term. If a REP Settlement can exist, it must rely to some degree on projections in order to demonstrate compliance with section 7(b)(2) for the period following the initial rate period. Because facts change over time and because one cannot see the future, projections used to ensure 7(b)(2) rate protection for the second and subsequent rate periods of a settlement term are unlikely to produce the same results as running a 7(b)(2) rate test at the future time when a rate case is held. But this is to be expected and is consistent with the nature of settlement. In any settlement, parties have disagreements about the subject matter of a dispute. If they settle, the only certainty is that the parties would have been in different positions in the absence of the settlement. A settlement is not expected to produce a result that is identical to the absence of the settlement.

In the instant case, the standard is not whether a REP settlement produces identical rate protection as would the establishment of rates for a particular future rate period in the absence of a settlement. This is an impossible standard. The standard is whether, through conducting extensive analysis and running 17 section 7(b)(2) rate tests, one for each year of the settlement and each with numerous alternative scenarios assessing cost changes and litigation risk, BPA can demonstrate rate protection sufficient to satisfy section 7(b)(2). It is worth noting that even in the traditional implementation of the REP, REP costs are not known with certainty at the end of a particular rate case. Once a rate case has been conducted, BPA implements the REP. During the actual implementation of the REP, costs may differ from the forecasts in the rate case. Even though the actual REP costs differ from those in the rate case, this does not mean the rates established based on those forecast costs are legally deficient. As the *PGE* Court held:

The ability to settle claims without resort to litigation or full-throated regulatory proceedings is certainly an important aspect for making BPA an efficient agency and fulfilling the Administrator's charge to conduct BPA as a well-run business. The ability to compromise claims, by its nature, requires flexibility and discretion. Regulatory claims are rarely capable of a sum-certain determination and an either/or assessment of the likelihood of success on the merits. It is thus implicit in the grant of settlement power that BPA have the flexibility to take into account a variety of considerations, including its litigation costs, differing damage assessments, and the risk of loss on the merits.

501 F.3d at 1030. Thus, BPA's settlement authority can encompass results that are not the same as those that would arise from the full-throated application of 7(b)(2), as long as such terms "protect the position of its preference customers, consistent with §§ 5(c) and 7(b)." *Id.*

Furthermore, section 7(b)(2) does not require an assessment of “the full range of possible future events” in consideration of the amount of rate protection afforded to the PF Public rate. *See* WPAG Br. Ex., REP-12-R-WG-01, at 26. Section 7(b)(2) speaks of “the projected amounts” and “the power costs,” not a range of amounts and costs. The “projected amounts” simply requires one projection; BPA has provided that projection in the Reference Case. However, to more fully test the Settlement, BPA has also provided projections under high and low ASCs and high and low BPA rates. BPA does this to test the robustness of the Settlement and to provide assurance that the Reference Case does not skew BPA’s analysis of the Settlement based on a single projection of future events. The results of this analysis show that the rate protection provided by the Settlement exceeds the protection provided in all cases. Far from WPAG’s contention that the Settlement falls in the “middle” of the range of results, WPAG Br. Ex., REP-12-R-WG-01, at 26, all results of BPA’s implementation of 7(b)(2) show superior rate protection under the Settlement. Of the cases modeled, the Low ASC-High BPA Rate scenario approaches, but does not provide, less rate protection than the Settlement; that scenario assumes that IOU costs grow much more slowly than the rate of growth observed over the past 25 years and BPA costs grow much more slowly than observed over the past 25 years. It is only when considering possible litigation outcomes that rate protection provided under the Settlement can fall short of a few litigation results.

WPAG acknowledges that BPA Staff has gone to some lengths to analyze the various possible outcomes that could ensue from pending litigation, as well as qualitatively analyzing possible changes to the future costs of BPA and the IOUs. WPAG Br., REP-12-B-WG-01, at 29-30. WPAG notes that based on this analysis, and the forecast values on which it relies, BPA has displayed a wide range of possible future outcomes regarding the level of REP benefits that could, under sections 7(b)(2) and (3), be lawfully charged to preference customers and lawfully paid to the IOUs. *Id.*, citing Evaluation Study, REP-12-E-BPA-01, pp. 163-178, 188-196. WPAG argues the analysis performed by Staff is legally insufficient for two reasons: first, for the out-years of the analysis, that is, those years not encompassed by the 7(b)(2) rate test performed for the FY 2012–2013 rate period, the forecasts of REP “amounts to be charged” preference customers are not based on costs that BPA will actually use to set rates in future rate cases. *Id.* This argument was addressed in the immediately prior discussion. It is worthy of note, however, that WPAG’s reliance on the phrase “amounts to be charged” is misplaced. WPAG fails to include a critical word that precedes the cited phrase. Section 7(b)(2) states that “[a]fter July 1, 1985, the “*projected* amounts to be charged” for firm power sold to preference customers may not exceed “an amount equal to the power costs during any year after July 1, 1985 plus the ensuing four years” if five specified assumptions are made. 16 U.S.C. § 839e(b)(2) (emphasis added). Thus, the 7(b)(2) rate test itself is based heavily on projections and recognizes that the costs used in implementing the rate test will not be exactly the same as those actually incurred in the year plus ensuing four years used in the test.

WPAG reviews the Settlement’s compliance with numerous provisions of the Northwest Power Act. WPAG begins its review noting that the Court in the *PGE* decision offers some guidance regarding REP settlements, stating:

REP-12-A-02

Chapter 5.0 – The 2012 REP Settlement Agreement’s Compliance with Northwest Power Act  
Sections 7(b) and 7(c)

[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).

WPAG Br. Ex., REP-12-R-WG-01, at 15, *citing PGE*, 501 F.3d. at 1030. Similarly, the Court stated:

In our view, however, settlement of BPA’s REP obligations must be grounded in the REP program authorized by § 5(c) that creates the occasion for the settlement in the first place.

*Id.*, *citing PGE* at 1031.

The Court provided additional guidance, noting that:

We have recognized in this opinion that BPA has broad authority to settle claims under the [Northwest Power Act]. We repeat: flexibility inheres in compromises under that authority. Nevertheless, BPA’s settlement does not resemble the REP program created in §§ 5(c) and 7(b) that it purports to be settling.

*PGE*, 501 F.3d. at 1037. This statement is particularly helpful, as it recognizes that a REP settlement must “resemble” the REP implementation it is settling. In other words, a REP settlement does not have to implement the statutory requirements in exactly the same way as they are implemented in the ordinary course of the REP. This is intuitively obvious. If a REP settlement simply implemented the statutory directives in the ordinary manner, it would not be a REP settlement, but would instead be a Residential Purchase and Sale Agreement, which is traditionally used to implement the REP.

WPAG claims that the Settlement is not consistent with the Northwest Power Act. WPAG Br. Ex., REP-12-R-WG-01, at 16. WPAG states that the relevant statutory provisions for determining REP benefits include section 5(c), which establishes the REP. *Id.*, *citing* 16 U.S.C. § 839c(c). WPAG states that the relevant statutory provisions for determining REP benefits also include section 7(a)(1), which requires BPA to periodically review and revise its rates to recover the costs it expects to incur during a rate period. *Id.*, *citing* 16 U.S.C. § 839e(a)(1). WPAG also cites section 7(b)(1), which governs how the PF rate is set. *Id.*, *citing* 16 U.S.C. § 839e(b)(1). WPAG notes that the PF rate serves as the base for developing the PF Exchange rate. *Id.*, *citing* 16 U.S.C. § 839e(b). WPAG states that the relevant statutory provisions for determining REP benefits also include section 7(b)(2), which contains the rate directives that BPA must implement to determine the costs, including REP costs, that can be lawfully charged to preference customers in the PF Public rate. *Id.*, *citing* 16 U.S.C. § 839e(b)(2). WPAG also lists section 7(b)(3), which governs how certain costs excluded from the PF Public rate by section 7(b)(2) will be allocated to the rates for all other power sold by BPA, including the PF Exchange, IP, and surplus rates. *Id.*, *citing* 16 U.S.C. § 839e(b)(3).

In describing how these provisions function, WPAG states that the 7(b)(2) rate test determines the amount of REP costs that can be lawfully included in the PF Public rate, and the amount of such costs (if any) that must be excluded from the PF Public rate. WPAG Br. Ex., REP-12-R-

WG-01, at 17. Further, WPAG states, the REP benefits available during a rate period cannot be determined until the 7(b)(2) rate test has been performed and the amount of REP costs excluded from the PF Public rate is known. *Id.* at 18. WPAG states that once the amount of these excluded REP costs is known, the PF Exchange rate can be determined by the reallocation, pursuant to 7(b)(3), of an equitable portion of the excluded REP costs to that rate. *Id.*

WPAG's foregoing description is inaccurate. The section 7(b)(2) rate test does not simply exclude REP costs from the PF Public rate. As explained previously in this ROD, the rate test compares the Program Case rate (which determines a rate reflecting the Northwest Power Act's requirements) with the 7(b)(2) Case rate (which reflects five assumptions, including an assumption that the REP is not implemented in the 7(b)(2) Case). If the Program Case is greater than the 7(b)(2) Case and the rate test "triggers," the trigger amount consists of costs that result from all five assumptions, not just the REP-related assumption. Thus, stating that the rate test determines the REP costs excluded from the PF Public rate is incorrect. The rate test determines the costs, undifferentiated by source, that are excluded from the PF Public rate.

WPAG argues that since the Settlement determines the REP benefits that the IOUs will be paid by BPA in each year of its term, and by implication both the amount of REP costs that preference customers will pay and the amount of REP cost protection they will receive, there is no need to perform the 7(b)(2) rate test nor the related 7(b)(3) cost reallocation step. WPAG Br. Ex., REP-12-R-WG-01, at 23. WPAG claims that under the Settlement, both of these steps will be dispensed with in every rate proceeding during the term of the Settlement. *Id.* WPAG's argument is misleading. The Settlement was developed by BPA's customers (primarily the IOUs and COUs) and certain stakeholders and submitted to BPA for its review. They drafted it with the goal of ensuring its sustainability. The Settlement contains REP benefit levels for BPA's IOU customers and the REP costs to be included in the rates of BPA's COU customers during the term of the Settlement. BPA did not simply accept the Settlement, but instead scheduled a formal hearing under section 7(i) of the Northwest Power Act to determine, *inter alia*, whether the proposed settlement complied with BPA's statutory directives, including sections 5(c) and 7(b).

In order to evaluate whether the Settlement complies with section 7(b)(2), BPA conducts an analysis that includes a Reference Case, which uses the best currently available and forecast information to conduct seventeen 7(b)(2) rate tests, one for each year of the Settlement. As addressed in the Evaluation Study, REP-12-FS-BPA-01; associated Documentation, REP-12-FS-BPA-01A; and testimony, Stiffler *et al.*, REP-12-E-BPA-07, the analysis also compares the Settlement schedule of benefits to those that can be expected from each of the seventeen 7(b)(2) rate tests under a multitude of scenarios. These scenarios incorporate a wide and measured degree of anticipated variation in costs, as well as the full set of issues currently under litigation (or expected to be litigated in already filed protests) with respect to the Lookback, 7(b)(2) assumptions, treatment of conservation, and discounting methodologies, among others. There are 24 scenarios in all. The first 4 scenarios analyze the degree to which forecasting uncertainty could affect REP benefits over the full 17-year prospective period. The additional 20 scenarios examine the range of REP benefits that could be expected under the rate directives of the

Northwest Power Act as interpreted under alternative litigation outcomes in court. Thus, BPA’s analysis reviews the Settlement to ensure that it provides 7(b)(2) cost protection greater than that provided in the absence of the Settlement. The results of the analysis show that this is true for every 7(b)(2) rate test in the Reference Case and risk scenarios, and in most of the tested litigation scenarios.

Also, as noted previously, the 7(b)(2) rate test is typically performed to establish rates for a single rate period. A REP settlement is virtually meaningless, however, unless it is for a term longer than a rate period. The analysis allows BPA to demonstrate compliance with the 7(b)(2) rate test requirements for the term of the Settlement. Once BPA has conducted seventeen 7(b)(2) rate tests to confirm the extent of the Settlement’s rate protection for its 17-year term compared to the absence of the Settlement, it is unnecessary to conduct additional rate tests during the term of the Settlement.

WPAG claims that its comparison of the traditional implementation of the statutory rate directives and the Settlement illustrates the difference between them. WPAG Br. Ex., REP-12-R-WG-01, at 24. WPAG claims that this comparison shows that the Settlement fails to ensure that REP benefits will be set at a level required to alleviate high wholesale power costs of the participating utilities (subject to the limits of section 7(b)(2)), and fails to ensure that those retail customers who need this subsidy the most will actually receive it. *Id.* WPAG’s sudden and unprecedented concern for the IOUs and their residential consumers is eye-opening. The IOUs, however, receive significant specified amounts of REP benefits under the Settlement. All of these benefits are required to be passed through to the IOUs’ residential consumers. Although BPA’s analysis shows that the IOUs are receiving significantly less REP benefits under the Settlement than is forecast in the absence of the Settlement, the IOUs have the ability to determine the extent of their participation in the REP. 16 U.S.C. § 839c(c). Parties also have the right to waive statutory entitlements. Thus, as explained in greater detail in this chapter and in Chapter 4 (discussing the Settlement’s compliance with section 5(c)), the Settlement more than “resembles” the REP as established in the Northwest Power Act.

WPAG argues that the analysis performed by BPA is being done in a proceeding (REP-12) in which no rates will be set. WPAG Br., REP-12-B-WG-01, at 30. WPAG claims Congress intended that the 7(b)(2) rate test be performed in each rate revision process to ensure that the REP costs, and 7(b)(2) rate protection, are determined based on the facts in hand when BPA is setting its rates in order to avoid setting BPA’s rates, and the 7(b)(2) rate protection, on forecast values that stretched far into the future. *Id.* WPAG ignores the procedural context of the REP-12 and BP-12 proceedings. First, BPA’s analysis is being done in a REP-12 proceeding conducted pursuant to section 7(i) of the Northwest Power Act, which governs BPA’s ratemaking proceedings. 16 U.S.C. § 839e(i). Furthermore, the REP-12 proceeding is being conducted concurrently with BPA’s BP-12 rate proceeding, which establishes BPA’s power rates for FY 2012–2013, absent the Settlement, using 7(b)(2) rate tests and rate protection from the REP-12 proceeding. From the inception of the REP-12 proceeding, it has been clear that the administrative record of the REP-12 proceeding would be included in the administrative record of the BP-12 proceeding. Parties may cite the record in the REP-12 proceeding in the BP-12

proceeding, and vice versa. Thus, BPA has satisfied the procedural requirements of the Northwest Power Act by conducting concurrent section 7(i) hearings when running the section 7(b)(2) rate tests and incorporating the results of the rate tests into BPA's rates.

Second, WPAG cites no authority for its assertion that Congress intended the 7(b)(2) rate test to be conducted in each rate revision process to avoid setting rates based on forecast values for the future. Indeed, section 7(b)(2) demonstrates the opposite intent. The 7(b)(2) rate test itself compares the "projected amounts to be charged" for a year and the ensuing four years with the "amount equal to the power costs" for preference customers based on specified assumptions for the same year and ensuing four years. By making each rate test cover a year plus four years, section 7(b)(2) *requires* BPA to rely on projected information outside the actual rate period being considered. BPA's 7(b)(2) rate tests in the instant case use a reference case that relies on current information for the first two years of the settlement period, just as in traditional rate tests. Information for subsequent years is projected, just as in traditional rate tests. Because the Settlement term is longer than a single rate period, however, BPA must rely on additional projections for the out-years of the settlement term. Congress did not limit the projections to a particular period of time in section 7(b)(2): "the projected amounts to be charged ... may not exceed in total ... *during any year* ... plus the ensuing four years, an amount equal to the power costs ...." 16 U.S.C. § 839e(b)(2) (emphasis added).

WPAG argues that an example of the wisdom of shortening the forecast horizon is provided by the 2000 REP Settlements. WPAG Br., REP-12-B-WG-01, at 31. WPAG states that when forecasting the benefits of the 2000 REP Settlements, BPA predicted that the settlement transaction would cost the preference customers about \$140 million per year, but after the West Coast energy crisis, the cost of this settlement increased to over \$300 million per year. *Id.* This example, however, is not convincing. First, the difference in the initial estimate of the cost of the 2000 REP Settlements increased dramatically because of the structure of the 2000 REP Settlements, not solely because of the external events. The benefit formula relied, in part, on market power costs rather than ASCs to calculate settlement benefit levels. As the *PGE* Court recognized, REP benefits should be based on costs as provided in BPA's ASC Methodology and in BPA's PF Exchange rate development, not the power market. Furthermore, the 2000 benefits were increased at a time when BPA's rates were threatening to increase exponentially, a logically inconceivable result. Even when faced with the prospects of a 250 percent rate increase, the REP benefits provided by the 2000 REP Settlements were more than doubled from \$140 million to over \$300 million. Logic dictates that when BPA's rates increase, REP benefits should decrease, all other things held equal. While ASCs might have increased due to market pressures, the IOUs were not facing the same pressure of substantial load increases requiring significant market purchases. Thus, one would expect that REP benefits would hold steady or decrease rather than double in the face of the West Coast energy crisis.

The 2012 REP Settlement, in contrast, is not influenced by power market costs. BPA proposes to institute tiered rates for the coinciding terms of the TRM and the Settlement and is unlikely to experience substantial loads as in 2002. Thus, the effects of another market excursion similar to the energy crisis would be completely opposite those of 2002. BPA is a net seller of energy in

the market; a price excursion like 2000–2001 would result in larger revenue credits to BPA’s firm power customers, thus driving rates downward. At the same time, IOUs are net purchasers in the market; a price excursion would drive ASCs upward. Under such circumstances, ASC benefits would increase to levels modeled in the risk scenario encompassing the low-BPA, high-ASC scenario in Staff’s analysis. The 2012 REP Settlement establishes fixed benefit levels for the IOUs for each year of the Settlement.<sup>12</sup> Thus, in conditions such as the one cited by WPAG, the rate protection offered to COUs by the Settlement provides maximum value for COUs. Unlike the 2000 REP Settlements, the 2012 REP Settlement is unlikely to impose greater costs on preference customers than would occur absent the Settlement.

Second, radical changes in costs can also occur under BPA’s traditional short-term ratemaking. After BPA’s rates go into effect, changes can occur in many factors that affect BPA’s cost recovery, *e.g.*, drought, earthquakes, faults in nuclear resources, energy shortages, and so on. Simply because radical changes in costs can occur does not mean the underlying rates or settlement are improper. Ratemaking, by its nature, accounts for cost changes through future ratemaking. In contrast, settlements such as the Settlement help to address this problem by establishing fixed REP costs for 17 years. Preference customers will not be harmed by IOU cost increases that would normally increase REP benefits because, under the Settlement, their cost exposure is fixed by the Settlement. This is particularly valuable in an environment in which IOUs’ costs are expected to increase more quickly than BPA’s costs, thereby otherwise increasing REP benefits. Furthermore, a settlement provides predictability and stability to all parties, something that is lacking in many BPA costs.

WPAG notes that BPA suggests section 7(b)(2) contains no precise language stating when it must be performed, so BPA can perform in the REP-12 proceeding a rate test for each year of the Settlement term, and thereby satisfy the requirements of section 7(b)(2). WPAG Br. Ex., REP-12-R-WG-01, at 25, 29. WPAG notes that the results of these seventeen 7(b)(2) rate tests demonstrate that in most cases the REP payments permitted under its rate tests were higher than the REP payments under the Settlement. *Id.* Similarly, in most instances the seventeen 7(b)(2) rate tests supporting the Settlement afford preference customers superior REP cost protection compared to that provided by the traditional implementation of the 7(b)(2) rate test in single rate period ratemaking. *Id.* WPAG states that, according to BPA, this proves that the Settlement provides adequate protection to the position of preference customers with respect to section 7(b). *Id.*

WPAG does not dispute that section 7(b)(2) contains no specific requirement that it be performed for any particular time period. *Id.* at 29. WPAG argues, however, that section 7(b)(2) should not be read in isolation. *Id.* at 30. WPAG then describes the provisions that guide BPA’s traditional implementation of section 7(b)(2) in ratemaking for a single rate period. *Id.* In

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<sup>12</sup> If parties do not sign the 2012 REP Settlement and, on appeal, the Court finds that BPA cannot use the Settlement in the development of rates for non-signers, the non-signers (subject to other direction from the Court) would likely pay the REP costs as determined in BPA’s traditional manner. Such costs may be higher than the REP costs included in preference customers’ rates under the Settlement, resulting in higher preference customer rates than under the Settlement.

summary, BPA conducts the 7(b)(2) rate test when it reviews and revises rates. WPAG notes that, pursuant to section 7(a)(1), BPA must review its costs to ensure that it has calculated all of the costs it is expected to incur. *Id.* at 31. BPA also must set rates at a level sufficient to collect such costs, which include BPA's REP payment obligations. *Id.* The Settlement is consistent with these requirements. First, whenever BPA sets power rates during the Settlement term, BPA will review its costs to ensure that it has included in rates all of the costs it is expected to incur for the upcoming rate period. In addition, whenever BPA sets power rates during the Settlement term, it will set such rates at a level sufficient to collect BPA's costs, which will include BPA's REP payment obligations. The difference in this area between the traditional implementation of BPA's rate directives for a single rate period and implementation under the Settlement is that BPA will know the REP payment obligation specified in the Settlement and will have established in this proceeding that those costs are allowed in rates pursuant to the 7(b)(2) rate test.

WPAG cites section 7(b)(1) of the Northwest Power Act, which states:

The Administrator shall establish a rate or rates of general application for electric power sold to meet the general requirements of public body, cooperative, and Federal agency customers within the Pacific Northwest, and the loads of electric utilities under [section 5(c)]. Such rate or rates shall recover the costs of that portion of the Federal base system resources needed to supply such loads until such sales exceed the Federal base system resources. Thereafter, such rate or rates shall recover the cost of additional electric power as needed to supply such loads, first from the electric power acquired by the Administrator under section [5(c)] ...

*Id.* at 31, *citing* 16 U.S.C. § 839e(b)(1). Whenever setting power rates during the Settlement term, BPA will also comply with this provision. BPA will establish a PF Public rate for power sold to meet the requirements of BPA's preference customers. BPA will also establish a PF Exchange rate for the loads of utilities participating in the section 5(c) REP. When BPA develops such rates, it will first recover the cost of the Federal base system resources need to meet the loads until the loads exceed the FBS, and will then use electric power acquired by the Administrator under the REP. (As noted previously, BPA implements the REP as a paper transaction, but treats the REP as an actual power transaction for ratemaking purposes.) Rate development under the Settlement thus satisfies section 7(b)(1) of the Act.

WPAG then cites section 7(b)(2), which states that the "amounts to be charged for firm power for the combined general requirements of public body ... customers ... may not exceed in total ... an amount equal to the power costs for general requirements of such customers ...." *Id.* at 31-32. WPAG argues that when read together, sections 7(b)(1) and 7(b)(2) require the Administrator to implement all of the subsections of section 7 at the time he revises rates, which includes the performance of the 7(b)(2) rate test. *Id.* at 32. WPAG also states that BPA's Section 7(b)(2) Legal Interpretation recognizes that the 7(b)(2) rate test is one of the directives that "the BPA Administrator must consider in establishing rates." *Id.*, *citing* Section 7(b)(2) Legal Interpretation, at 1.13. Under the Settlement, however, the 7(b)(2) rate test is one of the directives that BPA will "consider" in establishing rates during the Settlement term. In rate proceedings conducted during the term of the Settlement, BPA will look to the 7(b)(2) rate tests

it performed in the REP-12 proceeding for the respective rate period at hand. BPA will note that its 7(b)(2) rate test analysis demonstrates that the REP benefit amounts paid during the rate period provides greater 7(b)(2) rate protection in nearly all cases than in the absence of the Settlement. Rate development under the Settlement thus satisfies section 7(b)(2) of the Act.

WPAG cites the legislative history of the Northwest Power Act and provisions from BPA's Section 7(b)(2) Implementation Methodology for the proposition that the 7(b)(2) rate test is to be performed in a rate revision process, and is a comparison of the costs in the rate BPA proposes to charge preference customers in the next rate period with the same rate as modified by the requirements of section 7(b)(2). *Id.* at 33-34. WPAG argues that the seventeen 7(b)(2) rate tests, performed for each year of the Settlement period, do not do this, but instead create hypothetical costs to create a hypothetical rate that BPA has no intention of charging preference customers in the next rate period, or in any rate period. *Id.* First, as WPAG acknowledges, BPA's analysis of the Settlement conducts seventeen 7(b)(2) rate tests, one for each year of the Settlement, with each rate test examined under multiple scenarios. Although the REP-12 proceeding is not establishing rates, it is being used to provide information regarding REP costs and 7(b)(2) rate protection to BPA's concurrent BP-12 rate proceeding, which establishes rates for FY 2012–2013. The 7(b)(2) rate tests performed for the Settlement are thus conducted in the general context of a concurrent section 7(i) hearing to establish BPA's rates for a rate period. Furthermore, the section 7(b)(2) rate test is by nature an exercise in hypothetical ratemaking. The rate test uses some actual costs and some forecast or "hypothetical" costs for the two-year rate period, in addition to forecast or "hypothetical" costs for the following four years. There is no guarantee, and indeed it is extremely unlikely, that these forecast costs will be the same as the actual costs BPA incurs for these single rate periods. BPA's seventeen 7(b)(2) rate tests performed for the Settlement are similar. BPA's 7(b)(2) rate tests use some actual costs and additional forecast costs in the near term, and forecast costs for the out-years. The use of forecast costs does not render a 7(b)(2) rate test improper.

As noted above, WPAG argues that the 7(b)(2) rate test "is a comparison of the costs in the rate BPA proposes to charge preference customers in the next rate period with the same rate as modified by the requirements of section 7(b)(2)." *Id.* at 33-34. This is incorrect. The 7(b)(2) rate test compares two sets of costs, or rates: the Program Case rate and the 7(b)(2) Case rate. The Program Case rate is composed of BPA's costs (actual and forecast) but is adjusted to remove the costs of "conservation, resource and conservation credits, [and] experimental resources and uncontrollable events." 16 U.S.C. § 839e(b)(2). Thus, the Program Case rate, even in the traditional implementation of BPA's ratemaking directives, is not a rate that is "charg[ed] preference customers in the next rate period, or in any rate period." Similarly, the 7(b)(2) Case rate is not a rate that is "charg[ed] preference customers in the next rate period, or in any rate period." Thus, although BPA uses forecast costs in its seventeen 7(b)(2) rate tests, these are the forecast costs BPA would use to establish rates in the prospective rate periods under the Settlement, just as is done in the traditional use of section 7(b)(2) in the development of BPA's rates for a near-term rate period.

As noted above, in conducting its seventeen 7(b)(2) rate tests, BPA uses the forecast costs it believes would be used to establish rates in the prospective rate periods under the Settlement. It is important to recognize that BPA is taking extraordinary steps to ensure that the costs used in its seventeen 7(b)(2) rate tests would accommodate as well as possible the costs BPA would actually incur during these rate periods. BPA uses its best information to construct a Reference Case. The Reference Case (or Scenario 0) employs BPA's current 7(b)(2) Implementation Methodology and a base case, or best forecast, of inputs used in ratemaking. Evaluation Study, REP-12-E-BPA-01, at 164. The Reference Case is built upon the same data that would go into the Section 7(b)(2) Rate Test Study if BPA were performing the 7(b)(2) rate test in the BP-12 proceeding. Performing Scenario 0 in the Long-Term Rate Model produces 17 years of results consistent with the Section 7(b)(2) Rate Test Study. *Id.*

Input data assumptions for LTRM include:

- **BPA Loads:** BPA load inputs build from loads presented in the Load and Resource Study, BP-12-FS-BPA-03 and are consistent with BPA's 20-year load forecasts.
- **BPA Resources:** BPA resource inputs build from resources presented in the Load and Resource Study, BP-12-FS-BPA-03 and are consistent with BPA's 20-year resource forecasts.
- **ASCs:** ASC inputs are described in section 8 of the Evaluation Study.
- **Exchange Load:** Exchange load inputs are described in section 8 of the Evaluation Study.
- **Costs:** BPA cost inputs build from costs developed in the Revenue Requirement Study, BP-12-FS-BPA-02; starting with 2018, costs are escalated at 3.75 percent per year (2 percent real growth).
- **Revenue Credits:** BPA revenue credit inputs build from costs developed in the Power Rate Study, BP-12-FS-BPA-01; starting with 2018, costs are escalated at 3.75 percent per year (2 percent real growth).
- **Market Electric Prices:** Market electric price inputs build from the forecasts developed in the Power Risk and Market Price Study, BP-12-FS-BPA-04, through 2017 and escalate at 3 percent per year thereafter.
- **7(b)(2) Resource Stack Costs:** Resource costs are consistent with the costs developed in the Initial Proposal Section 7(b)(2) Rate Test Study, REP-12-E-BPA-02.
- **Miscellaneous Inputs:** BPA's transmission rates escalate after FY 2017 at the assumed annual inflation rate of 1.75 percent; the IP rate net margin remains constant at the -0.255 mills/kWh used in RAM2012; low density discount and irrigation rate discount costs are RAM2012 values through FY 2017 and are escalated to 3.75 percent thereafter; the PF flat load rate conversion factor is set at a constant 96.5 percent for all years; and the

30-year Treasury borrowing interest rate is consistent with the forecast in the Revenue Requirement Study Documentation, BP-12-FS-BPA-02A. Roughly 40 percent of Above High Watermark Load is assumed to be met by Tier 2 purchases from BPA for 2017 and beyond.

*Id.* at 164-165. BPA’s analysis of the Settlement also examines the ratemaking effects that the issues in litigation could have on REP benefits. Evaluation Study, REP-12-FS-BPA-01, section 10.5–10.6. REP benefits are a good benchmark of comparison for analyzing the Settlement because of the interrelationship between rate protection and REP benefits. *Id.*

In addition to analyzing the Reference Case, high and low rate scenarios are developed with high and low ASC levels and high and low BPA cost levels. *Id.* These rate level scenarios are divided into two types. *Id.* First, scenarios with high IOU ASCs, coupled with low BPA costs and PF rates (and vice versa) are run. *Id.* These scenarios adjust the new resource cost assumptions for IOUs’ ASCs and the revenue requirement assumptions for the PF Rate. Second, BPA analyzes market price and generation cost risk. *Id.* These scenarios include variations in gas prices, embedded CO<sub>2</sub> price assumptions in the market price curve, nuclear fuel price assumptions, as well as risk of resource output levels. *Id.* In addition to analyzing the effect of cost risks on projected REP benefits and rates using the LTRM, scenarios are developed to analytically assess the impact of each of the issues in litigation. *Id.*, section 10.4.

In summary, BPA uses forecast costs in its seventeen 7(b)(2) rate tests, which are the costs BPA would use to establish rates in the prospective rate periods under the Settlement, just as is done in the traditional implementation of section 7(b)(2) in the development of BPA’s rates for a single rate period.

### **C. Sub-issue: Whether Staff’s Analysis of the Settlement is Adequate**

WPAG notes that BPA Staff performs a primarily qualitative analysis of factors that could cause the costs of BPA and the IOUs to change in the future. WPAG Br., REP-12-B-WG-01, at 32, *citing* Evaluation Study, REP-12-E-BPA-01, at 162. In this analysis Staff considers such factors as natural gas prices, resource operation cost risk, wind generation impact, resource portfolio standards, carbon costs, and other environmental mandates. *Id.*, *citing* Evaluation Study at 153-157. In addition, Staff also performs a more robust analysis of possible outcomes of pending litigation, comparing various outcomes on pending issues to a base or reference case that assumes that BPA’s current positions on these matters would be sustained. WPAG Br., REP-12-B-WG-01, at 32. This analysis of possible legal issues does not encompass all possible outcomes, but instead focused on what BPA termed “likely outcomes.” *Id.*, *citing* Forman *et al.*, REP-12-E-BPA-04, at 5. WPAG commends BPA Staff for the substantial effort it put into this modeling effort. *Id.* WPAG argues, however, that Staff’s modeling is analytically deficient because attempts to model events 17 years into the future cannot capture the range of possible future events that will materially impact the operation of the 7(b)(2) rate test in each rate proceeding and the REP costs that can lawfully be charged preference customers. *Id.*, *citing* Saleba *et al.*, REP-12-E-WG-01, at 17-28. Similarly, APAC notes that Staff analyzes possible litigation outcomes and then projects the resulting costs over 17 years. APAC Br., REP-12-B-

AP-01, at 6. APAC argues that projecting costs over such an extended period produces an unreliable and unreasonable result. *Id.*

BPA agrees that there is a great deal of uncertainty in forecasting the future; forecasts rarely are precise. Stiffler *et al.*, REP-12-E-BPA-13, at 6. Yet BPA continues to set rates based upon projections of future loads, resources, costs, and revenues, all of which vary significantly from year to year and forecast to forecast. *Id.* In fact, this approach is statutorily mandated by the Northwest Power Act and, as such, ratesetting on a forecast basis is inherently unavoidable. *Id.* JP02 reasons that the “proper question from a ratemaking perspective is not speculation as to whether any forecast can be perfectly accurate [in hindsight], but rather whether the projection is reasonable and based on the best available information.” *Id.* at 12, quoting Deen *et al.*, REP-12-E-JP02-05, at 7.

Given its recognition that forecasting is inherently uncertain, Staff provides a structured and interconnected set of scenarios that accurately reflects a reasonable range of potential outcomes. Stiffler *et al.*, REP-12-E-BPA-13, at 6. The modeling assumptions are robust in establishing differing forecasts for ASCs that reflect a reasonable range of outcomes throughout the 17-year period. *Id.* Such forecasts are based upon resource cost expectations expressed in individual IOU integrated resource plans, combined with both high and low cost estimates for resource additions (based on market-priced purchases on the low end, and complete sets of expensive renewable resource additions on the high end). *Id.* These cost assumptions are an adequate proxy for the many cost variations that can be reasonably expected to occur through the next 17 years. *Id.*

In addition, both high and low BPA revenue requirement scenarios are tested and combined with the low and high ASC scenarios to produce a reasonable set of projections with upper and lower REP benefit bounds. *Id.* The entire set of known and currently briefed legal issues regarding 7(b)(2) rate test and Lookback implementations are included as a further test of the robustness of the projections. *Id.* The results of these analyses show that expected variations around the Reference Case projections produce higher REP benefits than the REP Recovery Amounts incorporated into the Settlement. *Id.*

When faced with the need to make decisions to position a company to face the future, long-term forecasting is an accepted practice. *Id.* at 8. Opposing parties acknowledge this: “long-term forecasts are a tool commonly used in the industry for a variety of purposes, and we routinely prepare such forecasts on a variety of variables.” *Id.*, citing Saleba *et al.*, REP-12-E-WG-01, at 19. JP02 states that “forecasts extending for longer than 17 years are frequently used to inform important decisions.” JP02 Br., REP-12-B-JP02-01, at 11. Although an implied rate forecast is embedded in Staff’s analysis, Staff targets the chosen scenarios (particularly risk scenarios) to incorporate a reasonable range of effects of future conditions on the 7(b)(2) rate test in particular (and thereby resulting effects on the level of anticipated REP benefits), without direct regard to particular impacts on rate levels. Stiffler *et al.*, REP-12-E-BPA-13, at 8. The question is not whether Staff has accurately predicted rate levels over the next 17 years, but whether Staff has tested the effects of future conditions on the results of the rate test. *Id.*

Nowhere does Staff propose to set *rates* for the full 17-year term of the Regional Dialogue contracts. *Id.* at 8-9. Rather, future rates to be charged will be in full accordance with sections 7(a) and 7(b) and established in each rate case going forward into the future. *Id.* at 9.

Rather than rely on a single estimate of future events, Staff makes considerable efforts to examine a reasonable range of the impacts of future conditions on REP benefits into the future. *Id.* For example, Staff includes High-ASC/Low-PF and Low-ASC/High-PF rate scenarios in the analysis, since ultimately the differences between ASCs and PF rates will determine the total net REP benefits resulting from the ratesetting process. *Id.* A High-ASC/High-PF or Low-ASC/Low-PF scenario would be less instructive, so Staff chose not to examine those cases. *Id.* Moreover, Staff augments the chosen scenarios with additional uncertainty in terms of market prices and revenue requirement expectations to further “stress test” the permissible set of REP benefits that can be expected over the 17 years of the Settlement. *Id.* While these analyses result in an extreme range of possible REP benefits circumscribing the Reference Case values (ranging from as low as \$400 million to over \$1 billion in 2028, compared to \$286 million under the Settlement), risk analysis results still strongly favor settlement as a “good deal” for COU ratepayers. *Id.* It has been demonstrated that the Settlement most likely provides greater rate protection to preference customers than is required under the 7(b)(2) statutory provisions of the Northwest Power Act. *Id.*

WPAG questions “the reliability of the 17 year forecasts and the way they are being used in this proceeding” for four reasons. Saleba *et al.*, REP-12-E-WG-01, at 19-28. The first reason is the analysis “appear[s] to be very sensitive to small changes in key variables, reducing the robustness of the results.” *Id.* at 20. WPAG cites the interest rate forecast used in the discounting of the two rate streams in the rate test comparison of costs, one stream without 7(b)(2) protections and the other stream with 7(b)(2) protections. Stiffler *et al.*, REP-12-E-BPA-13, at 9. WPAG appropriately notes that the analysis uses a Reference Case-level interest rate of 6.82 percent. *Id.* at 9-10. (Actually, the long-term analysis uses an interest rate that varies from 6.49 percent to 6.94 percent, averaging 6.82 percent over the 17-year period.) *Id.* at 10. WPAG claims that if the assumed interest rate drops to 4 percent, then REP benefits allowed by the rate test would drop to \$3,995 million over the 17-year period. Saleba *et al.*, REP-12-E-WG-01, at 20. Conversely, WPAG claims, if the assumed interest rate rises to 9 percent, the REP benefits allowed by the rate test would rise to \$4,270 million. *Id.* Assuming that WPAG is specifying the net present value (NPV) of the REP benefits, then its reasoning proves Staff’s analysis—testing the Settlement against the variability of 7(b)(2) rate test outcomes, even given the sensitivity of some input variables, demonstrates that the Settlement still produces REP benefits that are allowed by the rate test. Stiffler *et al.*, REP-12-E-BPA-13, at 10. The NPV of the Settlement stream of REP benefits is \$2,050 million, which is much less than the 4 percent interest scenario WPAG posits. *Id.* Because discounting uses the long-term debt rates for U.S. Treasury bonds, the 4 percent case is at the low end of likely interest rates in the future, roughly representing the low side of recent historical interest rates. This provides further evidence that under a wide range of interest rate projections, the level of REP benefits provided under the Settlement still allows for equal or greater rate protection than would otherwise be granted under application of the 7(b)(2) rate test. *Id.*

WPAG’s second reason is that “key variables change over time, meaning that the same forecasts performed two years ago or two years hence will likely produce materially different results.” Saleba *et al.*, REP-12-E-WG-01, at 21-22. Invariably, projections performed at different times will produce different results. BPA does not dispute that a projection of inputs to the 7(b)(2) rate test that might be performed two years hence may be considerably different than Staff used in its analysis. However, Staff is projecting amounts to be considered for the term of the Settlement at this point in time. Stiffler *et al.*, REP-12-E-BPA-13, at 10-11. WPAG does not criticize the current projections; rather, WPAG posits that the projections might be—BPA would substitute “would be”—different if performed two years from now. Saleba *et al.*, REP-12-E-WG-01, at 23. However, the question is not whether the projections may or may not be different, but whether new projections would *materially alter the conclusions being drawn at this time*. BPA does not believe that they would. If anything, based on Staff’s knowledge of the workings of the rate test, absent a court decision altering BPA’s implementation of the rate test, one would expect that a rate test two years hence would allow more REP benefits than the rate test allows at this time. Stiffler *et al.*, REP-12-E-BPA-13, at 11. This conclusion is based on the nature of the forecasts being used, especially Staff’s supposition that ASCs will increase more toward the high side of its projections rather than the low side. *Id.* Thus, given the nature of the forecasts, WPAG’s reasoning once again proves Staff’s analysis—testing the Settlement against the temporal nature of rate projections, the Settlement still produces REP benefits that are allowed by the rate test. *Id.*

Moreover, as discussed in Issue 3.5.2, BPA does not believe Staff must essentially be clairvoyant in order to make an “analytically sufficient” projection of future REP benefits. While WPAG may claim that such precision is necessary before BPA can make a reasoned decision on the Settlement, BPA disagrees. An agency need not “have perfect information before it takes any action.” *State of N. Carolina v. FERC*, 112 F.3d 1175, 1190 (D.C. Cir. 1997) *quoting United States Dep’t of the Interior v. FERC*, 952 F.2d 538, 546 (D.C. Cir. 1992). Rather, “in the face of ‘serious uncertainties,’ an agency need only ‘explain the evidence which is available,’ and ... offer a ‘rational connection between the facts found and the choice made.’” *Id.*, *quoting Motor Vehicle Mfrs. Ass’n of the United States v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 52 (1983) (*quoting Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

That is what BPA has done in this case. BPA has evaluated the Settlement in light of projections of future REP benefits calculated in accordance with sections 5(c) and 7(b) of the Northwest Power Act. Based on these projections, BPA finds that the Settlement provides lower REP benefits and higher rate protection for preference customers than the agency’s traditional implementation of the REP, including such implementation as adjusted for a multitude of the litigation scenarios.

WPAG’s third reason is that “the longer the forecast period, the less likely it is that the forecast will accurately predict future outcomes.” Saleba *et al.*, REP-12-E-WG-01, at 23-24. BPA agrees that the longer the duration of the forecast, the less accurate the forecast is likely to be. Staff tests a fixed stream of payments against its projections; its projections are not a single set of

annual forecasts of REP benefits. Stiffler *et al.*, REP-12-E-BPA-13, at 11-12. Rather, Staff includes a wide range of effects of potential uncertainties on its forecasts. *Id.* Furthermore, uncertainty does not equate to unreasonableness. Reasonableness is achieved by the robust analysis undertaken by Staff. Based on even less analysis, BPA’s preference customers advocated for and embraced a tiered rate design extending 17 years into the future. No preference customers were heard in that context to argue that time rendered the design unreasonable. Rather, BPA and the preference customers considered the future and determined the fixed design to be a superior approach to future ratemaking, in large part because of the certainty and predictability it afforded customers relative to basing rates on melded costs that could change significantly in each rate case.

WPAG presents a probability distribution chart of an inflation forecast that shows a distribution of inflation outcomes at different forecast horizons. Saleba *et al.*, REP-12-E-WG-01, at 24. WPAG posits that “[a]s the forecast horizon extends, the uncertainty increases, thus creating the fan shape.” *Id.* Once again, WPAG’s reasoning proves Staff’s analysis—testing the Settlement against a likely range of results, the Settlement still produces REP benefits that are allowed by the rate test. Staff’s analysis does not rely on a single forecast, but a “fan shape” of forecasts that demonstrate that under different cost projections, REP benefits are likely to be between an NPV of \$3,897 million on the high side and \$2,524 million on the low side (assuming Reference Case for litigated scenarios). Stiffler *et al.*, REP-12-E-BPA-13, at 12, *citing* Evaluation Study, REP-12-E-BPA-01-E07, at 5, Table 10.4, last two lines, scenario column. The \$2,050 million NPV of the Settlement falls below this expected distribution. *Id.* The fan shape of BPA’s analysis is displayed on the chart of REP Benefits Risk Scenarios. Evaluation Study, REP-12-FS-BPA-01, at Figure 4.

WPAG argues that BPA offers no citation or authority for the proposition that a reasonable forecast can legally justify replacing the REP cost projection in each rate proceeding that is established pursuant to the statute with the fixed REP payment stream under the Settlement. WPAG Br. Ex., REP-12-R-WG-01, at 28. The authority WPAG seeks is in section 7(b)(2) itself. The statute instructs BPA to determine the “projected amounts to be charged,” which is a forecast of future events, and the “the power costs ... if, the Administrator assumes,” which is a projection of a hypothetical set of events. The 7(b)(2) rate test is not simply an objective accounting exercise where one compares one set of dollars to another set of dollars as if either could be obtained by looking at a bank statement or audited financial report. Rather, the rate test is a complex legislative hypothesis that requires BPA to make numerous forecasts and assumptions. The test of this hypothesis must be reasonableness; BPA could not just make up any two sets of numbers it wishes and declare that they comprise a rate test that complies with section 7(b)(2). Section 7(b)(2) requires BPA to perform a projection and hypothesize about a specific set of what-ifs and compare the results. BPA has done so in this proceeding.

Further, it is not improper for BPA to evaluate the Settlement’s compliance with section 7(b)(2) by looking at the Settlement’s *effects* on rates and REP benefits. The courts have routinely affirmed agency authority to adopt a settlement where its effects meet the statutory criteria. For example, in *Mobil Oil Corp. v. Federal Power Comm’n*, 417 U.S. 283, 297 (1974), the United

States Supreme Court found that it was appropriate for the Federal Power Commission to adopt a settlement proposal that was submitted by a private party in litigation over the FPC's establishment of an area rate structure for interstate sales of natural gas produced in Southern Louisiana. The settlement was admitted into the record, and the Commission "weighed its terms by reference to the entire record in the Southern Louisiana area proceeding since 1961, and further supplemented that record with extensive testimony and exhibits directed at the proposal's terms." *Id.* at 312-313. The Commission then adopted the terms of the settlement. *Id.* One of the parties to the proceeding objected, claiming that the Commission was without power to adopt as a rate order a settlement proposal that "lacks unanimous agreement of the parties to the proceeding." The Supreme Court responded that such a contention "has no merit." *Id.* at 312.

The Supreme Court then quoted with approval the appellate court's finding that "if there is a lack of unanimity, it may be adopted as a resolution on the merits, if FPC makes an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonable' rates for the area." *Id.* 314. The Court concluded that "[t]he choice of an appropriate structure for the rate order is a matter of Commission discretion, to be tested *by its effects*. The choice is not the less appropriate because the Commission did not conceive of the structure independently." *Id.* at 314 (emphasis added); *see also FERC v. Triton Oil & Gas Corp.*, 712 F.2d 1450, 1458 (D.C. Cir. 1983) ("The choice of an appropriate structure for the rate order is a matter of Commission discretion, to be tested by its effects.")

The administrative law principles recognized by the Court in *Mobil Oil* are instructive to the issues in this case. Parties to this proceeding have entered into the record a Settlement that would resolve longstanding and contentious litigation. BPA has "weighed its terms" by reference to the extensive record developed in this case and BPA's statutory duties under the Northwest Power Act. *Gendron et al.*, REP-12-E-BPA-04, at 26-38; *see also* Evaluation Study, REP-12-FS-BPA-01, Chapters 10-11. Based on this evaluation, BPA finds that "substantial evidence on the record as a whole" supports a finding that the effects of the Settlement comply with the statutory protections afforded in the Northwest Power Act by providing lower overall REP benefits to the IOUs and greater rate protection to COUs when compared to BPA's implementation of the REP. *See Gendron et al.*, REP-12-E-BPA-04, at 26-38.

WPAG's fourth reason is that "long-term forecasts rarely predict the major events that will materially change the actual outcomes in the future, resulting in a false sense of confidence about the reliability of forecasts of future outcomes." *Saleba et al.*, REP-12-E-WG-01, at 20. WPAG argues that "[n]o matter how sophisticated the forecasting tools are, they rarely if ever predict major events that materially change the environment in which we do business, and which alter base assumptions upon which forecasts rely. This is not an indictment of forecasting tools, but merely recognition that models are not clairvoyant." *Id.* at 25. BPA agrees. Forecasters certainly expect discontinuities to occur in the future that would materially affect the forecasts. *Stiffler et al.*, REP-12-E-BPA-13, at 12. This raises two pertinent questions: (1) whether future discontinuities would materially alter the differences between ASCs and BPA rates, which are the prime components of the REP benefit levels, both before and after the 7(b)(2) rate test; and (2) whether one even needs to consider discontinuities, because the generally accepted purpose

of the statutory provision to include “... any year ... plus the ensuing four years” is to remove the effect of discontinuities on the results of the rate test. *Id.*, citing Wolverton, REP-12-E-AP-01, at 36.

As to the first question, it is unknown how a future discontinuity might affect the results of the rate test. Stiffler *et al.*, REP-12-E-BPA-13, at 13. For example, one much-talked-about potential discontinuity is the effects of global climate change and possible legislative actions attempting to forestall such future events such as, for example, the institution of carbon costs on thermal generating resources. *Id.* Such events can be predicted; it is the timing of such actions that is less predictable. *Id.* However, the effects on REP benefits can be reasoned to, even if they cannot be precisely predicted. *Id.* It is generally expected that because IOUs are more reliant on thermal generation and market purchases, while BPA is more reliant on hydro generation and is a net seller in power markets, ASCs would increase and BPA rates would decrease under most outcomes of this discontinuity. *Id.* This type of event would result in rate effects similar to the High-ASC/Low-PF scenario Staff includes in its analysis, which shows that REP benefits would increase substantially due to these types of events, resulting in greater advantages to COUs from the Settlement. *Id.*

Another possible type of discontinuity might be higher costs on BPA, perhaps due to Endangered Species Act compliance, as an example. *Id.* This type of event would result in upward pressure on the PF rate, ultimately decreasing the total level of benefits by reducing the spread between ASCs and the PF rate. *Id.* This effect is captured in Staff’s Low-ASC/High-PF scenario. *Id.* Staff’s analysis shows that although REP benefits would decrease substantially due to these types of events, Settlement would still be advantageous to PF customers. *Id.* Even though there might be fewer advantages from the Settlement than expected in the Reference Case, the analysis shows that the REP benefits under the Settlement do not exceed levels allowed by the 7(b)(2) rate test under these scenarios. *Id.* Put differently, even though the advantages to COUs are reduced, advantages to COUs still remain, compared to a no-settlement world. *Id.*

While one cannot say with certainty that Staff’s scenarios have analyzed the effects of all possible future events, especially when allowing for discontinuities, the scenarios reflect a reasonable set of possible future events. *Id.* at 14. Staff’s scenarios encompass the effects of many of the discontinuities that could possibly change the magnitude of the perceived advantages to the settling parties. *Id.* Notwithstanding an unlikely combination of adverse (to BPA) litigation scenarios, Staff is unaware of any future events that would call into question the advantages of the Settlement to COUs in particular. *Id.*

WPAG argues that even if BPA has the authority to conduct the 7(b)(2) rate test over the next 17 years, the results of that effort demonstrate that the Settlement does not provide equivalent 7(b)(2) protection to COUs. WPAG Br. Ex., REP-12-R-WG-01, at 35. WPAG states that in 18 of the 22 scenarios analyzed, the Settlement provides COUs with more rate protection (and a smaller REP payment obligation) than they would have experienced under the traditional 7(b)(2) rate test. *Id.* Thus, WPAG argues, according to Staff’s analysis, 18 percent of the time the Settlement can be expected to produce less rate protection for COUs than would be provided by

the traditional application of the 7(b)(2) rate test. *Id.* at 36. Therefore, WPAG argues, REP cost protection that falls short of that provided by traditional application of the 7(b)(2) rate test does not amount to protecting the position of COUs regarding section 7(b) and satisfy this legal standard. *Id.*

WPAG confuses the litigation scenarios with BPA's 7(b)(2) rate test. The 22 scenarios that WPAG cites are the parties' positions in litigation; these are not BPA's proffered interpretations or proposed implementation of the 7(b)(2) rate test. Rather than citing to BPA's rate test projections, which demonstrate *in all cases* that the Settlement provides superior rate protection, WPAG cites to potential futures where litigation resolves 7(b)(2) issues in a manner adverse to BPA's litigation position. Thus, assuming that 18 percent is a correct number, the most WPAG could argue is that under alternative findings by a court, the COUs could conceivably receive greater rate protection. But this is exactly what the Settlement seeks to avoid: a finding by a court that some party's litigation position is correct. The Settlement mitigates the risk to those on both sides of such an issue, and locks down the results of the 7(b)(2) rate test as an alternative to the litigation risk. Such is the nature of settlements. In this proceeding, BPA demonstrates that the Settlement provides greater rate protection in all instances when measured against BPA's implementation of the 7(b)(2) rate test, not just a portion of the cases. This meets the legal standard.

APAC states that BPA Staff attempts to justify its 17-year study window based on the IOUs' willingness to accept a defined benefit over that period:

If the IOUs are willing to take a fixed amount of REP benefits over multiple rate periods, we believe that it makes sense to run the 7(b)(2) rate test for an equivalent amount of time to determine whether the protections afforded to the COUs by the rate test have been met.

APAC Br., REP-12-B-AP-01, at 6, *citing* Bliven *et al.*, REP-12-E-BPA-12, at 6. APAC argues that a ratepayer's voluntary offer to take a particular benefit does not release BPA from its statutory obligation under section 7(b)(2). *Id.* BPA agrees. Indeed, the quoted passage does not state that if the IOUs accept a particular benefit, BPA will ignore section 7(b)(2). Instead, it states that if the IOUs accept a fixed amount of benefits, "it makes sense to run the 7(b)(2) rate test for an equivalent amount of time to determine whether the protections afforded to the COUs by the rate test have been met." Staff reviews and ensures, through extensive analysis documented in this proceeding, that the Settlement provides rate protection greater than would be provided in the absence of the Settlement.

WPAG notes Staff's demonstration that Settlement is complying with the rate directives contained in section 7 of the Northwest Power Act. WPAG Br., REP-12-B-WG-01, at 21, *citing* Bliven *et al.*, REP-12-E-BPA-17, at 3-4. WPAG notes that BPA is conducting a 7(b)(2) rate test for each of the 17 years of the Settlement. *Id.* WPAG notes Staff's position that because the extensive analysis supporting the 17 section 7(b)(2) rate tests demonstrates that the Settlement provides greater 7(b)(2) rate protection to preference customers than nearly every possible litigation scenario and the REP benefits provided to IOUs are consistent with that rate protection,

it is not necessary to rerun the 7(b)(2) rate test in rate proceedings during the Settlement term. *Id.* at 4-5. WPAG notes Staff's recognition that section 7(b)(2) contains no specific requirement that it be performed for any particular time period, making a 17-year forecast of the 7(b)(2) rate test results for future rate proceedings fully compliant with the requirements of the statute. *Id.* WPAG argues that under Staff's interpretation, it could have run the 7(b)(2) rate test in 1985 using forecast values and would not have needed to perform it in any subsequent rate case until 2028, as an example. *Id.* This argument is incorrect and overreaching. Staff does not state that, in the traditional implementation of BPA's ratemaking, BPA could conduct the rate test using forecast values and not perform it again for 43 years. These are not the facts before us. Instead, all of BPA's IOU customers and over 88 percent of WPAG's fellow preference customers (by load) used their intimate knowledge of BPA's implementation of section 7(b)(2) in BPA's WP-07 Supplemental and WP-10 rate cases, as well as the 7(b)(2) issues currently in litigation before the Ninth Circuit, to negotiate a REP Settlement. BPA could not simply adopt the proposed Settlement, however, but recognized from the outset that it had to thoroughly review the proposed settlement to determine whether it complied with BPA's statutory directives, including sections 5(c) and 7(b) of the Northwest Power Act. 75 Fed. Reg. 78694, at 78702 (2010).

The court in *PGE* recognized that *BPA can have REP settlements*, noting that “[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” *PGE* at 1030 (emphasis added). Thus, the *PGE* court recognized that establishing a REP settlement longer than five years (such as the 10-year 2000 REP Settlements reviewed in that litigation) would necessarily require BPA to find a way to recognize utilities' ASCs pursuant to section 5(c) and the rate test pursuant to section 7(b)(2) for a period that was *longer* than the then five-year rate period. BPA therefore conducted 17 section 7(b)(2) rate tests for the Settlement term, under numerous litigation and economic scenarios, in order to ensure that the Settlement protected the position of the preference customers consistent with section 7(b) of the Northwest Power Act. BPA determined that the Settlement provides preference customers greater rate protection than in the absence of the Settlement.

APAC notes the Court's recognition that “[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” APAC Br. Ex., REP-12-R-AP-01, at 8; *PGE*, 501 F.3d at 1030. APAC notes BPA's conclusion that for the Court's statement to be true, there must be “a way to recognize utilities' ASCs pursuant to section 5(c) and the rate test pursuant to section 7(b)(2) for a period that was longer than the then five-year rate period.” APAC Br. Ex., REP-12-R-AP-01, at 8. APAC argues that there may be settlement agreements that by their terms cannot be so tested. *Id.* This argument is not clear. In any event, however, BPA has evaluated the Settlement for compliance with both section 5(c) and section 7(b) of the Northwest Power Act. Unlike the 2000 REP Settlements reviewed in *PGE*, which relied on ASCs under an alternative ASC Methodology that was presumed to exist in the future, BPA's analysis in this proceeding uses ASCs based upon its current 2008 ASC Methodology. Also, unlike the 2000 REP Settlements reviewed in *PGE*, which ignored the implementation of section 7(b)(2), BPA's analysis of the

Settlement conducts and thoroughly reviews the Reference Case 7(b)(2) rate test and seventeen 7(b)(2) rate tests for the term of the Settlement (including extensive review of alternative scenarios for each 7(b)(2) rate test). The Settlement's compliance with section 5(c) and section 7(b) is addressed at length in respective sections of this ROD.

APAC argues that the *PGE* Court did not implicitly sanction settlement agreements setting rates for ten years because the procedural history indicates BPA offered the alternative of either a five- or ten-year settlement agreement, and the opinion does not indicate that any of its decisions assumed the ten-year version was proper. APAC Br. Ex., REP-12-R-AP-01, at 12, citing *PGE*, 501 F.3d at 1019. APAC has not fully presented the facts. Although it is true that BPA initially offered five-year and ten-year 2000 REP Settlements, all of the 2000 REP Settlements executed by the IOUs, and thus *the only settlements reviewed by the Court in PGE*, were ten-year contracts. Thus, BPA correctly concludes that the statements in the Court's opinion concern ten-year contracts, not five-year contracts. The Court recognized that BPA "may enter into REP settlement contracts with IOUs," but placed no limit on the length of REP settlements.

WPAG conflates this finding into a hypothetical argument that BPA could have conducted the rate test in 1985 once for 43 years using projected data and be done with 7(b)(2) for an extended period of time. This argument ignores the difference between such a hypothesis and the Settlement. In 1985, the IOUs were not willing to accept a fixed level of REP benefits for 43 years, the COUs were not willing to pay a fixed level of REP benefits for 43 years, and BPA was not facing substantial litigation disputing the conduct of the 7(b)(2) rate test. These conditions exist at this time. BPA is not attempting to apply its analysis of the Settlement into a longer application of the rate test outside the term of the Settlement. BPA understands it does not have substantial regional support, or internal support, to propose such a result simply to escape its obligations under the Northwest Power Act.

Alcoa states that BPA has performed a series of 7(b)(2) rate tests for the 17 years of the Settlement, but BPA has done so only for purposes of determining whether the amount of COU rate protection resulting from application of the Settlement's ratesetting directives would be greater or less than would be provided by a strict application of the statutory section 7(b)(2) rate test. Alcoa Br., REP-12-B-AL-02, at 17. APAC argues that testing the Settlement against many scenarios of projected economic factors and litigation outcomes is simply a semantic exercise because section 7(b)(2) states that "projected amounts" of costs may not exceed the costs under the assumptions of the 7(b)(2) Case. APAC Br., REP-12-B-AP-01, at 5. Staff's analysis of economic factors and 7(b)(2) issues is not a semantic exercise, because it evaluates the rate protection that is provided by comparing the Program Case with the 7(b)(2) Case for the Settlement period. As noted previously, a 7(b)(2) rate test conducted for a single rate period is insufficient to evaluate 7(b)(2) implementation for a longer period, such as that necessitated by a REP settlement. Furthermore, the Settlement resolves 7(b)(2) issues in litigation before the Ninth Circuit, which certainly is not a merely a matter of semantics. The COUs and IOUs have taken different positions on those issues, and the Court's adoption of either party's position would affect the rate protection and REP benefits provided to the COUs and IOUs, respectively.

It is therefore necessary to conduct an analysis of the potential litigation outcomes in order to determine whether the rate protection provided by the Settlement satisfies section 7(b)(2).

APAC argues that Staff's analysis violates section 7(b)(2) in that the projected costs under some of the various scenarios in Staff's analysis exceed the 7(b)(2) Case, and the Administrator cannot represent that his best estimate of "projected costs" is not exceeded by the rates under the Settlement. APAC Br., REP-12-B-AP-01, at 5. The record shows, however, that the Settlement provides rate protection superior to that of the 7(b)(2) rate test in all instances under BPA's implementation of the 7(b)(2) rate test and only in a few litigation scenarios does the Settlement fall short. Evaluation Study, REP-12-FS-BPA-01, section 11.3. To achieve higher rate protection, the non-settling COUs would have to prevail on multiple litigated issues. *Id.* But the courts do not review settlements to determine whether a settlement is superior to any possible eventuality. If this were the standard, settlements would become extinct. At the heart of a settlement is the art of reasonableness and compromise. It makes no sense that one side would have to give so much to satisfy any possible adverse result to the opposing side that it would become better for them to litigate to a conclusion. They could do no worse in litigation than they could under such an approach. As case law recognizes:

It is important to take particular note of the fact that in reviewing the compromise, this court need not and should not reach any dispositive conclusions on the admittedly unsettled legal issues which the case raises, yet at the same time we are apparently required to attempt to arrive at some evaluation of the points of law on which the settlement is based. A number of years ago this court set forth the applicable standard in *In Re Prudence* [98 F.2d 559 (2d Cir. 1938)]:

The district court did not determine the validity of the government's claim with respect to the taxability of the 'commissions'; nor need this court do so. The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues, as this court pointed out in the case of *In re Riggi Bros. Co.*, 2d Cir., 42 F.2d 174, 176. Hence, to succeed upon this appeal the appellant must show, assuming there are no issues of fact in dispute, that the rules of law for which she is contending are so clearly correct that it was an abuse of discretion for the district court to approve the settlement (98 F.2d at 560).

*State of West Virginia v. Pfizer & Co.*, 440 F.2d 1079, 1086 (2d Cir. 1971). Another case citing *West Virginia* recognizes:

Since defendants' liability was not prima facie established it becomes necessary to consider the strength of the case presented by the class members in order to determine whether there is any basis for appellants' claim that the settlement was grossly unfair and inadequate. It cannot be overemphasized that neither the trial court in approving the settlement nor this Court in reviewing that approval have the right or the duty to reach any ultimate conclusions on the issues of fact and law which underlie the merits of the dispute. It is well settled that in the judicial consideration of proposed settlements, 'the (trial) judge does not try out or attempt to decide the merits of the controversy,' *West Virginia v. Chas. Pfizer &*

*Co.*, [314 F. Supp. 710 (S.D.N.Y. 1970), *aff'd* 440 F.2d 1079 (2d Cir.), *cert. denied sub nom. Cotler Drugs, Inc. v. Chas. Pfizer & Co.*, 404 U.S. 871, 92 S. Ct. 81, 30 L. Ed.2d 115 (1971)] at 741, and the appellate court ‘need not and should not reach any dispositive conclusions on the admittedly unsettled legal issues . . . .,’ *West Virginia v. Chas. Pfizer & Co.*, [440 F.2d 1079, 1086 (2d Cir. 1971)], at 1085-1086.

*Detroit v. Grinnell Corp.*, 495 F.2d 448 (2d Cir. 1974). Thus, settlements must satisfy statutory requirements but need not demonstrate the satisfaction of every eventuality or assume that one party’s position would prevail. WPAG’s argument fails for the same reason.

APAC states that the PF Exchange rate to be used by BPA under the Settlement is different from that required by the operation of section 7. APAC Br. Ex., REP-12-R-AP-01, at 10. APAC notes that section 7 of the Northwest Power Act sets the PF Exchange rate equal to the PF Public rate, as it may be increased by a share of that trigger amount under section 7(b)(3), but under the Settlement, the PF Exchange rate is determined from the sum of the PF Public rate charges to exchanging utilities and the REP benefits provided by the terms of the Settlement. *Id.* APAC argues that unless it can be determined that the IOUs are always, throughout the 17 years of the Settlement, paying a higher PF Exchange rate than required by the statute, then the preference customers are shouldering an improper share of BPA’s total costs and subsidizing the PF Exchange rate. *Id.* APAC’s proposed standard is impractical and unreasonable. First, the determination of whether the IOUs are paying a higher PF Exchange rate “than required by the statute” is subjective. If this determination were based on BPA’s WP-07 Supplemental decisions, including 7(b)(2) decisions, there is no question that the Settlement provides preference customers *greater* rate protection than in the absence of the Settlement. However, the IOUs and COUs disagree with many of BPA’s WP-07 Supplemental decisions. All regional parties therefore face significant uncertainty regarding either the receipt of REP benefits or the amount of REP costs included in BPA’s rates during the Settlement term. No party knows with absolute certainty how these issues would be resolved by the Court. Indeed, APAC provides no methodology to determine the proper amount of rate protection or the REP benefits provided to the IOUs over the Settlement term other than to preclude any REP settlement whatsoever. BPA takes a much more practical approach.

BPA’s extensive analysis concludes that if BPA’s WP-07 Supplemental decisions (the status quo) were affirmed by the Court, BPA’s preference customers would receive greater rate protection under the Settlement than in the absence of a settlement under broad economic scenarios. BPA’s analysis also concludes that BPA’s preference customers would receive greater rate protection under the Settlement than in the absence of the Settlement if the IOUs were to prevail on their arguments. BPA’s analysis also concludes that BPA’s preference customers would receive greater rate protection under the Settlement than in the absence of the Settlement even if the preference customers won many of their arguments. Using its subjective “required by the statute argument,” APAC argues that rate protection would be greater absent the settlement if APAC prevailed on two issues, the inclusion in the Lookback Amount of payments under the Load Reduction Agreements (LRA) and the treatment of conservation in the 7(b)(2) rate test. APAC Br., REP-12-B-AP-01, at 14. This argument is directly addressed in section 3.5.

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However, APAC's argument is greatly weakened when one reviews the applicable standard of review and the merits of these two issues.

First, when challenging a BPA final action, BPA's actions are upheld unless they are "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). This standard of review is deferential and presumes the agency action to be valid. *Cal. Energy Comm'n v. Bonneville Power Admin.*, 909 F.2d 1298, 1306 (9th Cir. 1990). The Northwest Power Act also 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); *Central Lincoln*, 735 F.2d at 1116. The Court has recognized that substantial evidence is more than a mere scintilla, but less than a preponderance. *Edlund v. Massanari*, 253 F.3d 1152, 1156 (9th Cir. 2001) (*Edlund*). In addition, the Administrator's interpretations of the Northwest Power Act are entitled to substantial deference. *See, e.g., Aluminum Co. of America v. Central Lincoln People's Util. Dist.*, 467 U.S. 380, 389 (1984); *APAC I*, 126 F.3d at 1169; *Confederated Tribes of the Umatilla Indian Reservation v. Bonneville Power Admin.*, 342 F.3d 924, 928 (9th Cir. 2003) (*Confederated Tribes*) (the Court should give "special, substantial deference to BPA's interpretation of the [Northwest Power Act]," due to the broad expertise of BPA and the complicated nature of the issues ordinarily involved with BPA's decisions).

Second, with regard to the LRA issue, APAC argues that because the LRAs reduced BPA's obligation to provide power under the 2000 REP Settlements, they were invalidated by *PGE* and *Golden NW*. This argument ignores a series of critical facts: the LRAs were a crucial part of BPA's Load Reduction Program, which was entirely separate from the REP and under which a projected rate increase for preference customers was reduced from 250 to 46 percent; no party challenged either the LRAs or BPA's allocation of LRA costs to preference customers; the Court did not address the LRAs in *PGE* or *Golden NW* and explicitly declined to invalidate the LRAs in *Snohomish*; and petitions challenging the LRA payments were first filed seven years after the LRAs were executed, more than five years after the rates allocating LRA costs became final, and three years after the LRAs were fully performed and the preference customers had enjoyed all their benefits. The likelihood that the Court's resolution of this issue would provide preference customers greater rate protection if litigated is far from certain.

Third, with regard to the conservation issue, Northwest Power Act section 7(b)(2)(D) establishes a resource stack to serve preference customers' requirements loads in the 7(b)(2) Case after Federal base system resources are exhausted. Section 7(b)(2)(D) provides that "resources" purchased by BPA from public bodies and cooperatives pursuant to section 6 can be used to meet the general requirements of such customers. Conservation is a resource explicitly referenced in section 6 as being purchased by BPA from public bodies and cooperatives. Therefore, conservation is used in the resource stack to meet the general requirements of public bodies and cooperatives. BPA therefore adjusts loads in the 7(b)(2) Case to reflect the fact that because conservation is in the resource stack, it cannot have already been used to meet load. BPA has consistently applied this statutory interpretation for nearly 25 years. APAC argues that conservation costs should be excluded entirely from the 7(b)(2) rate test. Directly refuting this

argument, section 7(b)(2) provides that “the projected amounts to be charged for firm power for the combined general requirements of public body, cooperative and Federal agency customers, *exclusive of amounts charged such customers under subsection (g) of this section for the costs of conservation* ... may not exceed in total, as determined by the Administrator ... an amount equal to the power costs for general requirements of such customers, if the Administrator assumes [the Five Assumptions for the 7(b)(2) Case].” 16 U.S.C. § 839e(b)(2) (emphasis added). The plain language of the statute thus excludes conservation only *from the Program Case*. In addition, APAC’s interpretation is inconsistent with the Northwest Power Act’s definition of conservation as a resource and the 7(b)(2) rate test’s use of “resources” in the 7(b)(2) Case resource stack. Furthermore, even if part of APAC’s argument on conservation were adopted by the Court, on remand it would hard to argue that 7(b)(2) Case loads should be reduced by conservation acquired under section 6 of the Act, and that preference customers should benefit from those programs at no cost. Additional weaknesses in APAC’s conservation argument are contained in BPA’s respondent’s brief in *APAC*. In summary, the likelihood that the Court’s resolution of this issue would provide preference customers greater rate protection if litigated is also far from certain.

Thus, BPA’s analysis establishes that the Settlement provides superior 7(b)(2) rate protection than the absence of the Settlement in nearly all scenarios.

#### **D. Sub-issue: Whether the Duration of the Settlement is Unprecedented**

Alcoa claims that the duration of the 2012 Settlement and BPA’s section 7(b)(2) “evaluation” is unprecedented. Alcoa Br., REP-12-B-AP-01, at 17. In addition to the fact that “unprecedented” does not equate to unlawful or unreasonable, however, this claim is simply wrong. To the contrary, BPA’s REP settlements have traditionally been for extended terms. Indeed, beginning in 1987, BPA entered into numerous REP settlement agreements with its preference and IOU customers. During the 1980s and 1990s, BPA negotiated REP settlement agreements and paid benefits under such agreements to 33 exchanging utilities, including all of BPA’s exchanging preference customers, for terms up to 15 years. A.R. 0953-1110.<sup>13</sup> BPA’s preference customers made up the vast majority of the utilities that took advantage of this opportunity to settle their REP disputes. *Id.* Indeed, BPA executed REP settlement agreements with 29 preference customers between 1987 and 1996.<sup>14</sup> *Id.*

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<sup>13</sup> This citation is to the record filed with the Ninth Circuit in *PGE*. That record has been incorporated into the record of the REP-12 proceeding. REP-12-HOO-11.

<sup>14</sup> BPA executed REP settlement agreements with the following preference customers between 1987 and 1996: PUD No. 1 of Clallam County, WA; Glacier Electric Cooperative; PUD No. 1 of Klickitat County, WA; Prairie Power Cooperative, Inc.; Vigilante Electric Power Cooperative, Inc.; Flathead Electric Cooperative, Inc.; PUD No. 1 of Grays Harbor County, WA; Orcas Power & Light Co.; Salmon River Electric Cooperative, Inc.; Blachly-Lane Electric Cooperative Association; Central Electric Cooperative, Inc.; Consumers Power, Inc.; Coos-Curry Electric Cooperative, Inc.; Douglas Electric Cooperative, Inc.; Lost River Electric Cooperative, Inc.; Oregon Trail Electric Cooperative; Raft River Electric Cooperative, Inc.; Umatilla Electric Cooperative Association; PUD of Clark County; City of Idaho Falls; Oregon Trail Electric Consumers Cooperative; Lewis County PUD; Inland Power & Light Company; the Pacific Northwest Generating Cooperative; Fall River Rural Electric Cooperative; Lower Valley Power & Light, Inc.; Benton Rural Electric Association; Clearwater Power Company; and Harney Electric Cooperative, Inc. (A.R. 0953-1110.) BPA also entered into REP Settlement Agreements with IOUs between 1994

Alcoa claims that the Bonneville Project Act requires BPA to set rates at least every five years, citing section 5(a) of the Bonneville Project Act, which provides that “[c]ontracts entered into under this subsection shall contain (1) such provisions as the administrator and purchaser agree upon for the *equitable adjustment of rates* at appropriate intervals, not less frequently than once every five years ....” Alcoa Br., REP-12-B-AP-01, at 17-18, *citing* 16 U.S.C. § 832d(a) (emphasis added by Alcoa). This argument is misplaced. During the term of the Settlement, BPA will continue to set wholesale power rates every two to five years. The Settlement does not require otherwise. Furthermore, as is evident from reviewing the Settlement, the Settlement does not establish any rates. Indeed, Alcoa fails to identify a single rate that is established by the Settlement alone. This is because ratemaking involves many steps, including a forecast of loads and resources; a determination of BPA’s total revenue requirement; a forecast of market prices; an analysis of risk and its mitigation; a cost of service analysis; a rate design analysis; and additional steps. Because the Settlement does not establish any rates, it is not subject to any requirement to establish rates every five years<sup>15</sup> (if such requirement currently exists<sup>16</sup>). The Settlement resolves disputes regarding the implementation of section 7(b)(2) of the Northwest Power Act. Section 7(b)(2) determines rate protection for BPA’s preference customers, and thus the amount of REP costs that can be included in preference customers’ rates and the REP benefits that can be provided to BPA’s IOU customers. There is no statutory requirement that BPA’s ratemaking or cost methodologies must be revised every five years.

Furthermore, contrary to Alcoa’s argument, BPA has often established rates or ratemaking or cost allocation methodologies for periods exceeding five years.<sup>17</sup> *E.g.*, BPA’s 1986 IP-PF Rate Link (6 years), 1986 IP-PF Rate Link ROD, IP-PF-86-A-02; 1986 Variable Industrial Power Rate, (7 years), VI-86 Variable Industrial Rate ROD, VI-86-A-02; WNP-3 Settlement cost allocations (33 years), WNP-3 Settlement Agreement Costs and Benefits Allocation Methodology ROD, WN-86-A-02; Tiered Rate Methodology (17 years), TRM-12 Supplemental ROD, TRM-12S-A-02; 1984 Section 7(b)(2) Implementation Methodology (23 years),

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and 1998: Pacific Power & Light Company; PacifiCorp; Puget Sound Power & Light Company; and Portland General Electric Company.

<sup>15</sup> Canby asks whether BPA can set rates for longer than five years; whether such a requirement, if it existed, could be waived; and whether BPA’s customers have done so in the 2012 REP Settlement. Canby Br. Ex., REP-12-R-CA-01, at 2. As noted in the preceding discussion, the 2012 REP Settlement establishes only the amount of REP benefits provided to IOUs and the REP costs included in preference customers’ rates. The Settlement does not establish rates. Thus, it is unnecessary to address whether BPA can establish rates for longer than a five-year period.

<sup>16</sup> There is a question by some whether the Bonneville Project Act’s five-year requirement is still effective given the adoption of the Northwest Power Act, which authorized subsequent power sales contracts and provides that BPA’s rates shall be periodically reviewed and revised. *See* 16 U.S.C. § 839e(a)(1). Others believe that the five-year requirement is still effective. Because the 2012 REP Settlement does not establish rates, this issue need not be addressed.

<sup>17</sup> Canby asks whether BPA can establish a fixed cost component of rates in a manner consistent with the Bonneville Project Act’s five-year requirement. Canby Br. Ex., REP-12-R-CA-01, at 2. Section 5(a) of the Bonneville Project Act refers to the “equitable adjustment of rates” not less frequently than once every five years. Even assuming this standard is still applicable, it does not govern individual program costs, which can be fixed for extended periods. This is consistent with BPA’s longstanding practice of establishing cost methodologies for longer than five-year terms, as documented in the cited methodologies.

Section 7(b)(2) Implementation Methodology ROD, b2-84-F-02; 1984 ASC Methodology (23 years), ASCM ROD, ASC-83. Also, although the Settlement does not establish rates, BPA has periodically established rates with terms exceeding five years. *E.g.*, 1986 SCE rate (20 years), Southern California Edison Contract Formula Rate Adjustment Proceeding ROD, SC-86-A-02; PacifiCorp capacity rate (20 years), 1990 Pacific Power and Light Surplus Firm Capacity Rate Proceeding ROD, PPL-90-A-02; FPS-96 rate (10 years), Firm Power Products and Services Rate Adjustment Proceeding ROD, FPS-96R-A-02; Modified Surplus Power rate (20 years), 1987 Modified Surplus Power Rate Adjustment Proceeding ROD, WP-87-MSL-A-02; Third AC Participation rate (20+ years), 1989 Third AC Intertie Non-Federal Participation Rate Adjustment Proceeding ROD, 3ACP-89-A-03; 2002 Pacific NW Coordination Agreement rate (until superseded), Rate for Interchange Energy Imbalances under the Pacific Northwest Coordination Agreement ROD, PNCA-02-A-02.

APAC reiterates its argument that the Settlement violates BPA's statutory authority and FERC regulations, which APAC claims limit BPA to setting rates for a maximum of five years. APAC Br. Ex., REP-12-R-AP-01, at 12. APAC claims that BPA's argument that acceptance of the Settlement does not set an actual rate is asserting form over substance. *Id.* This is incorrect. Establishing rates and establishing costs are two substantively different things. The Settlement establishes the amount of REP benefits provided to the IOUs over the Settlement term and thus the amount of REP costs included in preference customers' rates during that term. The Settlement does not establish rates. APAC also states that the periodic review and update of costs that is required by the statute to occur every five years will not occur with regard to REP benefits. *Id.* First, as explained previously, because the Settlement establishes costs but not rates, costs are not subject to any 5-year rule applicable to rates. Second, the Northwest Power Act provides that REP costs are allocated to particular customer classes (16 U.S.C. § 839e(b)(1)) and that rates are established to recover BPA's total costs (16 U.S.C. § 839e(a)). Thus, whatever REP costs are (whether established by the traditional implementation of the REP or through the Settlement), the relevant statutes require only that BPA properly allocate such costs and recover such costs as part of its recovery of BPA's total costs through rates. Third, any practical settlement of disputes regarding the implementation of the REP requires the forecast of costs beyond a single rate period. BPA's analysis, which accommodates broad changes that could affect BPA's future costs, shows that in nearly all cases the amount of REP costs is less than would exist in the absence of the Settlement. BPA has therefore accounted for cost changes that could occur during the Settlement term.

APAC also argues that if the Settlement is adopted, it will be on the basis that the level of REP benefits for 17 years is reasonable based on costs developed and projected in 2011, while the actual PF Preference [Public] rates will be based on costs forecast during each rate case in the future. APAC Br. Ex., REP-12-R-AP-01, at 7. APAC states that the two rates will be determined based on different sets of costs. *Id.* First, however, the Settlement does not establish rates, but instead establishes the amount of REP benefits provided to the IOUs and thus the REP costs recovered from BPA's rates during the Settlement term. Therefore, BPA will have only one PF Public rate for each rate period during the Settlement's term, with each such rate based on BPA's then-current costs. The only exception to these costs is the amount of REP costs,

which is established in the Settlement. The purpose of a settlement is to resolve disputes for an extended period of time. Any such settlement must necessarily rely on forecasts of costs for future years. Forecast costs may differ from actual costs, but are a legitimate manner of establishing costs for a settlement. Stiffler *et al.*, REP-12-E-BPA-13, at 6-14.

In evaluating the Settlement, BPA conducts an analysis that includes a Reference Case, which uses the best information currently available to conduct the 7(b)(2) rate test. In order to ensure that the costs of the Settlement are reasonable throughout its term, BPA expands upon the Reference Case. As addressed in the Evaluation Study, REP-12-FS-BPA-01; associated Documentation, REP-12-FS-BPA-01A; and testimony, Stiffler *et al.*, REP-12-E-BPA-07, the analysis compares the Settlement schedule of benefits to those that can be expected under a multitude of scenarios. These scenarios incorporate a wide and measured degree of anticipated variation in costs, as well as the full set of briefed issues currently under litigation with respect to Lookback, 7(b)(2) assumptions, treatment of conservation, and discounting methodologies, among others. There are 24 scenarios in all. The first 4 examine the degree to which forecasting uncertainty could affect REP benefits over the full 17-year period. The additional 20 scenarios are range of REP benefits that could be expected under the rate directives of the Northwest Power Act as interpreted under alternative litigation outcomes in court. Thus, BPA has taken extraordinary steps to ensure that the REP benefits provided during the Settlement term reasonably reflect BPA's costs.

**E. Sub-issue: Whether the Settlement Improperly Replaces the 7(b)(2) Rate Test with Negotiated Values**

APAC states that the Northwest Power Act requires BPA to conduct the 7(b)(2) rate test to set a rate ceiling, and then the costs in excess of that ceiling are allocated to other rates, including the PF Exchange rate. APAC Br., REP-12-B-AP-01, at 5; APAC Br., Ex., REP-12-R-AP-01, at 9. APAC argues that under the Settlement, the PF rate is set to support the REP benefits that have been predetermined by the Settlement, without any constraint by the 7(b)(2) rate test. *Id.* Similarly, WPAG argues that the REP Settlement requires BPA to use negotiated values for the REP costs included in the PF rate (and the IP and NR rates as well), and by implication to set the amount of REP rate protection to be afforded to BPA's preference utilities. WPAG Br., REP-12-B-WG-01. WPAG argues that by setting its rates based on the provisions of the REP Settlement, BPA is substituting values negotiated by the IOUs and 88 percent of its preference customers (by load) for the values BPA is obligated to determine in a rate revision process using the rate directives contained in section 7 of the Act. *Id.*

First, APAC's characterization of the Settlement is incorrect. Extensive section 7(b)(2) rate protection has been incorporated in the Settlement, and such protection constrains the costs allocated to the PF Public rate, as discussed below. Also, contrary to WPAG's assertions, BPA is reviewing the Settlement's compliance with section 7(b)(2) in this section 7(i) proceeding, and is concurrently conducting a section 7(i) proceeding to establish rates for FY 2012–2013. Such rates reflect the rate protection provided by the Settlement. The Settlement was developed in the context of three 7(b)(2) rate tests conducted in BPA's WP-07 Supplemental rate case and a

7(b)(2) rate test conducted in BPA's WP-10 rate case. The COUs and IOUs developing the settlement are keenly aware of section 7(b)(2) and the rate protection it provides to BPA's preference customers. The COUs and IOUs are also aware of the specific 7(b)(2) issues that affect the calculation of rate protection and REP benefits. IOUs participating in the REP can lawfully agree to take less REP benefit than they are entitled to. As long as the amounts provided under the Settlement are less than the REP benefits projected pursuant to sections 7(b)(2) and 7(b)(3) of the Northwest Power Act, the Settlement complies with the rate protection provided by section 7(b)(2). It is the purpose of the REP-12 proceeding to measure the negotiated numbers in light of the 7(b)(2) rate test and other statutory provisions. 75 Fed. Reg. 78694, at 78702 (2010). To this end, Staff conducts an extensive analysis. This analysis includes having performed the 7(b)(2) rate test for each of the 17 years (plus the ensuing four years) of the Settlement. Staff concludes that the rate test would in most cases allow greater REP benefits than the Settlement provides.

But even so, BPA did not take these parties' word that the Settlement provided the protections afforded by the Northwest Power Act. Instead, Staff evaluated the REP benefits provided under the Settlement to ensure that the law's REP and ratemaking directives were being followed. In this way, the negotiated values proffered by the parties in the Settlement do not establish BPA's basis for determining they are lawful. Rather, the lawfulness of the Settlement has come through this proceeding and Staff's extensive evaluation of the Settlement's terms. As noted by Staff:

We do not view the Settlement as a mere substitution of negotiated numbers for values that would otherwise be determined in a rate case. This simplified view of the Settlement ignores the role of this proceeding in measuring the negotiated numbers in light of the 7(b)(2) rate test and other statutory provisions. It is our understanding that REP participants may lawfully agree to take lower REP benefits than they might otherwise be entitled to. Thus, as long as the amounts provided under the Settlement are less than the REP benefits projected pursuant to sections 7(b)(2) and 7(b)(3) of the Northwest Power Act, we see no legal infirmity.

Bliven *et al.*, REP-12-E-BPA-12, at 2-3.

Consequently, as long as the amounts provided under the Settlement are less than the REP benefits projected pursuant to sections 7(b)(2) and 7(b)(3) of the Northwest Power Act, the Settlement complies with the rate protection provided by section 7(b)(2). It is the purpose of the REP-12 proceeding to measure the negotiated numbers in light of the 7(b)(2) rate test and other statutory provisions. 75 Fed. Reg. 78694, at 78702 (2010). This analysis includes having performed the 7(b)(2) rate test for each of the 17 years (plus the ensuing four years) of the Settlement. Staff concludes that the rate test would in most cases allow greater REP benefits than the Settlement provides.

APAC argues that setting the 7(b)(2) rate protection amounts based on the Settlement precludes a future Administrator from making a 7(b)(2) determination for any of the future two-year rate periods to meet the statutory requirements of 7(b)(2) and reflect changed circumstances. APAC

Br. Ex., REP-12-R-AP-01, at 7-8. APAC states that as a consequence, no 7(b)(2) test that establishes the amounts charged to preference customers is being or will be performed from 2012 through 2027 because the rate test model merely tests a number of scenarios that have been posited. *Id.* at 8. First, the purpose of the Settlement is to resolve disputes regarding the implementation of the REP, including contentious 7(b)(2) issues. Therefore, it is no surprise that the Settlement, by establishing a conservative level of REP benefits and costs for the Settlement term, would make a number of determinations by the Administrator unnecessary in rate proceedings during that such term. As noted previously, BPA’s analysis of the Settlement extensively evaluates possible variations in BPA’s costs resulting from changing circumstances. This analysis uses a Reference Case that conducts the 7(b)(2) rate test using the best information currently available and also conducts 7(b)(2) rate tests for each of the 17 prospective years of the Settlement (plus four respective years for each year). This analysis demonstrates that the rate protection provided preference customers under nearly all scenarios is greater than in the absence of the Settlement. It is unnecessary for BPA to conduct additional 7(b)(2) rate tests during the Settlement term.

Alcoa and APAC argue that BPA’s section 7(b)(2) rate tests have always been tied to specific rates in a specific rate period. Alcoa Br., REP-12-B-AP-01, at 18; APAC Br., REP-12-B-AP-01, at 6. WPAG notes that the Northwest Power Act requires BPA to periodically establish rates to recover BPA’s costs. WPAG Br., REP-12-B-WG-01, at 14. WPAG notes that section 7(b)(2) states that the “amounts to be charged for firm power for the combined general requirements of public body ... customers ... may not exceed in total ... an amount equal to the power costs for general requirements of such customers ....” WPAG also notes that BPA’s Section 7(b)(2) Legal Interpretation refers to BPA’s rate directives. WPAG states that BPA’s Section 7(b)(2) Implementation Methodology defines the “Relevant Rate Case” in which the rate test is performed, that the rate test is run for the rate period plus four years, and that rate period revenue requirement, load, resource and cost allocation assumptions will be used (plus extrapolations for the ensuing four years). *Id.* WPAG argues that the intent of these provisions is that revised rates will be set in a ratesetting process using costs that are applicable to the rate period, and BPA cannot perform the 7(b)(2) rate test in a proceeding in which no rates are being set or do so for 17 years based on forecast numbers that will never be used in any rate revision proceeding to set rates. *Id.*

WPAG’s citations refer to the traditional manner of establishing BPA’s rates in the absence of a settlement. There is no dispute that when BPA sets rates in the absence of a settlement, it does so in a ratemaking proceeding designed to establish rates for a traditional rate period, and REP benefits are subject to change in each rate period. Bliven *et al.*, REP-12-E-BPA-12, at 6. In this case, however, BPA is faced with the prospect that REP benefits would not be subject to change in future rate periods as a condition of a settlement. *Id.* If the IOUs are willing to take a fixed amount of REP benefits over multiple rate periods, it makes sense to conduct the 7(b)(2) rate test for an equivalent amount of time to determine whether the protections afforded to the COUs by the rate test have been met. *Id.* Nothing in section 7(b)(2) or any other provision of the Northwest Power Act prohibits such an evaluation. *Id.* The fact that the REP benefits are “fixed” by the Settlement also does not conflict with the Northwest Power Act. *Id.* at 7.

Section 7(b)(2) directs that the “projected” power costs to the COUs “may not exceed” the power costs necessary to serve the general requirements of the COUs assuming the five assumptions in section 7(b)(2). *Id.* This language makes clear that the 7(b)(2) rate test creates a cap, not a floor, on REP benefits. *Id.* With this understanding of the statutory language, the critical question is whether the fixed payments in the Settlement provide the IOUs with more benefits than what the section 7(b)(2) rate test would allow. *Id.* Staff’s analysis demonstrates that the amount of REP benefits provided under the “fixed” schedule in the Settlement is below the amount of REP benefits that would be available to the IOUs in nearly every scenario considered, including non-modeled combinations of the issues. *Id.* If the IOUs are willing to agree to take less in REP benefits than they might otherwise be entitled to, they have the right to do so. *See* Issue 4.5.1.

As noted previously, however, section 7(b)(2) contains no express requirement for BPA to perform the rate test “for each rate period.” Section 7(b)(2) talks about “projected” costs, not the actual costs to be charged for a rate period. BPA acknowledges that it has been BPA’s practice to make section 7(b)(2) a rate case-by-rate case determination. This is because BPA was not previously operating in the context of a REP settlement such as the Settlement. As explained previously, running the 7(b)(2) rate test for a single rate period does not cover the period of a REP settlement, which must be longer than a single rate period to make any sense. Where a REP settlement is longer than a rate period, BPA must determine how to ensure 7(b)(2) rate protection for its preference customers. BPA has done so, in part, by performing the 7(b)(2) rate test for each of the 17 years of the Settlement (plus the ensuing four years for each year).

In the current case, BPA is reviewing the lawfulness of a settlement and, in a simultaneous companion case, is establishing rates for the coming two-year rate period. In evaluating the settlement, BPA conducts the 7(b)(2) rate test in the same manner as BPA conducted the rate test in its WP-10 proceeding and uses that rate test as a reference case for its analysis. In addition, in order to evaluate the rate protection provided for the term of the Settlement, BPA conducts 17 section 7(b)(2) rate tests, one for each year (plus the following four years) of the Settlement. BPA could not simply conduct a 7(b)(2) rate test and set rates for the coming two-year rate period because, if the Settlement were adopted, the amount of REP costs to be recovered in rates would be established for the coming rate period and subsequent rate periods. BPA must establish rates to recover those known costs. During the term of the settlement BPA will continue to establish rates every two years. These rates will use the most recent information available, including each rate period’s revenue requirement, load forecast, resource forecast, and cost allocation approach. There are two aspects of each rate case, however, that will already be established: namely, the design of tiered rates and the REP costs for each year of the Settlement period. REP costs are a product, in part, of the 7(b)(2) rate test. This is why, in order to ensure that 7(b)(2) rate protection is provided to preference customers for the term of the Settlement, such protection must be determined at the beginning of the Settlement period. If BPA has ensured that preference customers are provided proper rate protection for the Settlement period, then it is appropriate to include the specified Settlement costs in rates for each prospective rate period. If BPA were precluded from projecting future costs and ASCs to estimate rate protection and REP benefits, then, as a practical matter, BPA would be unable to settle REP disputes. *Id.* at 7. Parties would have to engage in full litigation of every REP issue unless all parties in BPA

rate proceedings agreed not to challenge BPA’s determinations on REP issues. *Id.* BPA’s settlement authority and sections 5(c) and 7(b) of the Northwest Power Act do not mandate such an outcome.

WPAG argues that the Settlement operates in a manner that is the reverse of the traditional ratesetting methodology. WPAG Br. Ex., REP-12-R-WG-01, at 19. WPAG notes that the Settlement does not solve for the level of REP benefits that can be included in the PF Public rate because those amounts are hardwired into the Settlement. *Id.* As a consequence, WPAG argues, the Settlement does not require the use of the steps set out in the Northwest Power Act for determining REP benefits. *Id.* WPAG cites the PF Exchange rate as an example of this “role reversal.” *Id.* According to WPAG, the fact that an increase in the PF Exchange results in a decrease in REP benefits is not the case under the Settlement because REP benefit levels are fixed. *Id.* WPAG claims that the levels of the PF Exchange rates no longer determine the total amount of REP benefits available to the IOUs as a class. *Id.*

Most of WPAG’s argument is true under the Settlement. The Settlement does fix the total amount of REP benefits, and rate protection costs are allocated to the PF Exchange rate to produce the fixed amount of REP benefits. However, while WPAG notes that this process differs from the traditional approach when the implementation of the 7(b)(2) rate test and the level of REP benefits is in dispute, WPAG does not offer any rebuttal to why such an approach is contrary to statute when the level of the PF Public rate and the level of REP benefits are lower than they would be under the traditional approach. While the Settlement approach is different, it has not been shown to be in violation of section 7(b).

WPAG argues that BPA’s interpretation is inconsistent with the manner in which BPA has set rates and administered the 7(b)(2) rate test for over two decades. WPAG Br., REP-12-B-WG-01, at 25. Any such difference, however, is easily explained. During the past two decades BPA has not been establishing rates in the context of the Settlement.<sup>18</sup> Establishing rates for a two-year rate period in which BPA is implementing the REP is not the same as establishing rates for a two-year period in which there is a settlement that establishes the REP costs to be included in rates for 17 years. Although the Settlement is a negotiated result, it is being analyzed and evaluated in this proceeding before BPA adopts it or rejects it. Bliven *et al.*, REP-12-E-BPA-12, at 8. In this proceeding, BPA has “set the §7(b)(2) protection, then an exchange rate, and then determine[d] the residential-exchange benefits to be paid to the IOUs as the difference between the exchange rate and the IOUs’ average system costs (ASCs), as applied to their exchange loads.” *Id.* The REP payments under the Settlement have been shown to be less than under no Settlement, the rate protection for COUs greater, and the IP rates lower, in almost all scenarios. *Id.* Thus, the Settlement passes the statutory tests of conforming to sections 5(c) and 7(b) of the Northwest Power Act. *Id.*

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<sup>18</sup> In BPA’s WP-02 rate case, BPA treated the 2000 REP Settlement costs as general costs and allocated such costs pursuant to section 7(g) of the Northwest Power Act, thereby unlawfully ignoring section 7(b)(2) of the Act. *PGE*, 501 F.3d at 1036.

WPAG argues that BPA’s interpretation of its duties and “new-found freedom to disregard the statutory rate directives” is “newly-minted . . . and inconsistent with prior agency actions,” *citing Defenders of Wildlife v. Norton*, 258 F.3d 1136, 1145-1146 (9th Cir. 2001). WPAG Br., REP-12-B-WG-01, at 25. This argument ignores the facts. First, WPAG’s claim that BPA believes it has a “new-found freedom to disregard the statutory rate directives” is patently false. To the contrary, this ROD repeatedly demonstrates BPA’s insistence that the Settlement be consistent with BPA’s statutory directives. Second, BPA’s approach to complying with section 7(b)(2) does not disregard BPA’s statutory rate directives, but rather implements such directives in the context of a REP settlement. The claim that BPA has disregarded section 7(b)(2) is refuted by the extensive studies and documentation developed by Staff to ensure compliance with section 7(b)(2) in the Settlement context. Third, BPA’s approach to compliance with section 7(b)(2) is not “inconsistent with prior agency actions” or “newly minted,” because it is occurring in a different context than prior traditional ratemaking. Even though BPA’s approach relies on the same Legal Interpretation, Implementation Methodology, and other substantive standards and therefore has similarities to BPA’s traditional approach, if BPA could not change its approach for compliance with section 7(b)(2) from that used in single rate period ratemaking, there could never be a REP settlement. A review for consistency with prior agency action must compare apples with apples. WPAG has not done so.

**F. Sub-issue: Whether the Amount of IOU REP Benefits Violates the 5(c)/7(b) Construct Established by the Northwest Power Act**

APAC argues that the Northwest Power Act prohibits an exchanging IOU from receiving a benefit greater than the difference between its ASC and the PF Exchange rate. APAC Br., REP-12-B-AP-01, at 6. APAC states that the Act contemplates that this benefit may change to reflect the economic realities of any particular rate period, and allowing a group of ratepayers to voluntarily set their own rate in violation of the statute is particularly egregious when it imposes a greater likely cost burden on other ratepayers. *Id.* The Settlement’s compliance with section 5(c) of the Act is thoroughly addressed in section 4. This separate response discusses APAC’s claim. Under the Settlement the IOUs do not set their own rate. Instead, the IOUs agree to accept a specified amount of benefits as a settlement of their REP disputes. These benefits were negotiated by the IOUs and COUs in the context of three 7(b)(2) rate tests in BPA’s WP-07 Supplemental rate proceeding (FY 2002–2006, FY 2007–2008, FY 2009), a 7(b)(2) rate test in the WP-10 rate proceeding, and the implementation of the REP since the beginning of FY 2009. Furthermore, the record emphatically shows that the IOUs are not receiving greater benefits than in the absence of the Settlement. Instead, the record shows that the IOUs are taking a significant reduction in the REP benefits they would receive under implementation of the REP in the absence of the Settlement. Accepting lower benefits than would have been received in the absence of the Settlement does not impose a cost burden on other ratepayers, and is entirely permissible under the law. *See* Issue 4.5.1.

**G. Sub-issue: Whether the Terminology of the Settlement Must Reference the 7(b)(2) Rate Test**

WPAG states that the “7(b)(2) rate test” does not appear in the terminology used by the REP Settlement, which means that the REP Settlement is intended to eliminate the performance and use of the rate test from every rate proceeding that BPA will conduct during the term of the REP Settlement. WPAG Br., REP-12-B-WG-01, at 13. This argument is poorly reasoned. First, contrary to WPAG’s implication, the words “section 7(b)(2)” are contained in the Settlement:

... a waiver of statutory rights or rate protections greater than are provided for in this Settlement Agreement, notwithstanding any past or future legal interpretations of section 5(c), 7(b)(2), or 7(b)(3) of the Act by BPA, any court, or any other entity, ...

Settlement, REP-12-A-02A, § 7.2. Furthermore, simply because the words “7(b)(2) rate test” are not generally used in the Settlement does not mean that the use of the rate test will be eliminated for the term of the Settlement. Staff has conducted extensive analysis (including 7(b)(2) rate tests for every year, plus the ensuing four years, of the 17 years of the Settlement) to ensure that the rate protection provided by section 7(b)(2) will be provided by the Settlement and reflected in each rate case during the term of the Settlement. Evaluation Study, REP-12-FS-BPA-01, section 6.4. Furthermore, although “7(b)(2) rate test” is not mentioned in the Settlement (because it was simply not necessary to mention “7(b)(2) rate test” in order to implement its rate protection through the Settlement), the rate test was one of the most important factors underlying the Settlement. The Settlement arose out of the desire of BPA’s COU and IOU customers to do something to address the extensive pending litigation challenging, among other actions, BPA’s WP-07 Supplemental decisions. Central to the WP-07 Supplemental proceeding are BPA’s decisions and the parties’ respective arguments regarding the 7(b)(2) rate test. Because the resolution of each 7(b)(2) issue could significantly harm the COUs or IOUs, it was critical to the parties that the REP Settlement not take any particular position on the merits of any 7(b)(2) issue. Finally, because the 7(b)(2) rate test was a critical factor in the development of the Settlement and because rate protection provided by the Settlement will be reflected in BPA’s prospective power rates during the Settlement term, the instant REP-12 proceeding is reviewing the Settlement for compliance with section 7(b)(2). As noted above, BPA has provided extensive documentation regarding the Settlement’s compliance with the rate protection provided by section 7(b)(2).

**H. Sub-issue: Whether the Settlement Constitutes a Delegation of Ratemaking Obligations**

Alcoa argues that BPA would effectively delegate its ratesetting obligations to the COUs and IOUs and would ignore the specific manner that Congress established for the calculation of COU rate protection. Alcoa Br., REP-12-B-AL-02, at 9-11. BPA has not delegated any of its statutory duties to the negotiating parties. The Administrator will execute the Settlement only if it comports with the requirements and limitations of the Northwest Power Act. This determination will be made by the Administrator, not the negotiating parties, after the Administrator reviews all of the evidence and arguments in the REP-12 proceeding. Because the

Administrator retains the ultimate authority to determine whether the requirements for determining REP benefits under sections 5(c) and 7(b)(2) of the Act have been met, no unlawful delegation has occurred. This issue is discussed in detail in section 4.5.

## **Decision**

*For the reasons set forth in the foregoing analysis, the Settlement complies with section 7(b)(2) of the Northwest Power Act.*

## **5.8 Compliance of the Settlement With Section 7(b)(3) of the Northwest Power Act**

### **5.8.1 Introduction**

In BPA's traditional ratemaking, the section 7(b)(2) rate test calculates the amount of rate protection that is to be afforded to public bodies, cooperatives, and Federal agency customers. 16 U.S.C. § 839e(b)(2). The calculated amount of rate protection reduces the costs allocated to the public body customers to the rate level allowed by the rate test, sometimes referred to as the rate ceiling. The costs not recoverable from public body customers are reallocated to be recovered from all other power sold pursuant to section 7(b)(3). 16 U.S.C. § 839e(b)(3).

BPA's traditional implementation of sections 7(b)(2) and 7(b)(3) were challenged in BPA's WP-07 Supplemental and WP-10 rate proceedings. BPA's decisions in those proceedings have been appealed before the Ninth Circuit. The current litigation details the challenges to BPA's implementation. *See* sections 1.3.7 and 1.3.8.

Because the settling parties cannot agree on the proper implementation of sections 7(b)(2) and 7(b)(3), among other disagreements, the settling parties established the proposed Settlement to inform BPA of the results of the section 7(b)(2) rate test and subsequent 7(b)(3) reallocations that are acceptable to them. As described earlier, BPA is analyzing and evaluating the proposed Settlement to establish whether it conforms to statute, including sections 7(b)(2) and 7(b)(3).

As part of the Settlement, the settling parties seek to codify results that hold both settling and non-settling parties in a financial and legal position similar to the status quo under WP-10 rates. In doing so, the settling parties establish the REP Surcharge as a 7(b)(3) surcharge to recover a portion of the costs of rate protection from the IP and NR rates. The REP Surcharge is designed to maintain a status quo relationship between the PF Public, IP, and NR rates. This status quo relationship is accomplished by using the 7(b)(3) Supplemental Rate Charge established in the WP-10 rate proceeding as the basis for calculating the REP Surcharge. The REP Surcharge is designed to maintain a more consistent and stable allocation of rate protection costs to the IP and NR rates than under the traditional implementation of sections 7(b)(2) and 7(b)(3).

BPA must evaluate the REP Surcharge to ensure that it is consistent with statutory rate directives. Alcoa challenges Staff's judgment that the REP Surcharge conforms to sections 7(b)(2) and 7(b)(3).

## **5.8.2 Issues**

### **Issue 5.8.2.1**

*Whether the REP Surcharge is established pursuant to section 7(b)(2) of the Northwest Power Act.*

#### **Parties' Positions**

Alcoa argues that “the REP Surcharge is not an amount of rate protection derived from the Section 7(b)(2) rate test.” Alcoa Br., REP-12-B-AL-02, at 20. Alcoa argues that the Draft ROD inaccurately contends that Alcoa has misstated Staff’s position. Alcoa Br. Ex., REP-12-R-AL-01, at 14, *citing* Draft ROD, REP-12-A-01, at 169.

#### **BPA Staff’s Position**

The REP Surcharge is assessed as a surcharge pursuant to section 7(b)(3) of the Northwest Power Act and is a recovery of amounts not charged to preference customers by reason of the rate protection afforded to preference customers pursuant to section 7(b)(2). Bliven *et al.*, REP-12-E-BPA-12, at 15.

#### **Evaluation of Positions**

Alcoa contends that BPA Staff “admits that the REP Surcharge is not calculated pursuant to Section 7(b)(2).” Alcoa Br., REP-12-B-AL-02, at 20.

Alcoa misstates Staff’s position. Throughout this REP-12 proceeding, Alcoa has often misquoted Staff’s response to an Alcoa data request. *See* Alcoa Statement, REP-12-B-AL-01, at 12-13 and n.13; Alcoa Br., REP-12-B-AL-02, at 20. In footnote 47 of Alcoa’s brief, it refers to Data Request No. AL-BPA-8. Although unstated, this data request was made in the BP-12 proceeding, and BPA objected to the request because it was not relevant to that proceeding. Despite the objection, Staff responded to the request by stating that:

The calculation of the REP Surcharge is not pursuant to section 7(b)(2) of the [Northwest Power Act]. Section 7(b)(2) provides for a rate test to determine the amount of rate protection that should be afforded to the PF Public rate. Costs of providing rate protection are allocated to all other power sold by the Administrator to all customers pursuant to section 7(b)(3). The REP Surcharge recovers the costs of rate protection allocated to the IP and NR rates pursuant to section 7(b)(3).

In this data request (which Alcoa did not seek to make a part of the record), Alcoa asks whether “BPA calculate[d] the REP Surcharge in the Initial Proposal pursuant to section 7(b)(2) of the [Northwest Power Act].” Alcoa quotes only the first sentence of the response. The full response clearly states that the REP Surcharge is established pursuant to section 7(b)(3).

Alcoa repeated its request in this proceeding in Data Request No. AL-BPA-3, which Alcoa cites without entering the response in the record. In response to Alcoa’s query, Staff expanded its BP-12 reply in greater detail:

**REQUEST No. AL-BPA-3:**

Did BPA calculate the REP Surcharge in the Initial Proposal pursuant to section 7(b)(2) of the [Northwest Power Act]? If the answer to this question is yes, please provide all documents and data demonstrating BPA’s 7(b)(2) calculation. Please note that Alcoa requested this information from BPA in the BP-12 proceeding (AL-BPA-8), but BPA objected on grounds that “explanations and data that are outside the scope of the BP-12 rate proceeding. All questions regarding the explanation of rate making under the 2012 REP Settlement and comparisons between Settlement ratemaking and non-settlement ratemaking are reserved for the REP-12 rate proceeding.”

**RESPONSE No. AL-BPA-3:**

The REP Surcharge is assessed pursuant to section 7(b)(3) of the [Northwest Power Act], and is intended to recover the amount of 7(b)(2) rate protection afforded to the PF Public rate. Section 7(b)(2) provides for a rate test to determine the amount of rate protection that should be afforded to the PF Public rate. BPA’s REP-12 Initial Proposal addresses the implementation of section 7(b)(2) in the context of (1) the proposed REP Settlement and (2) in the absence of the proposed REP Settlement. The implementation of section 7(b)(2) in the non-Settlement context is documented in the FY 2012–2013 Section 7(b)(2) Rate Test Study, REP-12-E-BPA-02 and FY 2012–2013 Section 7(b)(2) Rate Test Study Documentation, REP-12-E-BPA-02A.

Sections 6.2 through 6.4 of the 2012 REP Settlement Evaluation and Analysis Study, REP-12-E-BPA-01, give a more complete explanation of how the Settlement quantifies the amounts of rate protection due to preference customers pursuant to section 7(b)(2). The REP Surcharge is the means for recovering the portion of the costs of rate protection assigned to the IP and NR rates.

The documentation of the 7(b)(2) scenarios BPA conducted to review the proposed REP Settlement can be found in section 10 of the Study. Costs of providing rate protection are allocated to all other power sold by the Administrator to all customers pursuant to section 7(b)(3) of the [Northwest Power Act]. The REP Surcharge recovers the costs of rate protection allocated to the IP and NR rates pursuant to section 7(b)(3). All documents and data demonstrating 7(b)(3) calculations have been provided in the RAM2012, which is posted to BPA’s website at <http://www.bpa.gov/corporate/ratecase/2012/REP-12.cfm>.

Response to Data Request No. AL-BPA-3.

Based on Staff's response, Alcoa argues that the REP Surcharge is not calculated pursuant to section 7(b)(2). Alcoa Br., REP-12-B-AL-02, at 20. This argument is misplaced. To be clear, the REP Surcharge is calculated pursuant to section 7(b)(3), not section 7(b)(2). The REP Settlement is an allocation of costs not charged to the PF Public rate because of the rate protection afforded pursuant to section 7(b)(2). Its authority is rooted in section 7(b)(3), not section 7(b)(2).

While there is a direct linkage between section 7(b)(2) and section 7(b)(3), the two sections perform separate and distinct roles in BPA ratesetting and achieve different effects. Section 7(b)(2) establishes a rate test that sets a rate ceiling for the PF Public rate. Nowhere in section 7(b)(2) is there any instruction regarding non-PF Public rates, including the IP rate. If the rate test establishes that the PF Public rate would be greater than the rate ceiling, section 7(b)(2) caps the PF Public rate to the rate ceiling. In such a case, the costs allocated to the PF Public rate must be lowered to the level of the rate ceiling.

Section 7(b)(3) directs how BPA is to recover the costs that are no longer allowed to be recovered from the PF Public rate—through surcharges to non-PF Public rates. The REP Surcharge is such a 7(b)(3) surcharge. It is authorized by section 7(b)(3), and its function is to recover costs not recoverable through the PF Public rate.

Alcoa claims that it is not misstating Staff's position. Alcoa Br. Ex., REP-12-R-AL-01, at 14. Alcoa cites numerous examples where Staff stated that the 7(b)(2) rate test would not be performed in setting rates pursuant to the Settlement. *Id.* However, Alcoa misses the point of Staff's statements. BPA is not denying Staff's statements that the 7(b)(2) rate test will not be performed when setting rates pursuant to the Settlement because BPA has already established in the first instance in this case that the amounts provided under the Settlement conform to the section 7(b)(2) rate test. Alcoa, however, confuses section 7(b)(2) with section 7(b)(3). The issue being dealt with in this discussion is whether the REP Surcharge is established based on section 7(b)(3). It is. The question of whether BPA must perform the rate test to calculate the appropriate amount of rate protection afforded pursuant to section 7(b)(2) is a distinct issue and is discussed in Issue 5.7.1.

Thus, the REP Surcharge is not established by section 7(b)(2), as proposed by Alcoa. Rather, it functions as the surcharge required by section 7(b)(3).

### **Decision**

*The basis of the REP Surcharge is established in section 7(b)(3) of the Northwest Power Act.*

### **Issue 5.8.2.2**

*Whether the REP Surcharge is a surcharge pursuant to section 7(b)(3) or simply a form of such a surcharge.*

## **Parties' Positions**

Alcoa argues that BPA Staff “attempts to characterize the REP Surcharge as ‘a form of the 7(b)(3) Supplemental Rate Charge.’” Alcoa Br., REP-12-B-AL-02, at 20. Alcoa states that “BPA characterizes the REP Surcharge as a ‘form of the 7(b)(3) Supplemental Rate Charge,’ but only allocates the costs to the IP and NR rates.” *Id.* at 22. Alcoa argues that “BPA may not deny Alcoa and the DSIs the Congressionally-mandated rate protections afforded in section 7(b)(3) by imposing an invented and discriminatory form of non-statutory rate protection.” *Id.* at 21. Alcoa contends that BPA is unsure exactly how to characterize the REP Surcharge. Alcoa Br. Ex., REP-12-R-AL-01, at 14.

## **BPA Staff's Position**

The REP Surcharge builds upon the WP-10 7(b)(3) Supplemental Rate Charge (7(b)(3) Charge) included in the IP-10 and NR-10 rates. Bliven *et al.*, REP-12-E-BPA-05, at 3. The REP Surcharge is assessed as a surcharge pursuant to section 7(b)(3) of the Northwest Power Act and is a recovery of amounts not charged to preference customers by reason of the rate protection afforded to preference customers pursuant to section 7(b)(2). Bliven *et al.*, REP-12-E-BPA-15, at 15.

## **Evaluation of Positions**

Alcoa challenges the REP Surcharge on the grounds that it is just a form of a charge for the costs of rate protection. Alcoa Br., REP-12-B-AL-02, at 20. Alcoa argues that “BPA cannot invent a new form of rate protection out of whole cloth (or more accurately, adopt a new form of rate protection negotiated by the COUs and IOUs) and allocate it to the DSIs by simply characterizing it as ‘a form’ of the statutorily-authorized rate protection surcharge.” *Id.*

Staff does not characterize the rate protection afforded under the Settlement as “a form” of rate protection in the manner that Alcoa reads into text. Rather, it is, in substance, rate protection. “The Agreement includes a formula that determines a REP Surcharge Amount, which is *the amount of rate protection* allocated to the IP and NR rates.” Evaluation Study, REP-12-E-BPA-01, section 4.3.4 (emphasis added). “Th[e] REP Surcharge, when multiplied by the expected sales under the IP and NR rate schedules, will produce an amount of dollars comprising the second amount of rate protection.” *Id.* at 42.

In the BP-12 docket, Staff does state that “[t]he Initial Proposal proposes a REP Surcharge on the IP and NR rates, which is a form of the 7(b)(3) Supplemental Rate Charge.” Bliven *et al.*, BP-12-E-BPA-11, at 38, *citing* Power Rates Study, BP-12-E-BPA-01, sections 3.3.1.3 and 3.4.1. Two aspects of this statement should be considered. First, this particular statement is made before the Settlement was delivered to BPA. “A large number of the litigants have come to a preliminary agreement on the structure of a settlement and *are currently drafting* a comprehensive settlement agreement.” Bliven *et al.*, BP-12-E-BPA-11, at 15 (emphasis added). The statement that Alcoa cites in footnote 48 was made based on an early understanding of the Settlement and before Staff began its analysis and evaluation of the Settlement. Second, the use of the word “form” is subject to different interpretations. The context of Alcoa’s argument

suggests that Alcoa has read into the word “form” the meaning of a copy rather than an exemplar. A standard usage of the word “form” takes the meaning: “the particular mode, appearance, etc., in which a thing or person manifests itself.” World English Dictionary, def. 2, referenced through [www.dictionary.com](http://www.dictionary.com). Alcoa’s argument suggests Staff is trying to foist the REP Surcharge onto the DSIs as if it were a cheap “Ralex” watch rather than a true Rolex. Such is not the case. A thing can appear in different forms without making it completely different. A Ford can take the form of a Mustang or a Focus; neither form makes it less a legitimate Ford vehicle. Here, the question is whether the REP Surcharge is a valid statutory form of a 7(b)(3) surcharge. Based on all of the issues decided in this section, BPA finds that it is.

Alcoa contends that BPA’s comparison of Alcoa’s argument to the difference between a Rolex and Ralex is dismissive. Alcoa Br. Ex., REP-12-R-AL-01, at 18. Alcoa rather likens its argument to the difference between a Rolex and a clock radio. *Id.* Alcoa’s likeness fails because it is constructed on the false premise that the REP Surcharge is like a clock radio and the traditional 7(b)(3) surcharge is like a Rolex: both tell time, but the clock radio uses different parts to avoid the precise instructions on how to build a Rolex. This is a false premise, because the parts are not different and the instructions are not precise. First, the parts are not different, because both the REP Surcharge and the traditional 7(b)(3) surcharge are made from identical parts, rate protection amounts, and both are predicated on the traditional implementation of the 7(b)(2) rate test, including all five assumptions. Second, the instructions for calculating the rate protection amounts that are to be recovered by means of the 7(b)(3) surcharge are not precise. If the instructions were as precise as Alcoa would like everyone to believe, BPA would not be embroiled in the massive amount of current litigation that would continue in the absence of the Settlement. Rather, things are not as simple as Alcoa postulates. Section 7(b)(2) is a very complex statutory provision, has evoked much contention since the day it was first implemented, and continues to promise generations of litigation if another implementation is not contemplated. The Settlement provides such an implementation; not in a manner that violates any part of the Northwest Power Act, as Alcoa would like to believe, but in a manner thoroughly consistent with the statute, and in a manner that frees the region from continued uncertainty arising from year after year of litigation.

The REP Surcharge performs the same function as the traditional implementation of the 7(b)(3) surcharge (a reallocation of the costs of rate protection from the PF Public rate to other rates), and it does so in a similar manner as the traditional approach used in BPA’s WP-07 Supplemental and WP-10 rates (its basis is the 7(b)(3) surcharge calculated in the WP-10 rates). Thus, there is no violation of section 7(b)(3) inherent in the REP Surcharge. Section 7(b)(3) of the Northwest Power Act does not limit the 7(b)(3) surcharge to one single form. Even assuming *arguendo* that this were so, there is no difference in form between the current 7(b)(3) surcharge and the REP Surcharge; both take the form of a \$/MWh adder to the affected rates. The difference lies in the manner of calculation, leading to a lower adder under the REP Surcharge than under the traditional implementation.

Alcoa argues that the REP Surcharge “allocates the costs [only] to the IP and NR rates.” Alcoa Br., REP-12-B-AL-02, at 22. However, the REP Surcharge is not the total amount of rate

protection costs calculated under the Settlement. “The total rate protection provided to preference customers under Settlement ratemaking is composed of two parts. With the Unconstrained Benefits and the total IOU and COU REP benefits determined, the first amount of rate protection due to preference customers is calculated as the sum of Unconstrained Benefits minus the sum of REP benefits. The cost of this first part of rate protection is allocated entirely to the [PF Exchange] rate pool. . . . The second part of rate protection is calculated and allocated to the IP and NR rate pools. This second part of rate protection is equal to the REP Surcharge included in the IP and NR rates.” Evaluation Study, REP-12-FS-BPA-01, section 5.1. Thus, the total rate protection reducing the PF Public rate is composed of two parts: the amount allocated to the PF Exchange rate and the amount allocated to the IP and NR rates. The amount of rate protection allocated to surplus power sales is discussed later. *See* Issue 5.8.2.6.

The fact that the settling parties have agreed upon the results of the rate test does not mean the characterization of rate protection is either new or of a different character than the traditional approach to 7(b)(2) and 7(b)(3). The REP Surcharge is in substance a 7(b)(3) surcharge, accomplishing a reallocation of rate protection costs from the PF Public rate to the other rates. Thus, Alcoa’s argument that “[a]ny similarity in the level of rate protection is merely coincidental,” Alcoa Br., REP-12-B-AL-02, at 21, is neither true nor persuasive. The similarities between the REP Surcharge and the traditional 7(b)(3) surcharge are by design. The REP Surcharge is created by the Settlement to perform the same function in the same manner as the traditional 7(b)(3) surcharges. It carries a distinct title to differentiate it from the 7(b)(3) surcharge that is applied to the PF Exchange rates under the Settlement.

Alcoa goes on to argue that the REP Surcharge is “invented” and denies Alcoa the “Congressionally-mandated rate protections afforded in Section 7(b)(3).” Alcoa Br., REP-12-B-AL-02, at 21. However, having shown that the REP Surcharge is established pursuant to, and consistent with, section 7(b)(3), the REP Surcharge cannot also be in violation of section 7(b)(3) such that it denies statutory rate protections afforded to Alcoa.

Alcoa states that BPA is unsure exactly how to characterize the REP Surcharge. Alcoa Br. Ex., REP-12-R-AL-01, at 14. Alcoa cites a number of statements by Staff and BPA in an attempt to misstate Staff’s and BPA’s consistent position. Alcoa first cites Staff’s statement discussed above that the REP Surcharge is “a *form* of the 7(b)(3) Supplemental Rate Charge.” *Id.*, *citing* Bliven *et al.*, BP-12-E-BPA-11, at 38 (emphasis added by Alcoa). Alcoa next cites BPA’s statement that the “REP Surcharge is *calculated* pursuant to section 7(b)(3).” *Id.* at 14-15, *citing* Draft ROD, REP-12-A-01, at 171 (emphasis added by Alcoa). Alcoa adds that BPA also describes the REP Surcharge as an amount “assessed pursuant to section 7(b)(3).” *Id.* at 15, *citing* Draft ROD, REP-12-A-01, at 170. Alcoa then charges that BPA makes a “tacit admission” that the REP Surcharge is not a 7(b)(3) surcharge, by citing the statement that the “REP Surcharge *performs the same function* as the traditional implementation of the 7(b)(3) surcharge.” *Id.*, *citing* Draft ROD, REP-12-A-01, at 173 (emphasis added by Alcoa). Alcoa continues by citing BPA’s statement that the “REP Surcharge is *in substance* a 7(b)(3) surcharge.” *Id.*, *citing* Draft ROD, REP-12-A-01, at 173 (emphasis added by Alcoa). Alcoa next cites BPA’s statement that the REP Surcharge is an amount of rate protection that “*builds upon*

the WP-10 7(b)(3) Supplemental Rate Charge.” *Id.*, citing Draft ROD, REP-12-A-01, at 172 (emphasis added by Alcoa). Finally, Alcoa cites BPA’s statement that “[t]he REP Surcharge is no different in form and essence from the 7(b)(3) surcharge that would be included in the IP rate if there is no settlement.” *Id.* at n.56, citing Draft ROD, REP-12-A-01, at 179.

Based on the cited statements, Alcoa then argues that “BPA’s assorted descriptions beg the question—what exactly is the REP Surcharge? A ‘form of’ a section 7(b)(3) surcharge? An amount ‘calculated’ under section 7(b)(3)? An amount ‘assessed’ under section 7(b)(3)? An amount that ‘performs the same function’ as the section 7(b)(3) surcharge? An amount that ‘builds upon’ a prior 7(b)(3) surcharge?” Alcoa Br. Ex., REP-12-R-AL-01, at 15. Alcoa’s attempt at confusing Staff’s or BPA’s words to mean something other than their plain meaning is nugatory. The REP Surcharge is exactly what Staff and BPA have consistently said it is: a section 7(b)(3) allocation of rate protection costs to the IP and NR rates. Alcoa appears to have no trouble understanding BPA’s position later in its brief when it explicitly states that “the REP Surcharge (which BPA consistently characterizes as a 7(b)(3) rate protection surcharge) . . .” *Id.* at 20 (footnote omitted).

Alcoa argues that BPA is simply characterizing the REP Surcharge amounts as a form and amount of self-styled rate protection that can be recovered through section 7(b)(3) because it is “an amount not charged to the public bod[ies].” *Id.* at 16. Alcoa maintains that this conflicts with BPA’s current legal interpretation of section 7(b)(2). *Id.* Alcoa argues that the REP Surcharge has *not* been calculated in a manner that “conscientiously follow[s] the requirements of section 7(b)(2)” (*i.e.*, consideration of the five statutory assumptions). *Id.* at 17, quoting Legal Interpretation of Section 7(b)(2), REP-12-E-BPA-02, Attachment 1, at 6. Indeed, Alcoa argues, nowhere in the REP Surcharge formula are the five assumptions that lie at heart of section 7(b)(2) acknowledged or considered. *Id.*

Alcoa misses the mark on three important points of its argument. First, BPA’s Legal Interpretation is currently being challenged in litigation before the Ninth Circuit. The Settlement establishes a methodology for calculating rate protection consistent with section 7(b)(2), but does so in a manner that obviates the need for continuing the current (and future) litigation. The Settlement institutes rate calculations that conform with sections 7(b)(2) and 7(b)(3), but in a manner that would not require the settling parties to continue with their litigation. Second, Alcoa is incorrect that the five assumptions are not included in the REP Surcharge formula. The REP Surcharge formula is stated as:

$$\text{REP Surcharge} = (\text{REP Recovery Amounts plus COU REP Benefits}) * (7.38 / 265,846,587)$$

Settlement, REP-12-A-02A, § 3.3.1. The two numbers in the formula are taken directly from the application of the five assumptions that have been calculated in a manner that, consistent with BPA’s litigation position, conscientiously follow the requirements of section 7(b)(2). The 7.38 is the WP-10 7(b)(3) surcharge, and the 265,847,587 is the two-year average REP benefits included in the WP-10 rates. Evaluation Study, REP-12-FS-BPA-01, section 5.1. Thus, the key elements of the REP Surcharge formula contained in the Settlement embody the very heart of section 7(b)(2), even though the settling parties that negotiated the REP Surcharge formula

fundamentally disagree with the manner in which BPA calculated the two WP-10 numbers. Third, as Alcoa itself states:

Section 7(b)(3) instructs BPA on how to recover costs that are not charged to the preference customers as a result of the section 7(b)(2) test. Section 7(b)(3) addresses cost recovery, and nothing in that subsection describes how rate protection should be calculated.

Alcoa Br. Ex., REP-12-R-AL-01, at 15, n.57. One would not expect to see the five assumptions in the determination of the 7(b)(3) surcharges. The five assumptions—actually, the entire 7(b)(2) rate test—determine the total amounts to be recovered by application of the 7(b)(3) surcharges. The fact that the Settlement’s formulation of the 7(b)(3) surcharges for the IP and NR rates does not mention the five assumptions is unremarkable.

### **Decision**

*The REP Surcharge is a surcharge pursuant to section 7(b)(3) of the Northwest Power Act. The differences in the method of calculation do not change the character of the surcharge or make it contrary to section 7(b)(3).*

### **Issue 5.8.2.3**

*Whether the reallocation of costs pursuant to section 7(b)(3) is limited to amounts directly determined solely by reference to BPA’s traditional method for implementing the section 7(b)(2) rate test.*

### **Parties’ Positions**

Alcoa argues that “the REP Surcharge is not an amount of rate protection derived from the Section 7(b)(2) rate test.” Alcoa Br., REP-12-B-AL-02, at 20. Alcoa argues further that “[b]ecause BPA has not, and will not, perform a Section 7(b)(2) rate test for each rate period if it adopts the Settlement, it cannot allocate the REP Surcharge (or any other form of rate protection not derived from Section 7(b)(2)) to the IP rate.” *Id.* at 21. Alcoa claims that the REP Surcharge is simply a negotiated amount of rate protection derived from the specific formulas set out in section 3.3.2 of the Settlement. Alcoa Br. Ex., REP-12-R-AL-01, at 15, *citing* Settlement, REP-12-A-02A, § 3.3.2.

### **BPA Staff’s Position**

The REP Surcharge is assessed as a surcharge pursuant to section 7(b)(3) of the Northwest Power Act and is a recovery of amounts not charged to preference customers by reason of the rate protection afforded to preference customers pursuant to section 7(b)(2). Bliven *et al.*, REP-12-E-BPA-12, at 15.

## **Evaluation of Positions**

Alcoa appears to argue that any 7(b)(3) surcharge must directly flow from the results of the 7(b)(2) rate test. Alcoa Br., REP-12-B-AL-02, at 20-21. The consideration of this position must be based in an understanding of how the 7(b)(2) rate test interacts with the 7(b)(3) surcharge, how the surcharge is determined, and how the surcharge operates.

First, when the section 7(b)(2) rate test indicates that no rate protection should be incorporated into the PF Public rate, that is, the proposed rate test is less than the rate ceiling, there is no 7(b)(3) surcharge. The IP rate would remain linked to the PF Public rate, and REP participants would be paid the amount of Unconstrained Benefits established by the difference between the participant's ASC and the Base PF Exchange rate multiplied by the participant's qualifying exchange load.

Second, when the section 7(b)(2) rate test indicates that rate protection should be incorporated into the PF Public rate, that is, the proposed rate test is greater than the rate ceiling, there is a 7(b)(3) surcharge. The traditional application of sections 7(b)(2) and 7(b)(3) simply reduces the costs allocated to the PF Public rate by reducing Unconstrained Benefits to an amount allowed by sections 7(b)(2) and 7(b)(3) and determining which rate classes pay for any REP benefits that remain after the rate test and the 7(b)(3) reallocations.

Under the Settlement, neither of the two conditions is changed. While the settling parties cannot agree on how the 7(b)(2) rate test should be implemented, they have found that they could agree on the results of the rate test. By agreeing on the amount of REP benefits that the IOUs would receive under the Settlement, the Settlement satisfies the requirements of the rate test—it determines the amounts not charged to public body customers by reason of section 7(b)(2), the amount of REP benefits, and which rate classes pay for the REP benefits that remain in rates. As such, under the Settlement the amount of rate protection incorporated into the PF Public rate and the 7(b)(3) cost reallocations are determinable.

Setting rates pursuant to the Settlement does not change the characterization of the cost reallocations performed pursuant to the Settlement. The difference between Unconstrained Benefits and REP Recovery Amounts (as this term is defined in section 3.3 of the Settlement) is rate protection: amounts not charged to public body customers by reason of section 7(b)(2). There is no other rationale for REP participants to accept less than Unconstrained Benefits other than the rate protection afforded pursuant to section 7(b)(2) and the subsequent cost reallocations pursuant to section 7(b)(3). Further, there is no reason for COUs to pay any cost of any REP benefits other than some amount of REP benefits if allowed into the PF Public rate by the workings of section 7(b)(2). Thus, having agreed upon the final amount of REP benefits, the settling parties have agreed upon the appropriate amounts to be “not charged to public body ... customers by reason of paragraph [7(b)](2) ....” 16 U.S.C. § 839e(b)(3).

Having determined the amounts not charged “by reason of” section 7(b)(2) under the Settlement, it thus is appropriate to determine the allocation of such amounts not charged to all other rate classes, including the IP rate. The Settlement specifies how much of such amounts is to be

allocated to the IP and NR rates (and to surplus power sales; *see* Issue 5.8.2.6). The Settlement does so through the REP Surcharge. The Settlement specifies the results of the 7(b)(3) reallocations, but not the rationale or the methodology. The question before BPA is whether the results desired by the settling parties can be achieved in a manner consistent with BPA's statutory rate directives. Having shown above that the difference between Unconstrained Benefits and REP Recovery Amounts under the Settlement is amounts not charged "by reason of" section 7(b)(2), the reallocation of such amounts to other rate classes is permissible, and required, pursuant to section 7(b)(3).

Thus, Alcoa's argument regarding the REP Surcharge is misplaced. Alcoa argues that the REP Surcharge is not an amount of rate protection derived from the 7(b)(2) rate test. Alcoa Br., REP-12-B-AL-02, at 20. Alcoa is wrong; the REP Surcharge can be nothing else. By providing REP benefits less than Unconstrained Benefits, rate protection is provided to the PF Public rate, and the consequent rate protection costs are reallocated to other rate classes pursuant to section 7(b)(3). Alcoa further states that only amounts that are "derived from" section 7(b)(2) can be allocated to the IP rate pursuant to section 7(b)(3). But "derived from" is neither the words of section 7(b)(3) nor the hypothesis of section 7(b)(3). Section 7(b)(3) states that the amounts not charged "by reason of paragraph [7(b)](2) ... shall be recovered through supplemental rate charges for all other power sold." 16 U.S.C. § 839e(b)(3). "By reason of" does not demand a sole causal linkage as Alcoa postulates. Granted, linkage must be present; not just any cost can be reallocated pursuant to section 7(b)(3), as Alcoa has stated. Alcoa Br., REP-12-B-AL-02, at 20. The costs being reallocated to the PF Exchange, IP, and NR rates (and surplus power sales) must be costs "not charged to public bod[ies]," and they must be "by reason of" section 7(b)(2). As established above, the difference between Unconstrained Benefits and REP Recovery Amounts is such an amount not charged to public bodies. The REP Surcharge formula in the Settlement is simply the quantification of the portion of such amounts not charged to public bodies that is to be allocated to the IP and NR rates and (surplus power sales).

Alcoa claims that the REP Surcharge is simply a negotiated amount of rate protection derived from the specific formulas set out in section 3.3.2 of the Settlement. Alcoa Br. Ex., REP-12-R-AL-01, at 15, *citing* Settlement, REP-12-A-02A, § 3.3.2. Alcoa contends that that section provides that the "REP Surcharge *will be determined* as provided in the following table." *Id.* (emphasis supplied by Alcoa). BPA does not completely disagree with Alcoa. Yes, the REP Surcharge is based on a negotiated amount of rate protection; as described throughout this ROD, the parties to BPA's rate proceedings have been unable to agree on how to perform the 7(b)(2) rate test, and thus the proper calculation of the amount of rate protection, since 1985 when the rate test was first instituted. The settling parties have stated that they would rather refrain from pursuing extended litigation in an attempt to have the courts provide an answer and instead they have proposed the Settlement. However, the fact that the Settlement contains formulas to calculate the amount of rate protection to be included in rates is unremarkable; but it is a necessary feature of the Settlement. As discussed earlier in this section, the presence of the formulas does not make the rate protection anything less than rate protection, nor does it make the costs of providing rate protection anything other than a cost referred to in section 7(b)(3) as any amounts not charged to public body customers.

Where BPA parts company with Alcoa is the conclusions drawn from this. Alcoa contends that Staff repeatedly testifies that the REP Surcharge is not an amount calculated pursuant to section 7(b)(2). *Id.* at 16, *citing* Evaluation Study, REP-12-E-BPA-01, at 47. Here, Alcoa argues that the only possible manner to determine the appropriate amount of rate protection is through conducting the 7(b)(2) rate test. BPA does not agree. In the context of the current litigation that challenges virtually every major aspect of BPA’s determination of the proper amount of rate protection, BPA demonstrates that the Settlement’s basis for determining the amount of rate protection can be established by agreement, especially when the agreement represents the vast majority of customers that are entitled to the rate protection, the COUs, and those that pay for that amount of rate protection, the IOUs. *See* Issue 5.7.1 and Chapter 9. Under the Settlement, Alcoa actually receives rate benefits in the form of lower rates. BPA has established that Alcoa is bearing no increase in costs resulting from the Settlement. Therefore, having found that the Settlement conforms to the Northwest Power Act and shifts costs only to customers willing to pay increased costs, the Settlement is both legal and reasonable.

Alcoa argues that BPA would apparently prefer to read the “by reason of [section 7(b)(2)]” language out of the statute. Alcoa Br. Ex., REP-12-R-AL-01, at 17. Alcoa states that the statute says what Congress intended, that section 7(b)(3) is unambiguous—only amounts not charged *by reason of* section 7(b)(2) may be allocated through a section 7(b)(3) supplemental surcharge. *Id.* (emphasis in original). BPA is unsure how Alcoa concludes that BPA attempts to excise the “by reason of” phrase out of section 7(b)(3). BPA does no such thing. In fact, BPA relies upon those very words in making its point that the REP Surcharge is a 7(b)(3) surcharge, and that the amounts recovered by the REP Surcharge are rate protection costs not recovered from public body customers *by reason of* section 7(b)(2). BPA agrees with Alcoa that no other types of costs may be allocated away from the PF Public rate to other rates by virtue of section 7(b)(3) other than rate protection costs. But this is precisely why BPA has found the REP Surcharge to be consistent with section 7(b)(3): it is a reallocation of rate protection costs away from the PF Public rate to the IP and NR rates.

### **Decision**

*Section 7(b)(3) requires that any added amounts recovered through a surcharge to rates other than the PF Public rate must be “by reason of” section 7(b)(2). This statutory language does not require the amounts be determined solely by reference to BPA’s traditional method for implementing the section 7(b)(2) rate test.*

### **Issue 5.8.2.4**

*Whether the REP Surcharge is “discriminatory” in its application to the IP and NR rates.*

## **Parties' Positions**

Alcoa argues that “BPA may not deny Alcoa and the DSIs the Congressionally-mandated rate protections afforded in Section 7(b)(3) by imposing an invented and discriminatory form of non-statutory rate protection.” Alcoa Br., REP-12-B-AL-02, at 21.

## **BPA Staff's Position**

This is a legal issue raised by Alcoa in brief. Thus, Staff did not address the issue.

## **Evaluation of Positions**

Without supporting evidence or argument, Alcoa charges that the REP Surcharge is discriminatory. Alcoa Br., REP-12-B-AL-02, at 21. However, there is no discrimination standard in the Northwest Power Act for DSIs.

Any argument by Alcoa that the REP Surcharge is discriminatory fails because (1) the REP Surcharge is not discriminatory; (2) no discrimination standard exists in the Northwest Power Act with regard to rates for DSIs; and (3) even if a discrimination standard existed in the Northwest Power Act, the REP Surcharge would not be unlawful, because the DSIs are not similarly situated as a discriminated party.

First, the REP Surcharge is not discriminatory. In the issues discussed above, BPA has established that the REP Surcharge is neither “invented” nor contrary to statute. It is a surcharge authorized and mandated by section 7(b)(3) to recover costs not recoverable from public body customers. Section 7(b)(3) directs BPA to reallocate costs to “all other power sold.” In relevant part, section 7(b)(3) states: “Any amounts not charged to public body, cooperative, and Federal agency customers by reason of paragraph (2) of this subsection shall be recovered through supplemental rate charges for all other power sold by the Administrator to all customers.” 16 U.S.C. § 839e(b)(3). The Northwest Power Act provides no guidance as to how “any amounts not charged” shall be recovered “through supplemental rate charges for all other power sold.” BPA has traditionally reallocated costs based on energy usage, but that implementation is not demanded by statute.

The REP Surcharge implements a 7(b)(3) surcharge in a manner similar to the 7(b)(3) surcharge established by BPA in the WP-10 rate proceeding. The WP-10 7(b)(3) surcharge included in the IP-10 rate is \$7.38/MWh; the proposed BP-12 REP Surcharge in the IP-12 rate is \$7.72/MWh. The increase in the 7(b)(3) surcharge from WP-10 to BP-12 mirrors the increase between the IOU REP benefits included in WP-10 rates and the IOU REP Recovery Amount included in the proposed BP-12 rates. If the Settlement is not adopted, the 7(b)(3) surcharge in the BP-12 rates would be \$8.94/MWh, *almost \$1.2/MWh higher*. This latter surcharge is calculated in the same manner as Alcoa argues that it should be calculated. These results provide a basis for concluding that the REP Surcharge is a reasonable and non-discriminatory surcharge, not only because it allocates rate protection consistent with the requirements of section 7(b)(3), but also because it results in a *lower rate* for Alcoa. Why Alcoa would oppose a surcharge that reduces its rate is unclear. BPA can only assume that its opposition is less about the rate treatment BPA is

proposing in this case and more about “long-term access to BPA power at the statutory IP rate.” Alcoa Br., REP-12-B-AL-02, at 4. Alcoa’s appeal to BPA’s discretion is an odd one.

Second, even if the REP Surcharge could be characterized as allocating rate protection costs in a “discriminatory” manner, which it cannot, no statutory violation has occurred. The Northwest Power Act does not contain a discrimination standard with regard to rates for DSIs. Congress knows how to make discrimination a substantive standard. As the Ninth Circuit held:

Congress has expressly prohibited discrimination or “undue” discrimination in other very similar administrative contexts. *See, e.g.*, 16 U.S.C. § 824d(b) (forbidding public utilities from granting any person “undue preference or advantage” and from subjecting any person to “undue prejudice or disadvantage”); 16 U.S.C. § 825s-3 (dictating that the Southwestern Power Administration sell electricity “at uniform system wide rates, without discrimination between customers”); 16 U.S.C. § 838d (ordering that BPA make its transmission facilities available to utilities “on a fair and nondiscriminatory basis”). Yet, it has not done so in § 7(k). We therefore are reluctant to infer that Congress intended the standard to apply to BPA’s nonfirm power rates.

*Southern Cal. Edison Co. v. Jura*, 909 F.2d 339, 342-43 (9th Cir. 1990). Likewise, section 7 in general, and section 7(b)(3) in particular, contains no discrimination standard. Thus, there is no section 7(b)(3) standard to judge the REP Surcharge as being discriminatory.

Third, even if a discrimination standard existed in the Northwest Power Act, the REP Surcharge would not be unlawful, because the DSIs are not similarly situated as a discriminated party. To be discriminatory, the DSIs would need to be in a similar position as a discriminated party.

Thus, there is no antidiscrimination standard that applies to BPA’s provision of wheeling services to the DSIs but not to APAC’s members. APAC’s argument that the Federal Power Act, as amended by the Energy Policy Act, prohibits BPA’s rates for transmission services from being “unjust, unreasonable, or unduly discriminatory or preferential,” 16 U.S.C. § 824k(i)(1)(ii), does not require a different conclusion. *See also* 16 U.S.C. § 824k(a). The issue is not whether BPA may charge discriminatory rates for transmission services but whether, having offered transmission services to some of its retail customers, it must offer those services to all.

Even if section 6 did apply, we believe BPA’s actions would be fully justified. To make out a discrimination claim under the Federal Power Act, APAC must at a minimum show that: (1) its members are similarly situated to the DSIs; and (2) there is disparate treatment for the same service. *City of Vernon v. F.E.R.C.*, 845 F.2d 1042, 1045-46 (D.C. Cir. 1988).

APAC’s members and the DSIs are not similarly situated.

*Association of Public Agency Customers, Inc. v. BPA*, 126 F.3d 1158, 1172 (9th Cir. 1997).

DSI rates are not subject to the standards set forth in the Federal Power Act. Ratesetting for the IP rate under the Settlement conforms in every aspect to the IP rate in the absence of the Settlement; the sole difference is that the total amount of rate protection costs allocated to the IP rate is less under the Settlement than in the absence of the Settlement. However, if Alcoa wants to pay a higher REP Surcharge than specified in the Settlement, as the traditional implementation of section 7(b)(3) indicates it would, it should have said so in its brief on exceptions. BPA doubts the COUs would complain.

### **Decision**

*Lacking a discrimination standard, the REP Surcharge cannot be discriminatory in its application to the IP and NR rates. Even if such a standard existed, the REP Surcharge would not be discriminatory.*

### **Issue 5.8.2.5**

*Whether the REP Surcharge deviates from Congress's rate directives.*

### **Parties' Positions**

Alcoa argues “the fact that imposing rate-protection surcharges derived outside the confines of Section 7(b)(2) may ‘maintain the value structure agreed to by the [IOUs and COUs]’ does not justify deviation from Congress’ unambiguous directives.” Alcoa Br., REP-12-B-AL-02, at 21. Alcoa states that this is particularly true when non-statutory costs are being imposed on parties such as Alcoa that were foreclosed from negotiating the terms of the proposed Settlement. *Id.*

WPAG argues that the function of the 7(b)(3) surcharge is not satisfied by the operation of the REP Surcharge. WPAG Br. Ex., REP-12-R-WG-01, at 22. WPAG contends that purpose of the REP Surcharge is not to allocate costs excluded from the PF rate by operation of the 7(b)(2) rate test, but to directly allocate a portion of the predetermined annual REP benefits to the IP and NR rates. *Id.*

### **BPA Staff's Position**

This is a legal issue raised by Alcoa and WPAG in brief. Thus, Staff did not address the issue.

### **Evaluation of Positions**

Alcoa suggests that Staff's justification for including the REP Surcharge in the IP rate is that it “maintain[s] the value structure agreed to by the [IOUs and COUs].” Alcoa Br., REP-12-B-AL-02, at 21, n.49, *citing* Gendron *et al.*, REP-12-E-BPA-04, at 10. This ignores the bulk of Staff's position. First, the REP Surcharge is an allocation of the costs of rate protection. Evaluation Study, REP-12-FS-BPA-01, section 5.1. Second, the REP Surcharge is built on the foundation of the WP-10 7(b)(3) Supplemental Rate Charge. Gendron *et al.*, REP-12-E-BPA-04, at 3. The REP Surcharge is no different in form and essence from the 7(b)(3) surcharge that

would be included in the IP rate if there is no settlement. Bliven *et al.*, REP-12-E-BPA-12, at 9. Congress did not establish any particular method for calculating 7(b)(3) surcharges, once the “amounts not charged” had been calculated. *Id.* at 10. The REP Surcharge is a recovery of rate protection costs (*i.e.*, amounts not charged to public body customers) as directed by section 7(b)(3). *Id.* at 14.

As established in the issues above, the REP Surcharge is a 7(b)(3) surcharge authorized by section 7(b)(3) of the Northwest Power Act. It recovers “amounts not charged to public body ... customers” from the IP and NR rates; a separate 7(b)(3) surcharge recovers such amounts from the PF Exchange rates. Having established that the REP Surcharge is authorized and conforms to the requirements of section 7(b)(3) of the Northwest Power Act, the REP Surcharge does not deviate from the unambiguous rate directives established by Congress.

The fact that Alcoa did not participate in negotiating the terms of the proposed Settlement does not alter the fact that the REP Surcharge is authorized, and indeed mandated, by section 7(b)(3) of the Northwest Power Act. To exclude the REP Surcharge from the IP rate would violate BPA’s rate directives regarding the IP rate. *See* Issue 5.8.2.2.

Alcoa asserts that Staff includes the REP Surcharge because it is simply the will of the settling parties: “As BPA observes, its primary purpose in imposing the terms of the proposed REP Settlement Agreement is to ‘maintain the value structure agreed to by the parties.’” Alcoa Br., REP-12-B-AL-02, at 21, n.49, *citing* Gendron *et al.*, REP-12-E-BPA-04, at 10. However, the cited statement is not Staff’s rationale for recommending that the Administrator adopt the Settlement; rather, it is a description of why the settling parties incorporate a specific calculation of rates into the Settlement. Staff does not merely accept the specifics of the Settlement and apply them to ratemaking. Rather, Staff conducts a thorough analysis and evaluation of the Settlement to determine if it meets statutory requirements and would fairly resolve the many and longstanding disputes over the implementation of the REP. Gendron *et al.*, REP-12-E-BPA-04, at 26-36.

WPAG argues that the function of the 7(b)(3) surcharge is not satisfied by the operation of the REP Surcharge. WPAG Br. Ex., REP-12-R-WG-01, at 22. WPAG contends that the purpose of the REP Surcharge is not to allocate costs excluded from the PF rate by operation of the 7(b)(2) rate test, but to directly allocate a portion of the predetermined annual REP benefits to the IP and NR rates. *Id.* Other than a simple gainsaying of BPA’s description of the operation of the REP Surcharge, WPAG offers no explanation of why the operation of the REP Surcharge does not satisfy section 7(b)(3). There are several errors in WPAG’s argument. First, the REP Surcharge is one of the allocations of the amounts not charged to public body customers by reason of section 7(b)(2); the other is the allocation to the PF Exchange rate. *See* Power Rate Study Documentation, BP-12-FS-BPA-01A, Tables 2.4.12 and 2.4.14. Second, as discussed in this section of the ROD, the REP Surcharge is a 7(b)(3) surcharge; it does not merely satisfy section 7(b)(3), it is a direct application of section 7(b)(3). Third, the REP Surcharge does not allocate REP benefits; it allocates rate protection costs, that is, amounts not charged to public

body customers by reason of section 7(b)(2). WPAG confuses costs not charged (rate protection costs) with costs charged (REP benefits).

### **Decision**

*The REP Surcharge does not deviate from Congress’s rate directives. It is a mandatory and appropriate implementation of section 7(b)(3) of the Northwest Power Act.*

### **Issue 5.8.2.6**

Whether the Settlement’s prohibition of applying the REP Surcharge to surplus power sales violates section 7(b)(3).

### **Parties’ Positions**

While not granting the argument that the REP Surcharge is a 7(b)(3) surcharge, Alcoa contends *arguendo* that the allocation proposed by the Settlement “conflicts with Section 7(b)(3), which explicitly provides that any rate protections allocated pursuant to that section must be allocated to ‘all other power sold by the Administrator to all customers.’” Alcoa Br., REP-12-B-AL-02, at 22, *quoting* 16 U.S.C. § 839e(b)(3) (emphasis added by Alcoa). Alcoa argues that this must include “sales to customers purchasing surplus power.” *Id.* at 23. According to Alcoa, the proposed application of the REP Surcharge violates section 7(b)(3), *id.* at 22, and BPA’s prior decisions regarding 7(b)(3) surcharges, *id.* at 24. Alcoa argues that the Settlement precludes recovery of rate protection costs in violation of section 7(b)(3), and that BPA abdicates to the settling parties, because the preference customers and IOUs agree on the negotiated approach. Alcoa Br. Ex., REP-12-R-AL-01, at 22.

WPAG argues that because the allocation of REP costs to surplus sales is implicit and unquantifiable, then it is difficult to credit that it has actually occurred. WPAG Br. Ex., REP-12-R-WG-01, at 25.

### **BPA Staff’s Position**

BPA’s determination to allocate rate protection costs to surplus sales is one of the issues being litigated before the Ninth Circuit Court of Appeals and thus is one of the issues that is analyzed and evaluated in the Evaluation Study. Bliven *et al.*, REP-12-E-BPA-12, at 17. In order to settle the issues in litigation, the settling parties have agreed that the relative values of their positions on this issue have been incorporated into the payment streams set forth in the Settlement. *Id.* The formula for the REP Surcharge set forth in the Settlement appropriately reflects the effects of the allocation of rate protection costs to surplus sales in the IP and NR rates. *Id.*

### **Evaluation of Positions**

Alcoa misconstrues the Settlement’s implementation of the REP Surcharge as allocating rate protection costs solely to the IP and NR rates. Alcoa Br., REP-12-B-AL-02, at 22. The rate

protection costs pursuant to the Settlement are allocated to the PF Exchange rates as well as the IP and NR rates. In addition, hard-wired within the Settlement’s formula for the REP Surcharge is an allocation of rate protection costs to surplus power sales. Bliven *et al.*, REP-12-E-BPA-12, at 17. Thus, the REP Surcharge meets the requirements of section 7(b)(3) to recover amounts not charged to public body customers from all other power sold. It does so through several means. First, it recognizes such amounts by allocating to the PF Exchange rates sufficient amounts to reduce Unconstrained Benefits to REP Recovery Amounts defined in the Settlement. Next, the REP Surcharge recognizes such amounts through a separate allocation to the IP and NR rates, and a hard-wired allocation to surplus power sales.

Alcoa is correct that BPA previously determined that section 7(b)(3) requires an allocation of rate protection costs to surplus power sales. Alcoa Br., REP-12-B-AL-02, at 24-25. However, Alcoa does not mention that this decision by BPA is being challenged in the litigation before the Ninth Circuit. Bliven *et al.*, REP-12-E-BPA-12, at 17. The COUs have argued to the Court that this allocation is contrary to the statutory intent set forth by Congress. *See* WP-07 Supplemental ROD, WP-07-A-05, at 335-372. Thus, BPA’s decision to allocate 7(b)(3) costs to surplus power sales is disputed, and it is uncertain whether it would survive. *Id.* This uncertainty creates risk for Alcoa and other ratepayers that pay a 7(b)(3) surcharge. The IOUs, being in the same risk position as Alcoa and other DSIs with regard to the allocation to surplus, are not willing to settle the litigation based on the COUs’ position that no 7(b)(3) costs should be allocated to surplus power sales. Likewise, the COUs are unwilling to settle the litigation based on BPA’s position on 7(b)(3), with which the IOUs and Alcoa concur. The settling parties found they could agree on settling this issue in a manner that anchors the results of the 7(b)(3) allocation based on the status quo (BPA’s decision), but in such manner as to not set a precedent for future 7(b)(3) allocations.

Nevertheless, the settling parties realized that not allocating rate protection dollars under the Settlement to surplus sales could harm the rights of IP and NR ratepayers. To address this concern, as noted above, the parties included an allocator in the Settlement that effectively “hardwires” an allocation of rate protection dollars to surplus sales for purposes of calculating the REP Surcharge applicable to the IP and NR rates. Bliven *et al.*, REP-12-E-BPA-12, at 17; Gendron *et al.*, REP-12-E-BPA-04, at 18-19. The REP Surcharge thus reads as follows:

$$\text{REP Surcharge} = (\text{REP Recovery Amounts plus COU REP Benefits}) * (7.38 / 265,846,587)$$

REP Settlement, REP-12-A-02A, § 3.3.1. The equation “(7.38 / 265,846,587)” results in the allocator that reflects the 7(b)(3) surcharge that BPA applied to the IP rate in the WP-10 rate case. Murphy, Oral Tr. at 154. As noted above, BPA allocated rate protection dollars to surplus sales in the WP-10 rate case. By using this formula, then, BPA can calculate the IP and NR rates as *if BPA had continued to allocate* rate protection dollars to surplus rates *without actually* performing such an allocation. Bliven *et al.*, REP-12-E-BPA-12, at 17.

In this way the parties were able to achieve their dual goals of not addressing the legal merits of BPA’s decision to allocate rate protection dollars to surplus sales, while at the same time protecting the other rates affected by BPA’s decision:

the formula for the REP Surcharge *set forth in the Settlement appropriately reflects the effects of the allocation of rate protection costs to surplus sales in the IP and NR rates*. As Alcoa states, Speer, REP-12-E-AL-01, at 7, BPA appropriately allocated rate protection costs to surplus sales in the WP-07 Supplemental and WP-10 rate cases. Because the REP Surcharge is based on the level of the 7(b)(3) surcharge determined in the WP-10 rate case, the REP Surcharge has already been reduced by the appropriate allocation to surplus sales. Thus, the three rates that share the allocation of rate protection costs would all be established in a manner that recognizes what BPA and Alcoa believe is appropriate to do, allocate rate protection costs to surplus sales, but in a manner that does not cause the COUs to be forced to pursue their challenge of this determination before the Ninth Circuit.

Bliven *et al.*, REP-12-E-BPA-12, at 17 (emphasis added). Thus, the IP and NR ratepayers continue to receive the benefit of BPA's decision to allocate rate protection costs to surplus power sales, thus lowering their 7(b)(3) surcharge.

Furthermore, this is not, as Alcoa argues, an action by BPA to reverse its prior decision on the issue. BPA maintains its position that 7(b)(3) costs are properly allocable to surplus power sales, and that position is being reflected in the REP Surcharge. Bliven *et al.*, REP-12-E-BPA-12, at 17. As to the broader issue of whether BPA (or the parties) have withdrawn their respective legal positions in entering the Settlement, the Settlement is clear that no such admissions have occurred. As noted by the Settlement:

**11.1 No Admission.** This Settlement Agreement reflects the compromise of disputed issues, claims, and defenses and does not constitute any Party's admission or concession with respect to the merits of any such disputed issues, claims, or defenses.

**11.2 No Precedential or Evidentiary Effect.** Neither this Settlement Agreement nor its performance will (i) constitute any Party's agreement to any underlying principle or statutory interpretation in any context, (ii) constitute any Party's agreement to any methodology other than for purposes of implementing this Settlement Agreement in accordance with its terms for the Payment Period, or (iii) serve as procedural or substantive precedent regarding any matter in any context other than BPA proceedings to implement the terms of this Settlement Agreement.

Settlement, REP-12-A-02A, §§ 11.1-11.2.

As opposed to solving the legal question of allocation of rate protection to surplus sales, the REP Surcharge is a practical method to implement 7(b)(3) allocations in such a way that BPA does not need to enforce a final decision on parties that object to that decision. Gendron *et al.*, REP-12-E-BPA-04, at 10. The REP Surcharge preserves the effect of BPA's prior decision in such a way as to cause no harm to Alcoa and other ratepayers subject to the 7(b)(3) surcharge.

Thus, under the Settlement, BPA is not agreeing with settling parties that 7(b)(3) costs should or should not be allocated to surplus power sales. *Id.* The Settlement has struck a balance between the settling parties' desire to not litigate BPA's prior decisions, decisions that BPA still stands behind, but to implement section 7(b)(3) in such a way that non-settling parties, such as Alcoa, retain the benefits of BPA's prior decision but without the risk of an adverse decision arising from the litigation.

Finally, Alcoa's call for applying the REP Surcharge to surplus sales is not only unnecessary, because the REP Surcharge already reflects such an allocation, but also improper. Had the REP Surcharge been applied to surplus sales, as demanded by Alcoa, it would result in a 7(b)(3) surcharge to the IP and NR rates that would be based on a *double allocation* of rate protection costs to surplus sales. As noted above, within the REP Surcharge formula itself is an allocator that calculates the 7(b)(3) charges to the IP rate and NR rate *as if* BPA allocated rate protection to surplus sales. Bliven *et al.*, REP-12-E-BPA-12, at 17. If BPA were to *again* allocate the REP Surcharge to surplus sales, as requested by Alcoa, then the 7(b)(3) surcharge to the IP and NR rates would be reduced *again*. It is precisely to avoid this "double allocation" that the settling parties included language in the Settlement that prohibited BPA from allocating REP Surcharges to surplus sales. REP Settlement, REP-12-A-02A, § 3.5. As described by counsel for the JP02 parties:

even taking into consideration the ruling that the Administrator made in WP-10, the fact of the matter is the methodology used for spreading the first round of REP costs [through the REP Surcharge] was based upon the 7(b)(3) surcharge that was applied to the DSIs in the WP-10 case when, in fact, that 7(b)(3) surcharge was reduced by the allocations that was made to ... surplus [sales]. The language that [Alcoa's counsel] points to was language that [the COUs] insisted on ... *to assure that we wouldn't in effect have two allocations to surplus. The first allocation was already taken into account in the way the first round of costs was dealt with in the contract....*

Murphy, Oral Tr. at 152 (emphasis added). Nothing in section 7(b)(3) directs BPA to establish a surcharge to the IP and NR rates based on a double allocation of rate protection costs to surplus sales. For these reasons, the Settlement's limitation on a *second* allocation of rate protection dollars to surplus sales is reasonable.

Alcoa argues that the Settlement precludes recovery of rate protection costs, in violation of section 7(b)(3). Alcoa Br. Ex., REP-12-R-AL-01, at 22. Alcoa charges that BPA is attempting to sidestep prior findings regarding the 7(b)(3) allocation to surplus sales by abdicating to the settling parties, because the COUs and IOUs agree on the negotiated approach. *Id.* Alcoa presumes too much; nowhere does BPA renounce or relinquish its statutory responsibility to the settling parties. The settling parties have presented a Settlement to BPA, and BPA is examining the Settlement to ensure, among other things, that it conforms to BPA's statutory rate directives. In this instance, BPA is not simply taking the settling parties' word that the Settlement conforms to the requirements of section 7(b)(3); rather, BPA is making an independent assessment of the

Settlement and, as discussed above, finds that the Settlement does not violate the directives in section 7(b)(3) to allocate rate protection costs to all other power sold, *including* surplus sales.

Under the Settlement, the REP Surcharge assessed to the IP rate will be based on the WP-10 7(b)(3) surcharge that is lower because of the allocation to surplus sales. The settling parties have agreed upon the effect of this allocation, among many other considerations, on REP benefits and the effect of that benefit level on the PF Public rate. That benefit level is less than would occur absent the Settlement, making the PF Public rate lower than it would be in the absence of the Settlement. The IP rate is linked to this lower PF Public rate. Therefore, Alcoa is receiving additional rate benefits under the Settlement because both the PF Public rate and the 7(b)(3) surcharge are lower than they would be absent the Settlement.

WPAG argues that because the allocation of REP costs to surplus sales is implicit and unquantifiable, it is difficult to credit that it has actually occurred. WPAG Br. Ex., REP-12-R-WG-01, at 25. As explained above, the allocation of rate protection costs (not REP costs, as WPAG argues) is fully factored into the REP Surcharge methodology. It may be unquantified, because no party asked that it be quantified, but is it not “unquantifiable.”

### **Decision**

*The REP Surcharge hardwires the application of section 7(b)(3) to surplus power sales in a manner to which parties opposed to BPA’s prior findings can agree and in a manner that does not harm parties benefitting from BPA’s prior findings.*

### **Issue 5.8.2.7**

*Whether the Settlement results in an excessive allocation of costs to the IP rate.*

### **Parties’ Positions**

Alcoa argues that, because the Settlement provides preference customers with *more* rate protection than 7(b)(2) dictates, BPA will collect such excessive rate protection from the DSIs and other customers. Alcoa Br. Ex., REP-12-R-AL-01, at 19 (emphasis in original). Alcoa states that Congress understood section 7(b)(2) as both protecting the preference customers’ rates from certain costs, but also restricting the manner in which BPA could calculate rate protection. *Id.* The REP Surcharge, Alcoa argues, does not “conscientiously follow” the requirements of section 7(b)(2) because it provides the preference customers with a greater amount of rate protection than would be calculated under the statutory test. *Id.* at 20. Alcoa contends that the REP Surcharge recovers this excessive amount of rate protection from the DSIs, and in doing so, runs afoul of the limitations Congress placed on the calculation and recovery of preference customer rate protection. *Id.*

### **BPA Staff’s Position**

This is a legal issue raised by Alcoa in brief. Thus, Staff did not address the issue.

## **Evaluation of Positions**

Alcoa argues because the Settlement provides preference customers with more rate protection than 7(b)(2) dictates, BPA will collect such excessive rate protection from the DSIs and other customers. Alcoa Br. Ex., REP-12-R-AL-01, at 19. While Alcoa is correct that the Settlement provides preference customers with more rate protection than the traditional 7(b)(2) rate test provides, this does not mean that the extra rate protection costs are allocated to the IP and NR rates, whether through the REP Surcharge or through any other means.

The REP Surcharge, Alcoa argues, does not “conscientiously follow” the requirements of section 7(b)(2) because it provides the preference customers with a greater amount of rate protection than would be calculated under the statutory test. *Id.* at 20. While this is true, this is not prohibited by statute. The only restriction is that the amounts charged to the public body customers may not exceed the amounts established by the 7(b)(2) rate test. The fact that the IOUs are willing to take fewer REP benefits that might be allowed under sections 7(b)(2) and 7(b)(3) does not violate statutory rate directives.

Alcoa contends that the REP Surcharge recovers this excessive amount of rate protection from the DSIs, and in doing so, runs afoul of the limitations Congress placed on the calculation and recovery of preference customer rate protection. *Id.* Alcoa is incorrect in its conclusion that because the Settlement provides greater rate protection to preference customers the IP rate is burdened with greater costs. In fact, the evidence in this proceeding shows the opposite to be true. The IP rate is protected from increased costs, and actually benefits from the cost allocations made pursuant to the Settlement. This is not a matter of coincidence; it is part of the design of the Settlement. Ratemaking respecting the Settlement was carefully crafted to ensure that any increased costs of rate protection due to the IOUs taking fewer REP benefits than they might be entitled to are assigned solely to the IOUs, not other rates. This is accomplished by tying the REP Surcharge to the WP-10 7(b)(3) surcharge. The REP Surcharge changes only in response to REP benefits paid, not to changes in rate protection costs. Thus, no matter how high IOU ASCs may go, the IP and NR rates are shielded from any surcharge increases resulting from increased rate protection stemming from such ASC escalation. This is not the case in the absence of the Settlement. Without the Settlement, the 7(b)(3) surcharges increase dramatically as IOUs’ ASCs increase, as Staff demonstrates in its High ASC-Low BPA Rate scenario analysis. Finally, the IP rate is also benefited by the Settlement because the applicable wholesale rate is lower as a result of fewer REP benefits included in the PF Public rate, also lowering the IP rate. Because the applicable wholesale rate is lower and the 7(b)(3) surcharge is lower, the IP rate is much lower under the Settlement than it would be without the Settlement.

## **Decision**

*The Settlement does not result in an excessive allocation of costs to the IP rate. Rather, the Settlement reduces costs allocated to the IP rate.*

### **Issue 5.8.2.8**

*Whether the REP Surcharge complies with Northwest Power Act sections 7(b)(2) and 7(b)(3).*

#### **Parties' Positions**

Alcoa argues that “the REP Surcharge is not an amount of rate protection derived from the Section 7(b)(2) rate test.” Alcoa Br., REP-12-B-AL-02, at 20. Alcoa argues “BPA cannot invent a new form of rate protection out of whole cloth (or more accurately, adopt a new form of rate protection negotiated by the COUs and IOUs) and allocate it to the DSIs by simply characterizing it as “a form” of the statutorily-authorized rate protection surcharge.” *Id.* at 20-21. Alcoa contends that “the REP Surcharge is not 7(b)(2) rate protection. Any similarity in the level of rate protection is merely coincidental.” *Id.* at 19. Alcoa claims section 7(b)(3) does not grant BPA unfettered discretion to allocate settlement costs to the IP rate. *Id.* Instead, Alcoa claims, it is a narrow grant of authority that constrains BPA to allocating rate protection costs that are the direct result of the section 7(b)(2) rate test to “all other rates.” *Id.*

#### **BPA Staff's Position**

The REP Surcharge is assessed as a surcharge pursuant to section 7(b)(3) of the Northwest Power Act and is a recovery of amounts not charged to preference customers by reason of the rate protection afforded to preference customers pursuant to section 7(b)(2). Bliven *et al.*, REP-12-E-BPA-12, at 15.

#### **Evaluation of Positions**

Alcoa argues that the REP Surcharge impermissibly spreads costs to Alcoa through an allocation of “the unrecovered costs of the negotiated rate protection (referred to as the REP Surcharge) exclusively to the IP and NR rates.” Alcoa Br., REP-12-B-AL-02, at 18-19.

In the resolution of the issues above, BPA has found that (1) the basis of the REP Surcharge is established in section 7(b)(3) of the Northwest Power Act; (2) the REP Surcharge is a surcharge pursuant to section 7(b)(3), and the differences in method of calculation do not change the character of the surcharge or make it contrary to section 7(b)(3); (3) the statutory language does not require the amounts to be determined solely by reference to BPA’s traditional implementation of the section 7(b)(2) rate test; (4) the REP Surcharge is not discriminatory in its application to the IP and NR rates; (5) the REP Surcharge does not deviate from Congress’s unambiguous rate directives; it is an mandatory and appropriate implementation of section 7(b)(3); and (6) the REP Surcharge hardwires the application of section 7(b)(3) to surplus power sales in a manner that does not harm parties benefitting from the application to surplus power.

Having made these determinations, BPA cannot conclude, as Alcoa does, that the REP Surcharge is not an amount of rate protection derived from the section 7(b)(2) rate test; that it is a new form of rate protection invented out of whole cloth; that it is simply “a form” of the statutorily authorized rate protection surcharge; that the REP Surcharge is not 7(b)(2) rate protection; and

that it is a result of imposing unfettered discretion to allocate settlement costs to the IP rate. BPA agrees with Alcoa that section 7(b)(3) is a narrow grant of authority that constrains BPA to allocating rate protection costs that are the direct result of section 7(b)(2) to “all other rates.” BPA does not agree that the only manner in which the rate protection costs can be determined is through BPA’s traditional implementation of the section 7(b)(2) rate test.

The decisions above have determined that the REP Surcharge is a recovery of amounts not charged to public body customers. The REP Surcharge is authorized by section 7(b)(3) as an appropriate supplemental rate charge for all other power sold. The REP Surcharge is, in essence, not merely a form of a 7(b)(3) surcharge. It is not mandatory that the REP Surcharge directly flow from a contemporaneous 7(b)(2) rate test but must recover amounts not charged to public body customers by reason of section 7(b)(2). The REP Surcharge is not discriminatory in its application to the IP and NR rates. The REP Surcharge does not deviate from Congress’s unambiguous rate directives. The REP Surcharge is structured in a manner that hardwires a section 7(b)(3) allocation to surplus power sales.

The Settlement does not dispense with section 7(b)(3). The Settlement does not change the intent of section 7(b)(3). Rather, the Settlement modifies BPA’s traditional implementation of section 7(b)(3) in a manner that settling parties, which hold conflicting opinions on the proper implementation, can abide by and does not violate the statutory rights of non-settling parties, including Alcoa.

Alcoa argues that BPA “cannot allocate” the costs of the Settlement to the IP rate because such amounts were not derived from application of the section 7(b)(2) rate test. Alcoa Br., REP-12-B-AL-02, at 19-21. Earlier in this ROD, BPA explains the basis upon which it believes the fixed level of REP benefits provided by the Settlement is consistent with the section 7(b)(2) rate test. *See* Chapter 3 and the foregoing sections of Chapter 5. Such analysis demonstrates that the level of REP benefits provided under the Settlement comports with the protections afforded to the COUs under section 7(b)(2) and is not otherwise unlawful. If BPA’s findings on these issues are sustained, which BPA believes they will be, then BPA has *no choice* but to assign the costs of the Settlement to the rates of Alcoa in the manner prescribed by section 7(b)(3). While Alcoa may wish that BPA did not allocate additional costs to its rates under the Settlement, BPA does not have discretion to not allocate such costs. As noted above, section 7(b)(3) is clear that amounts not charged to the COUs’ rates by reason of section 7(b)(2) “*shall be recovered* through supplemental rate charges for all other power sold by the Administrator to all customers.” 16 U.S.C. § 839e(b)(3) (emphasis added). This language is prescriptive; BPA does not have the option of *not* allocating these amounts to other rates. Provided that the “amounts not charged” to the COUs are “by reason of” the section 7(b)(2) rate test, which under the Settlement such amounts are, then BPA *must* allocate these amounts to “all other rates,” including the IP rate. The requirements of section 7(b)(3) are no less in effect because BPA is proposing to implement the REP through the Settlement.

At its core, then, Alcoa’s chief objection to the REP Surcharge is that it recovers a disproportionate amount of costs of the Settlement from the IP rate than from other rates.

Alcoa Br., REP-12-B-AL-02, at 21. This is particularly bothersome to Alcoa because, in its view, “Alcoa [was] foreclosed from negotiating the terms of the proposed Settlement.” *Id.* at 21. However, any settlement of the REP must retain the essential features of the traditional REP, including the recovery of REP costs from rates in a manner consistent with section 7(b)(3). The effect of implementing this statutory provision in the context of this Settlement means that certain customers, such as the DSIs, will be assigned additional costs of the REP in order to protect other customers, such as the COUs. This result cannot be avoided. The Court in *PGE* made it clear that, when settling BPA’s obligations under the REP, BPA will be in “plain violation of the Rate Adjustment Test” if such settlement results in “BPA’s preference customers ... paying for the REP settlement the same as BPA’s other customers.” *PGE*, 501 F.3d at 1036 (emphasis added). That is precisely what would occur if there were no REP Surcharge in the Settlement. The IP rate would be charged the same REP costs as the COUs, resulting in the very violation the Court rejected in *PGE* and *Golden NW*. BPA believes that the REP Surcharge properly implements the essential elements required by section 7(b)(3) and the Court’s opinions in *PGE* and *Golden NW*.

### **Decision**

*The REP Surcharge is in accord with sections 7(b)(2) and 7(b)(3).*

## **5.9 Compliance of the Settlement with Section 7(c) of the Northwest Power Act**

### **Issue 5.9.1**

*Whether Staff’s evaluation criteria properly consider the Settlement in light of the statutory rate directives applicable to the IP Rate under section 7(c) of the Northwest Power Act.*

### **Parties’ Positions**

Alcoa contends that BPA has not evaluated the Settlement in light of whether the IP Rate developed pursuant to the Settlement will comply with section 7(c) of the Northwest Power Act. Alcoa Br., REP-12-B-AL-02, at 5. Alcoa asserts that this alleged omission renders BPA’s decision to adopt the Settlement “arbitrary and capricious.” *Id.* at 8.

### **BPA Staff’s Position**

Staff properly considers section 7(c) when evaluating the Settlement. Evaluation Study, REP-12-E-BPA-01, at 179-180. The evaluation establishes a criterion that examines whether the rates for non-settling parties are reasonable. *Id.* Staff believes that a rate that does not comply with law is not reasonable. The Settlement resolves only issues pertaining to BPA’s implementation of the REP. It does not resolve all issues with BPA ratemaking, such as BPA’s implementation of section 7(c). The REP affects the development of the IP Rate through the allocation of costs of rate protection under section 7(b)(3) and through the “linking” of the IP Rate and the PF Public rate as required by section 7(c)(2). Staff considers both of these issues in its evaluation of the Settlement. Staff also considers and disagrees with Alcoa’s new

arguments raised for the first time in this proceeding regarding alleged violations of the “equitable in relation to” language of section 7(c)(1)(B).

### **Evaluation of Positions**

Alcoa contends that Staff has not evaluated the Settlement in light of whether the IP Rate developed pursuant to the Settlement will comply with section 7(c) of the Northwest Power Act. Alcoa Br., REP-12-B-AL-02, at 5. Alcoa notes that the criteria Staff uses to evaluate the Settlement take into consideration, among other things, the impact on COU rate protection, the level of REP benefits that the IOUs are entitled to, and the “fair and equitable” treatment of Lookback amounts. *Id.* However, Alcoa asserts, BPA’s evaluation criteria do not assess whether DSI rates would comply with section 7(c). *Id.*

Alcoa ignores the record in this case. In considering the Settlement, Staff states that the Settlement must have a clear and direct connection to the protections and requirements set forth in the Northwest Power Act. Evaluation Study, REP-12-E-BPA-01, section 6.2. To that end, Staff develops a set of criteria that it uses to “test” the Settlement. *Id.*, section 11.2; Gendron *et al.*, REP-12-E-BPA-04, at 26-27. These criteria include three primary and two secondary criteria, which are:

- the Settlement would provide COUs with at least as much rate protection compared to the rate protection afforded under section 7(b)(2) of the Northwest Power Act;
- the Settlement would provide REP benefits in a manner consistent with section 5(c) of the Northwest Power Act and distribute such REP benefits among the settling IOUs in a manner consistent with BPA’s current ASC Methodology and with rates that are consistent with section 7 of the Northwest Power Act;
- the Settlement would resolve, in a fair and equitable manner, all of the outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period;
- the Settlement would recognize that not all COUs were equally harmed by the costs of the 2000 REP Settlements and that IOUs were differentially affected by BPA setting off REP benefits for Lookback Amounts;
- the Settlement would provide reasonable rates for non-settling parties and other classes of BPA’s customers.

Evaluation Study, REP-12-E-BPA-01, at 179-180; Gendron *et al.*, REP-12-E-BPA-04, at 26-27.

As these objectives make clear, Staff’s concern is not limited to the rate and statutory issues pertaining to the COUs and IOUs. Rather, Staff considers the effect that the Settlement would have on other rates, including the IP Rate. If this is not obvious enough from Staff’s criteria, Staff made clear during cross-examination that consideration of the Settlement’s impact on the

IP Rate was a component of both the third criterion and the fifth criterion listed above. In terms of the third criterion, Staff states as follows:

Q. [Counsel for BPA] And could you open that for a second, to that, that cite? That's the evaluation study at REP-12-E-BPA-01 at 179 through 180. At the bottom of 179 there's a second bullet. Could you just review that—or read that bullet into the record, please.

A. (Mr. Bliven) The last bullet says, on page 179 says: The settlement would provide REP benefits in a manner consistent with Section 5(c) of the Northwest Power Act and distribute such REP benefits among the settling IOUs in a manner consistent with BPA's current ASC methodology and with rates that are consistent with Section 7 of the Northwest Power Act.

Q. And in referring to Section 7, what were you intending to mean by referring to Section 7?

A. (Mr. Bliven) Referring to the totality of the section as it relates to the setting of rates.

Q. Would that include Section 7(c)?

A. (Mr. Bliven) Certainly it would.

Cross-Ex. Tr. at 155-156. Staff clarified for Alcoa's counsel that the fifth criterion also encompassed consideration of section 7(c):

Q. And we agree that Bonneville's evaluation criteria are set forth here at REP-12-E-BPA-12 beginning at line 26 over to page 2, line 2. What I'm curious about is I see in these evaluation criteria here all sorts of discussion of whether the settlement will provide the customer-owned utilities with rate protection consistent with the statute, whether it will provide REP benefits consistent with the statute, whether it's going to resolve the litigation. And what I don't see here is one of -- Bonneville saying one of its evaluation criteria is that the IP Rate set, if the REP settlement is adopted, will be equitable in relation to, it's consistent with Section 7(c).

A. (Mr. Bliven) Well, it's in No. 5 that it provides a reasonable rate for non-settling parties. And then the parenthetical says the statutory basis for non-settling parties is encompassed in Items 1 and 2. So I think that is the basis that we would say that we were looking at the IP Rate, does it apply reasonable rates and is it statutory is encompassed by No. 5.

Cross-Ex. Tr. at 82-83. Counsel for Alcoa, however, apparently could not accept this answer, and so again attempted to assert that BPA "doesn't use the statutory criteria for the IP Rate as an evaluation criteria," to which Staff responded:

A. (Mr. Bliven) No. I've already said that the statutory basis of the IP Rate was a consideration as encompassed in Part 5 of our agreement or of our criteria that we set forth.

Q. We can agree to disagree about what those evaluation criteria say.

A. (Mr. Bliven) You're certainly welcome to, but we're the ones that wrote it, and I think that's how we understood it to be.

*Id.* at 85-86.

Alcoa relies on the above-mentioned examination as grounds for its claim that BPA's evaluation criteria did not consider section 7(c). Alcoa Br., REP-12-B-AL-02, at 7. As noted above, the Staff who wrote the criteria believes Alcoa is misreading the criteria. The answer to this question, however, does not lie in engaging in a literary debate over what five bulleted points mean. Rather, to test whether Staff uses the criteria it says it uses, the record developed in this case provides the most objective proof. From the record, Staff's commitment to consider the effects of the Settlement on the IP Rate is clearly evident. Staff conducts extensive analysis to test the Settlement's terms against the two provisions of the Northwest Power Act that determine the amount of REP costs included in the IP Rate: (1) section 7(b)(3) (which, following the 7(b)(2) rate test, allocates REP costs away from the PF Public rate to "all other power sold" by the Administrator, including the IP Rate); and (2) section 7(c)(2) (which "links" the IP Rate to the PF Public rate after the 7(b)(2) rate test is performed). Staff considers both of these statutory provisions when evaluating the Settlement in light of the IP Rate.

With respect to section 7(c), Staff concludes that there are no material changes to the ratesetting methodology through the 7(c)(2) step. Bliven *et al.*, REP-12-E-BPA-05, at 1. Thus, all cost allocations of the COSA Step are unchanged by the Settlement. *Id.* In addition, the linking of the IP and PF rates pursuant to section 7(c)(2) would be unchanged under the Settlement. *Id.* Staff explains at length how the IP Rate would be "linked" to the PF Public rate following application of the REP Surcharge under the Settlement. *Id.* at 4. After evaluating various methods for linking the PF Public rate with the IP Rate, Staff chooses a method that, in Staff's expert opinion, ensures that the "PF [Public] and IP Rates [are] properly linked" under section 7(c)(2). *Id.* at 6. This analysis, which Alcoa studiously avoids mentioning, clearly shows that Staff considers section 7(c) in its evaluation of the Settlement.

With respect to section 7(b)(3), Staff evaluates the Settlement's use of the WP-10 section 7(b)(3) surcharge as the allocator of REP costs to the IP Rate during the term of the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 18. Staff performs an extensive analysis to test whether the Settlement burdened the IP Rate with more than the lawful amount of REP costs. Bliven *et al.*, REP-12-E-BPA-12, at 9-16. Based on this analysis, Staff concludes that not only is the IP Rate not bearing an unlawful portion of the rate protection costs allocated under section 7(b)(3), but "a larger share of rate protection costs is allocated to the PF [Exchange] rate under the Settlement and a smaller share to the IP and NR rates." Bliven *et al.*, REP-12-E-BPA-12, at 16. In short, the Settlement reallocates a larger portion of rate protection dollars away from the IP and NR rates than under the no-settlement alternative, resulting in the IP Rate being reduced by \$1.32/MWh under the Settlement. Evaluation Study, REP-12-FS-BPA-01, Table 10.5 (showing the IP Rate under Settlement at \$36.32/MWh), and Table 10.6 (showing the IP Rate under no-settlement at \$37.63/MWh). Assuming Alcoa receives 320 aMW over the next

two-year rate period, this rate reduction translates into roughly \$7.4 million in savings to Alcoa for FY 2012–2013. *See also* Issues 5.8.2.1–5.8.2.8.

While the record clearly shows that the IP Rate is better off under the Settlement in the near term, this determination is only part of the picture Staff analyzes. Staff also considers the long-term impacts of the Settlement’s terms on the IP Rate. Stiffler *et al.*, REP-12-E-BPA-07, at 3-5. To do this, Staff includes the IP Rate as part of the Long-Term Rates Model. *Id.* The LTRM is an annual model that develops annual rates rather than two-year rates. *Id.* at 3. It is based on many of the same input data as used by RAM2012 through 2017, with input values extended through 2032. *Id.* When developing the LTRM, Staff designed it to “employ section 7 rate directives to link the Industrial Firm Power (IP) and Priority Firm Public (PFp) rates and to perform the 7(b)(2) rate test.” *Id.*

Based on the long-term modeling, Staff finds that under the Settlement, the IP Rate would not only be lower in the near term, but also would be protected over time from escalating ASCs. Gendron *et al.*, REP-12-E-BPA-04, at 35; *see also* Bliven *et al.*, REP-12-E-BPA-12, at 12. Staff’s analysis shows that the IP Rate is “highly exposed” to the level of future ASCs. Bliven *et al.*, REP-12-E-BPA-12, at 13. As a consequence, Staff concludes under BPA’s current non-settlement rate modeling, over time “the higher the ASCs, the higher the IP Rate.” *Id.* This result occurs because while the section 7(b)(2) rate test protects the PF Public rate from higher ASCs, it does not protect the IP Rate from higher ASCs. *Id.* The Settlement mitigates this risk, however, by fixing the level of the REP Surcharge to the level integrated in the WP-10 rates, plus a fixed escalation through the Settlement term. *Id.* Staff’s analysis shows that the savings the IP Rate sees under the Settlement from the IOUs’ ASCs continues over time. Evaluation Study, REP-12-FS-BPA-01, Figure 6 (showing the IP Rate under Settlement below the IP Rate without settlement for the entire 17 years of the Settlement). Because the Settlement protects the DSIs from increasing ASCs, thereby producing lower IP Rates, Staff concludes that the Settlement is reasonable for the DSIs. Gendron *et al.*, REP-12-E-BPA-04, at 35; *see also* Bliven *et al.*, REP-12-E-BPA-12, at 13.

In short, as the foregoing record makes clear, there can be little question that Staff considers the statutory ratemaking directives applicable to the IP Rate as part of Staff’s analysis of the Settlement. Alcoa’s claim that Staff “did not assess whether DSI rates would comply with Section 7(c)” is simply wrong.

Alcoa also argues that the fault in BPA’s criteria lies in the fact that BPA does not consider whether under the Settlement the IP Rate would be set consistent with section 7(c)(1)(B), which provides that the DSI rate must be “equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial consumers in the region.” Alcoa Br., REP-12-B-AL-02, at 8; *citing in part* 16 U.S.C. § 839e(c)(1)(B). Alcoa’s criticism is misguided. The Settlement does not purport to settle the IP Rate for 17 years. Instead, the Settlement is intended to address *one part* of BPA’s ratemaking: the development and allocation of REP costs. 75 Fed. Reg. 78694, at 78695 (2010) (“BPA is conducting an evidentiary hearing, Docket No. REP-12, to review the terms and conditions of a proposed [27]-year settlement of *issues*

regarding the implementation of the Residential Exchange Program (REP).”) (emphasis added). There are many other parts of BPA ratemaking that are unrelated to the calculation and allocation of REP costs that are nonetheless important to calculating rates. Alcoa correctly points out that section 7(c)(1) is one such provision. However, Staff does not expressly evaluate these unrelated ratemaking issues when considering the Settlement in the initial phase of the REP-12 proceeding for the simple reason that *these ratemaking issues are not being resolved through the Settlement*. Indeed, in the case of the IP Rate, the Settlement expressly reserves all of the settling parties’ rights to *contest* BPA’s development of the IP Rate in the existing litigation and in future rate cases: “This Settlement Agreement is not intended to, and does not, affect any claim or defense in the Litigation pertaining to service to any DSI or pertaining to the rates applicable to any DSI.” Settlement, REP-12-A-02A, § 10.1. These issues will be addressed in each subsequent rate case in accordance with the statutory rate directives prescribed by the Northwest Power Act. In sum, Alcoa’s objection that Staff does not expressly address section 7(c)(1) in this case is moot, because the Settlement does not purport to settle BPA’s implementation of this rate provision.

Alcoa asserts that in evaluating the Settlement, Staff improperly ignores the explicit statutory criteria applicable to the DSI rates, while considering the statutory requirements applicable to the COUs and IOUs. Alcoa Br., REP-12-B-AL-02, at 8. As noted above, Staff has not ignored anything relevant to the issues being addressed by the Settlement. The Settlement affects the implementation of the section 7(b)(3) surcharge and the linking of the PF Public rate and the IP Rate under section 7(c)(2). The record is replete with BPA’s analysis on these issues.

Alcoa claims that BPA’s failure to evaluate the Settlement in light of the DSI rate standards set out in section 7(c) of the Northwest Power Act renders its decision to adopt the Settlement and set rates pursuant to its terms arbitrary and capricious. Alcoa Br., REP-12-B-AL-02, at 8. Alcoa cites *Center for Biological Diversity v. NHTSA*, 538 F.3d 1172, 1047 (9th Cir. 2008) for the proposition that an agency action is arbitrary and capricious when it “entirely failed to consider an important aspect of the problem.”

In this proceeding, however, BPA has not “entirely failed to consider an important aspect of the problem.” Even though the Settlement does not settle BPA’s implementation of section 7(c)(1) and the IP Rate, BPA *nonetheless* addresses these issues in this case as part of Staff’s evaluation of the Settlement. Bliven *et al.*, REP-12-E-BPA-12, at 23-30; *see also* Issues 5.8.2.1–5.8.2.8, Issue 6.5.2, and Issue 6.5.6. Alcoa has raised a number of new issues in this proceeding challenging the rate treatment of the Lookback Credits (referred to as Refund Amounts in the Settlement) under the guise of section 7(c)(1). Speer, REP-12-E-AL-01, at 5. Alcoa complains that BPA should have included these issues expressly in Staff’s criteria, but Staff can hardly be faulted for not having the prescience to know that Alcoa intended to raise new issues with the rate treatment of Lookback Amounts in this case. These new issues were first presented to Staff in Alcoa’s direct case. Speer, REP-12-E-AL-01, at 5. Prior to Alcoa’s direct case, Staff had no notice that Alcoa believed that either Lookback Amounts or Refund Amounts would be objectionable to Alcoa under the section 7(c)(1) ratemaking standard, as Alcoa had not raised these concerns in either the WP-07 Supplemental or WP-10 rate proceedings. The Settlement

continues BPA’s current rate treatment of the Lookback Amounts , which has been in effect since 2008, when BPA issued the WP-07 Supplemental ROD. WP-07 Supplemental ROD, WP-07-A-05, at 279-282. In that ROD, BPA clearly held that it would return the Lookback Amounts as an after-the-fact refund bill credit to the injured COUs. *Id.* at 282. Alcoa, which was a party in that proceeding, did not object. *Id.* at 279. In the WP-10 ROD, BPA held that it would retain the Lookback Amounts approach adopted in the WP-07 Supplemental ROD for the FY 2010–2011 period, and again, Alcoa did not object. WP-10 ROD, WP-10-A-02, at 380.

Now, however, after two rate cases in which Alcoa sat by in silence, Alcoa claims BPA should abandon this method of allocating Lookback Amounts on the grounds that it would “inequitab[ly] allocate REP Lookback costs to Alcoa and other DSIs.” Alcoa Br., REP-12-B-AL-02, at 26. BPA will address the merits of Alcoa’s remarks later in this ROD. *See* Chapter 6. For purposes of this issue, however, Staff’s initial evaluation criteria do not “entirely fail[ ] to consider an important aspect of the problem,” because prior to Alcoa’s direct case there was no problem to consider. Since the original WP-07 Supplemental ROD, there has been no dispute among BPA customers regarding the ratemaking treatment of the Lookback Amounts. Moreover, when Alcoa made it a problem in this case by raising belated objections to BPA’s treatment of the Lookback Amounts, Staff responded to Alcoa’s concerns on the record. Bliven *et al.*, REP-12-E-BPA-12, at 23-30. Alcoa’s claim that BPA has ignored the explicit statutory criteria applicable to the DSI rates is without merit.

Alcoa asserts that BPA misses the point of Alcoa’s argument that Staff did not consider section 7(c) in its analysis and evaluation. Alcoa Br.Ex., REP-12-R-AL-01, at 11-12, *citing* Draft ROD, REP-12-A-01, at 57-58. Alcoa argues that there is “no testimony or other evidence” backing Staff’s assertion that it considered section 7(c) in its analysis and evaluation. *Id.* at 10. Alcoa contends that the record in this proceeding is “void of any conclusion that rates set pursuant to the Settlement’s terms will result in an IP rate that complies with the section 7(c) ‘equitable in relation to ‘standard.’” *Id.* at 10-11. Alcoa is mistaken on two counts. Alcoa overlooks an abundance of Staff testimony indicating that it considers compliance with section 7(c) in its analysis and evaluation. *See, i.e.*, Evaluation Study, REP-12-FS-BPA-01; Evaluation Study Documentation, REP-12-FS-BPA-01A; Gendron *et al.*, REP-12-E-BPA-04, at 35-36; Bliven *et al.*, REP-12-E-BPA-12, at 9-30; Cross-Ex. Tr. at 82-86, 155-156. Staff explicitly testifies that it considers compliance with section 7(c) as an evaluation criterion. Cross-Ex. Tr. at 82-86, 155-156. Alcoa’s mere gainsaying of Staff’s testimony does not eliminate the evidence Staff provides.

Alcoa argues that BPA makes the “telling admission” that it views the “equitable in relation to” standard as a “tertiary ratemaking issue” that is “not being resolved through the Settlement” and suggests that Alcoa can raise arguments concerning the rate impact of the Settlement in subsequent ratemaking proceedings. Alcoa Br. Ex., REP-12-R-AL-01, at 11, *citing* Draft ROD, REP-12-A-01, at 61 (note that BPA has changed the word “tertiary” to “unrelated” in this Final ROD). BPA is puzzled as to what “telling admission” it has made. Alcoa cites the two Federal Register notices delineating the scope of issues to be considered in the two concurrent dockets. *Id.*, *citing* 75 Fed. Reg. 70744 (2010) and 75 Fed. Reg. 78694 (2010). Alcoa states that it

attempted to present evidence and argument concerning the manner in which the Settlement will impact its FY 2012–2013 rates in the BP-12 proceeding. *Id.* at 11-12. BPA moved to strike Alcoa’s testimony because it was outside the scope of the BP-12 proceeding. *Id.* at 12. Alcoa contends that BPA now proposes to disregard Alcoa’s arguments concerning “the agency’s failure to evaluate the Settlement in light of section 7(c) on grounds that Alcoa can raise such arguments in future rate cases (but apparently not this one—in either side of the case).” *Id.*, *citing* Draft ROD, REP-12-A-01, at 61. However, such is not the case. BPA has responded to each issue Alcoa has raised in this REP-12 proceeding. BPA recognizes that Alcoa was confused regarding in which docket to address particular issues. But in this confusion, neither Staff nor BPA has deferred from taking on any issue raised by Alcoa in this REP-12 proceeding, regardless of whether it more properly should have been raised in the BP-12 proceeding. Staff and BPA did this precisely to avoid what Alcoa is now accusing BPA of doing: trying to play a shell game with the issues by saying this is the wrong forum. Rather, Staff and BPA responded in the REP-12 proceeding to every issue raised by Alcoa in the REP-12 proceeding. For Alcoa to now attempt to claim otherwise is incorrect.

Alcoa contends that BPA seems to suggest that Alcoa’s arguments concerning the agency’s failure to expressly consider the section 7(c) standards are inappropriate because they are “new arguments raised for the first time in this proceeding.” Alcoa Br. Ex., REP-12-R-AL-01, at 12, *citing* Draft ROD, REP-12-A-01, at 57. This argument is incorrect. Alcoa attempts to construe a simple statement of Staff’s position that Alcoa raises new issues, not contemplated prior to the construction of the five evaluation criteria, as somehow a statement by BPA that it will not consider these new issues. As stated above, neither Staff nor BPA has sidestepped any issue raised by Alcoa in this proceeding simply because they are “new.”

Finally, Alcoa charges that BPA makes a tacit acknowledgement that it failed to consider the section 7(c) standard by changing the wording of the fifth evaluation criterion. *Id.* at 13, *citing* Draft ROD, REP-12-A-01, at 325. Once again, Alcoa ignores BPA’s reasoning for proposing such change. After thoroughly rebutting Alcoa’s contention that Staff did not consider section 7(c) in its analysis and evaluation, *see* Issue 5.9.1, and a discussion and draft decisions that the Settlement does not violate section 7(c), *see* Draft ROD, REP-12-A-01, at 187-188, BPA offered to modify the language simply to “assuage any concerns” that BPA is not considering section 7(c) in its evaluation of the Settlement. Draft ROD, REP-12-A-01, at 325. Alcoa, not content to accept a gracious offer of assurance that section 7(c) is being fully considered by BPA, now accuses that “[i]ncluding a new evaluation factor, without actually evaluating that factor and supporting it with evidence, renders BPA’s decision to adopt the Settlement arbitrary and capricious.” Alcoa Br. Ex., REP-12-R-AL-01, at 13. BPA notes that the change to the fifth criterion is not merely a wording change. Every IP rate issue raised by Alcoa is being addressed in this proceeding. This Chapter 5 discusses Alcoa’s several contentions regarding the REP Surcharge. Issue 6.5.2 discusses Alcoa’s contention that the REP Surcharge is an improper allocation of costs to the IP rate. Issue 6.5.3 discusses Alcoa’s contention that *Golden NW* requires Lookback Amounts/Refund Amounts to be returned through rates rather than through credits on power bills. Issue 6.5.6 discusses Alcoa’s contention that the Refund Amounts have not been evaluated in light of the “equitable in relation to” standard.

Contrary to Alcoa’s attempt to misstate the facts and findings of this case, BPA is considering all of section 7(c) in its evaluation of the Settlement, and BPA offered draft decisions that held that section 7(c) is not addressed by the Settlement. Those draft decisions are reaffirmed herein.

In conclusion, as established above, Staff does consider section 7(c) in its evaluation. Staff has recommended that BPA adopt the Settlement. Staff does not adopt the Settlement, and therefore Staff has not rendered a “decision to adopt the Settlement.” Therefore, Staff’s actions cannot be considered arbitrary and capricious. This document sets forth BPA’s decision to adopt the Settlement. Even assuming *arguendo* that Staff did not factor section 7(c) in its evaluation of the Settlement, BPA has considered Alcoa’s stated section 7(c) concerns in this decision. *See* Issue 6.5.6. In BPA’s assessment of the record of this proceeding, BPA finds that section 7(c) is properly considered in the evaluation of the Settlement and that the Settlement does not violate any provisions of section 7(c).

### **Decision**

*Staff’s evaluation criteria properly consider the proposed Settlement in light of the statutory rate directives applicable to the IP Rate under section 7(c) of the Northwest Power Act.*

### **Issue 5.9.2**

*Whether the IP rate determined under the Settlement complies with section 7(c) of the Northwest Power Act.*

### **Parties’ Positions**

Alcoa argues that “[s]ection 7(c) of the Northwest Power Act establishes how the IP rate must be calculated.” Alcoa Br., REP-12-B-AL-02, at 19. Alcoa contends that “[a]llocating the REP Surcharge to the IP and NR rates conflicts with the [Northwest Power Act’s] plain language.” *Id.* Alcoa maintains that “[s]ection 7(b)(3) does not grant BPA unfettered discretion to allocate settlement costs to the IP rate.” *Id.* Alcoa concludes that “BPA may not deny Alcoa and the DSIs the Congressionally-mandated rate protections afforded in Section 7(b)(3) by imposing an invented and discriminatory form of non-statutory rate protection.” *Id.* at 21. Alcoa argues that the “proposed Settlement would impermissibly spread costs that have no basis in the [Northwest Power Act] to the IP rate paid by Alcoa ....” *Id.* at 18.

Alcoa argues that BPA fails to adequately review the Settlement in light of section 7(c). Alcoa Br. Ex., REP-12-R-AL-01, at 9-13. Alcoa contends that section 7(c) is violated through the inclusion of Lookback Amounts/Refund Amounts in IP rates. *Id.* at 9. Alcoa also charges that BPA’s reformulation of the evaluation criteria to include a mention of section 7(c) is “tacit acknowledgement” that BPA has failed to consider the section 7(c) standard. *Id.* at 13. Alcoa argues that there is no “guarantee” that the IP rate will be lower under the Settlement. *Id.* at 4.

### **BPA Staff's Position**

The components of the IP rate affected by the calculation of REP benefits under section 7(b)(2) and 7(b)(3) have been properly set. Bliven *et al.*, REP-12-E-BPA-12, at 11-16. Staff found in its evaluation that, under the Settlement, the DSIs would not pay rates that do not conform to the directives set forth in section 7(c). *Id.* at 25.

### **Evaluation of Positions**

Alcoa outlines the construction of the IP rate:

The IP rate is based on the [PF Public] rate, and adjusted to reflect the typical margins charged by the COUs to their industrial customers and the value of BPA's right to curtail or interrupt DSI loads. In prior rate cases, BPA has allocated to the IP rate a portion of the rate protections afforded the COUs by application of the Section 7(b)(2) rate test. And BPA has allocated those rate protection costs pursuant to Section 7(b)(3).

Alcoa Br., REP-12-B-AL-02, at 19 (citation footnote omitted)

Alcoa's depiction of the determination of the IP rate conforms to BPA's understanding of the Northwest Power Act, and BPA's ratemaking implementation is consistent with this depiction. Nevertheless, Alcoa contends that imposition of the REP Surcharge results in an IP rate that does not conform to the statutory rate directives. *Id.* at 21.

The IP rate is not being established in this proceeding. While this proceeding has implications for the IP rate, the final form of the IP rate cannot be judged in this proceeding. But the implications of the Settlement on the IP rate have been investigated, analyzed, evaluated, and decided. The implications of the Settlement for the IP rate conform to statutory rate directives.

In addition to complying with statutory rate directives, the Settlement offers additional benefits to Alcoa and the IP rate. First, it offers a lower IP rate by reallocating some 7(b)(3) costs from the IP rate to the PF Exchange rates. Second, it removes risk to the IP rate by settling the issue of an adverse court decision regarding 7(b)(3) cost allocations to surplus power sales, and the Settlement does so without imposing a higher cost on the IP rate. Third, the Settlement removes from the IP rate much of the risk of increasing ASCs, thus lowering the IP rate throughout the term of the Settlement compared to the IP rate with no Settlement.

This last risk is discussed in Staff's rebuttal testimony. Bliven *et al.*, REP-12-E-BPA-12, at 12-13. The effect of ASC levels on the IP rate can be seen in an examination of two cases performed in the Initial Proposal analysis. The High-ASC/Low-PF case demonstrates the effects of ASCs increasing faster than the Reference Case while BPA costs are increasing slower than the Reference Case. The Low-ASC/High-PF case demonstrates the opposite effects, ASCs decreasing and BPA costs increasing compared to the Reference Case. These rate projections illustrate that, before the rate test, higher ASCs push the PF rate upward more than is offset by lower BPA costs, with the same effect on the IP rate. *Id.* However, while the rate test protects

the PF Public rate from higher ASCs, it does not protect the IP rate from higher ASCs. Thus, the IP rate is highly exposed to the level of future ASCs—the higher the ASCs, the higher the IP rate. The Settlement mitigates this risk by fixing the level of the REP Surcharge to the level integrated in the WP-10 rates, plus a fixed escalation through the Settlement term. The savings to Alcoa over the term of the Settlement are expected to be substantial.

Alcoa also raises the issue of whether the IP rate under the Settlement properly incorporates the directive in section 7(c) that the IP rate be “equitable in relation to the retail rates charged by the [COUs] to their industrial [consumers] in the region.” Alcoa Br., REP-12-B-AL-02, at 32. This issue is addressed at Issue 6.5.6. The finding there is that the treatment of Refund Amounts under the Settlement does not violate section 7(c).

Alcoa argues that BPA has failed to adequately review the Settlement in light of section 7(c). Alcoa Br. Ex., REP-12-R-AL-01, at 9-13. Alcoa contends that section 7(c) is violated through the inclusion of Lookback Amounts/Refund Amounts in IP rates. *Id.* at 9. The issue of BPA’s methodology of providing Refund Amounts as a bill credit rather than a general reduction in rates is discussed in Chapter 6. Alcoa also argues that the failure to allocate the 7(b)(3) surcharge to surplus power also inequitably violates section 7(c). *Id.* at 11. The issue of the REP Surcharge and 7(b)(3) allocations to surplus power is dealt with in Issue 5.8.2.6.

Alcoa appears to believe that cost allocations under section 7(b) of the Northwest Power Act somehow violate section 7(c) of the Act. BPA cannot agree with such a construction. The treatments of Refund Amounts and the REP Surcharge are not section 7(c) issues. Alcoa tries to inject section 7(c) into every cost allocation, whether such allocation is pursuant to sections 7(b) or 7(c), or by extension of Alcoa’s logic, pursuant to section 7(g). Alcoa is arguing that all such allocations must be evaluated as to whether each cost meets the “equitable in relation” standard. BPA disagrees. Section 7(c) is clear as to congressional intent on how to determine “equitable in relation.” Section 7(c)(2) states:

The determination [of “equitable in relation to the retail rates”] under [section 7(c)(1)(B)] shall be based upon the Administrator’s applicable wholesale rates to such public body and cooperative customers and the typical margins included by such public body and cooperative customers in their retail industrial rates ....

16 U.S.C. § 839e(c)(2). Section 7(c) does not require an examination of Refund Amounts or any other cost to determine if such costs are to be allocated to the IP rate because there is no allocation of costs pursuant to section 7(c). It has long been recognized, and is undisputed by Alcoa, that section 7(b)(3) cost allocations to the IP rate are in addition to any determination of the IP rate pursuant to section 7(c). Further, the Settlement specifies that no costs be allocated to the IP rate, other than the REP Surcharge, which is an allocation of rate protection costs pursuant to section 7(b)(3). Assuming *arguendo* that Refund Amounts were an actual cost that is being allocated to rates, a notion that BPA vigorously disputes, there is no allocation of such costs to the IP rate except to the extent such costs are included in the “applicable wholesale rate,” which is the PF Public rate. Thus, the Settlement in no way violates section 7(c).

The settling parties clearly state that the Settlement does not settle the implementation of section 7(c). Responding to a question from BPA’s General Counsel, counsel for JP02 states:

MR. ROACH: [Alcoa] took the position that Bonneville has failed entirely to consider how the allocation [of] costs ... to the DSIs, pursuant to the settlement, in any way comports with the equitability or equitable standard of Section 7(c). Are you saying the testimony in your belief does address that?

MR. MURPHY: No. That's totally irrelevant. We didn't settle any of those issue[s]. We didn't [a]ffect any of those issues.

The issues that we dealt with that affect the IP rate is how REP costs are reflected in the IP rate indirectly through the PF rate; and secondly, how the IP rate is [a]ffected by 7(b)(3). And I think there's extensive testimony in the record that makes it clear that, in fact, staff tested those allocations against the statutory allocations and concluded that the settlement imposed less REP costs on the IP rate in the absence of a settlement.

Murphy, Oral Tr. at 150-151.

Alcoa argues that since BPA will set the IP rate for the next 17 years pursuant to the Settlement, numerous aspects of the Settlement require evaluation under the “equitable in relation to” standard. Alcoa Br. Ex., REP-12-R-AL-01, at 9. This is simply not true. The IP rate will be established in section 7(i) rate proceedings every two years from now through FY 2028. The Settlement does not change this; nor does it speak to any aspect of section 7(c). The Settlement does address cost allocations pursuant to section 7(b)(3), but such allocations have no implications regarding section 7(c). Alcoa cites the treatment of Refund Amounts (or Lookback costs) as the sole “numerous aspects.” *Id.* (Alcoa later refers to the 7(b)(3) allocation to surplus power, but this is not an aspect of section 7(c).)

Alcoa contends that there is no “guarantee” that Alcoa will actually benefit from lower rates over the Settlement’s 17-year term. Alcoa Br. Ex., REP-12-R-AL-01, at 4. Alcoa complains that BPA is asking Alcoa to simply “trust the parties that negotiated the Settlement[.]” *Id.*

Alcoa’s arguments lack merit. First, BPA is not asking Alcoa to “trust” the settling parties. Rather, Staff demonstrates with the analysis presented in this case, most of which has gone unrebutted, that Alcoa’s rate will be lower under the Settlement than in the absence of the Settlement. This lower rate begins this rate period, and is expected to stay lower for the duration of the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 35; *see also* Bliven *et al.*, REP-12-E-BPA-12, at 13. While Alcoa may be correct that BPA cannot guarantee that under every conceivable circumstance the IP rate will always be lower than it could otherwise be had BPA implemented the traditional REP, BPA does not believe that such a showing is necessary. *See* Issue 3.5.1.

Second, Alcoa’s argument that BPA must guarantee that the IP rate will be lower under each year of the Settlement is even less compelling when considering that Alcoa has no basis to claim that BPA *must* serve Alcoa’s power needs for the entire period covered by the Settlement. At present, BPA and Alcoa have a contractual arrangement that provides for BPA (consistent with the terms of the contract) to serve Alcoa through May 2012, with an additional five to six years contingent on certain conditions being met. BPA intends to perform its obligations under Alcoa’s current contract in accordance with its terms. However, there may come a time when BPA will no longer have a contractual obligation to serve Alcoa. Despite Alcoa’s contention that there is no “guarantee” that Alcoa will actually benefit from lower rates over the 17 years, Alcoa Br. Ex., REP-12-R-AL-01, at 4, it is not certain that BPA will continue to serve Alcoa after the expiration of its current contract. Although there are many unsettled questions with the analysis BPA must perform before determining whether to engage in power service arrangements with Alcoa and other DSIs, one matter has been definitively settled by the Court: BPA is authorized, *but not obligated*, to sell power to Alcoa and other DSIs. As noted by the Ninth Circuit:

We conclude, in sum, that BPA's interpretation of the [Northwest Power Act] as authorizing but not obligating the agency to sell nonsurplus firm power to the DSIs is a reasonable one. We therefore reject both the Cooperative's contention that such sales are prohibited and Alcoa's contention that BPA has an ongoing obligation to sell power to the DSIs under § 839c(d)(1).

*Pac. Nw. Generating Coop., et al. v. Dept. of Energy*, 550 F.3d 846 (9th Cir. 2008), *amended on denial of reh’g*, 580 F.3d 792 (9th Cir. 2009) (*PNGC I*); *see also Pac. Nw. Generating Coop., et al., v. Bonneville Power Admin.*, 580 F.3d 828 (9th Cir. 2009), *amended on denial of reh’g*, 596 F.3d 1065, 1074 (9th Cir. 2010) (“[T]he panel in *PNGC I* agreed with BPA that it has no statutory obligation to sell power to Alcoa.”) (emphasis added).

Alcoa has claimed that its key interest in this case is not to be the “spoiler” of the Settlement, but rather to secure a long-term power supply from BPA to ensure the life of its local smelter. Alcoa Br. Ex., REP-12-R-AL-01, at 8, 50. BPA understands Alcoa’s interest, but questions why Alcoa believes it can achieve this objective through opposing a Settlement that provides regional stability to a program that has been embroiled in contentious and destabilizing litigation for over a decade. Alcoa’s objections make even less sense when considering that nearly all BPA ratepayers benefit under the Settlement through lower rates, *including Alcoa* (when compared to the no-settlement alternative). *See* Issue 6.5.2 (noting Alcoa will save \$7.4 million over the FY 2012–2013 rate period alone if the Settlement is adopted).

## **Decision**

*Section 7(c) is not addressed by the Settlement. Portions of the IP rate affected by the Settlement are related to sections 7(b)(2) and 7(b)(3). In this ROD, BPA determines that the Settlement complies with the section 7(b)(2) and 7(b)(3) statutory rate directives. The issues raised by Alcoa regarding the Settlement and the IP rate have been properly addressed by BPA.*

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## 6.0 TREATMENT OF REFUND AMOUNTS UNDER SETTLEMENT

### 6.1 BPA's Lookback Amount Construct

#### 6.1.1 Origin of the Lookback Amounts

In *PGE*, 501 F.3d 1009 (9th Cir. 2007), the Ninth Circuit held that the 2000 REP Settlements executed by BPA and the IOUs were inconsistent with the Northwest Power Act. In a companion case, *Golden NW*, 501 F.3d 1037 (9th Cir. 2007), the Ninth Circuit remanded the WP-02 power rates to BPA on the grounds that BPA improperly allocated the costs of the 2000 REP Settlements, as amended, to BPA's preference customers. Although the Ninth Circuit's decision in *Golden NW* addressed only the WP-02 rates, the WP-07 wholesale power rates were implicated by the decisions because they contained the same infirmity identified by the Ninth Circuit. See WP-10 ROD, WP-10-A-02, at 379.

To respond to the Ninth Circuit's decisions, BPA revisited its WP-02 and WP-07 rate case assumptions through a comprehensive "Lookback" construct. *Id.* As explained in the WP-07 Supplemental ROD, the Lookback construct compared the amounts paid under the 2000 REP Settlements for FY 2002–2008 with the amounts BPA would likely have paid qualifying IOUs under the traditional operation of the REP. *Id.*; see also WP-07 Supplemental ROD, WP-07-A-05, at 165. The difference between these two amounts, subject to certain specified rules, is generally referred to as the "Lookback Amount." *Id.*; see also FY 2002–2008 Lookback Study, WP-07-FS-BPA-08, Chapters 13-15.

In the WP-07 Supplemental ROD, BPA determined that the total Lookback Amount owing from the IOUs (and payable as refunds to the COUs) was approximately \$1.003 billion, which was later revised to \$985 million. See Lookback Recovery and Return, WP-10-FS-BPA-07, at 3, Table 1.<sup>19</sup> To refund this amount to the COUs, BPA provided the COUs an initial cash payment of approximately \$256 million, which refunded all overcharges to the COUs for rates charged in FY 2007–2008. *Id.* at 61; see also FY 2012–2013 Lookback Recovery and Return Study, REP-12-E-BPA-03, at 3. The remaining \$746 million in outstanding Lookback Amounts was associated with overcharges incurred by the COUs that purchased power from BPA at the PF-02 rate in effect during the WP-02 rate period (FY 2002–2006). *Id.* at 186. The \$746 million Lookback Amount was an aggregate calculation; each IOU was responsible for a portion of this total based upon the amount of overpayments it received under the 2000 REP Settlements. See Gendron *et al.*, REP-12-E-BPA-04, at 11. BPA planned to recover the Lookback Amounts from the IOUs over time by reducing each IOU's future REP benefit payments. See WP-07 Supplemental ROD, WP-07-A-05, at 256-260. In addition, in each subsequent rate case, BPA would decide whether or not to apply the "50 percent rule," which limits the amount of REP

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<sup>19</sup> The COUs were overcharged approximately \$746 million from FY 2002 through 2006. See Lookback Recovery and Return, WP-10-FS-BPA-07, at 3. The COUs were overcharged an additional \$257 million from FY 2007 through 2008. *Id.* The sum of these two figures (\$1.003 billion) is BPA's calculation of the total overcharges. This number was slightly revised to \$985.2 million after BPA and Avista reached a settlement over Avista's deemer balance. *Id.*

benefits an IOU applies to its Lookback Amount to 50 percent of the REP benefits the IOU is eligible to receive. *Id.* at 263-276. This method of recovery made recouping Lookback Amounts highly dependent upon the amount of future REP benefits each IOU would receive from BPA. Gendron *et al.*, REP-12-E-BPA-04, at 11. The REP benefits withheld from the individual IOUs were then used to supply the funds from which BPA would pay refunds to the COUs. BPA also decided to assess interest on the outstanding Lookback Amounts. *See* WP-07 Supplemental ROD, WP-07-A-05, at 207-216.

In the WP-07 Supplemental ROD, BPA also addressed how it would distribute the Lookback Amounts among the COUs. *See* WP-07 Supplemental ROD, WP-07-A-05, at 279-280. Initially, BPA proposed to provide these refunds as an across-the-board rate reduction to all PF rate customers, regardless of whether the COU paid the PF-02 rate or not. *Id.* This proposal was vigorously opposed by certain parties, however, because it meant spreading the refunds to COUs that did not “suffer[ ] the harm created by the inclusion of the REP settlement costs in the PF-02 rates.” *Id.* at 280. BPA found these objections well founded, because not all COUs purchased power from BPA during the WP-02 rate period at the PF-02 rates. *Id.* Instead, some COUs purchased power under special negotiated rates that shielded these customers from the costs of the 2000 REP Settlements. *Id.*

In light of the differing effects the 2000 REP Settlements had on BPA’s customers, BPA decided to adopt a more targeted approach to returning the refunds. *Id.* Instead of an across-the-board reduction to the PF rate on a going-forward basis, BPA chose to provide a credit, based on each COU’s percentage share of total PF-02 revenues paid during the FY 2002–2006 period, to the power bills of the individual COUs that paid the PF-02 rate. *Id.* BPA explained that this approach was reasonable because it targeted the refunds to those COUs that actually paid the PF-02 rates (and therefore were injured by the 2000 REP Settlements), and excluded COUs and other parties that were not harmed by the 2000 REP Settlements in rates. *Id.* at 281-282.

### **6.1.2 Rate Treatment of Lookback Amounts and REP Benefits**

In the WP-07 Supplemental ROD, BPA also described how it intended to treat the Lookback Amount recoveries in ratemaking. Specifically, BPA proposed to determine the IOUs’ REP benefits through a two-step process. First, BPA would determine the total amount of REP benefits the IOUs would be entitled to for the rate period using the traditional REP parameters: the IOUs’ ASCs and exchange loads, BPA’s Base PF Exchange rate, the section 7(b)(2) rate test, and the section 7(b)(3) surcharges. *See* Bliven *et al.*, REP-12-E-BPA-12, at 18-19. This calculation produced what BPA referred to as the *total REP benefits* (also referred to as “amount of REP benefits included in rates” or “REP benefits before setoff”). *Id.* at 19. Once the total REP benefits were calculated, BPA would set final rates for all rate classes (including the PF and IP rates) to collect this amount of REP costs. *Id.* at 19. The second step to determining the IOUs’ REP benefits occurred during the administration of the parties’ power bills. *Id.* In this step, BPA would withhold a portion of the REP benefit payments to the IOUs in order to pay down each IOU’s Lookback Amount and to provide credits on the power bills of the COUs that paid the PF-02 rates. *Id.*; *see also* WP-07 Supplemental ROD, WP-07-A-05, at 282. The amount of REP benefits actually sent to the IOUs net of the amounts withheld by BPA to repay

Lookback Amounts is referred to as *REP benefits paid* (also referred to as “net” REP benefits and “REP benefits paid”). *Id.*

## **6.2 Challenges to BPA’s Lookback Construct**

Following BPA’s issuance of the WP-07 Supplemental ROD, COUs and IOUs alike vigorously opposed BPA’s Lookback construct. In general, the COU litigants argued that the actual quantification of the overcharges the COUs incurred as a result of the 2000 REP Settlements yielded a sum far greater than BPA’s calculation. *See* Evaluation Study, REP-12-FS-BPA-01, section 9.2. The COUs also contested BPA’s proposal to consider in each rate case the amount of REP benefits to withhold from the IOUs, arguing that this approach left too much discretion to BPA and was too slow in returning refunds to the injured COUs. *Id.* The IOU litigants, on the other hand, argued that no refunds were due at all. *Id.* These parties also argued that BPA had no authority to withhold REP benefits and was in breach of the 2000 REP Settlements by seeking refunds from the IOUs in the first place. *Id.* Various parties also challenged the interest rates BPA was applying to the outstanding Lookback Balance and BPA’s decision to permit the IOUs to retain a “reasonable” amount of REP benefits each rate period. *See generally* Evaluation Study Documentation, REP-12-E-BPA-01A, at 392-94, 396-400. Although virtually every aspect of BPA’s Lookback construct was attacked in the litigation, no party appealed BPA’s decision to provide the Lookback Amount refunds as credits to the power bills of the COUs that paid the PF-02 rates.

A year after issuing the WP-07 Supplemental ROD, BPA commenced a section 7(i) proceeding to establish power rates for the FY 2010–2011 period (WP-10). In the WP-10 rate proceeding, BPA followed the directions set forth in the WP-07 Supplemental ROD and established rates (including the PF and IP rates) to collect the total cost of REP benefits permitted by section 7(b)(2). BPA again proposed to withhold a portion of these REP benefits to fund refund payments to the COUs that paid the PF-02 rates. *See* WP-10 ROD, WP-10-A-02, at 379-389. Parties to the WP-10 proceeding challenged a number of issues pertaining to BPA’s Lookback Amount decisions, including whether BPA could withhold REP benefits at all and the amount of REP benefits being withheld. *Id.* at 380-421. No party contested BPA’s decision to base the PF and IP rates on the full cost of the REP, however, or BPA’s decision to target the Lookback Amount refunds to the COUs that paid the PF-02 rates as individual credits on power bills. *Id.*

By the end of FY 2011, BPA will have returned to the COUs \$587 million in refund payments under the Lookback construct. *See* FY 2012–2013 Lookback Recovery and Return Study, REP-12-E-BPA-03, at 5. This includes \$256 million in refunds provided in FY 2009 for repayment of all overcharges incurred in FY 2007–2008 and \$317 million in refund payments paid during FY 2009–2011, including accumulated interest. *Id.* at 6. The total remaining Lookback Amount as of the end of FY 2011, under BPA’s calculations, is approximately \$511 million. *Id.* at 7.

### **6.3 BPA’s Evaluation Criteria**

In developing the three primary and two secondary criteria to apply to its review of the Settlement, BPA considered it important to evaluate the Settlement in light of BPA’s previous findings that not all parties were equally harmed by the 2000 REP Settlements. To that end, BPA developed two criteria to specifically address whether the Settlement properly considered the past issues of refunds and overcharges associated with the FY 2002–2007 period. The third primary criterion is as follows:

(3) the Settlement would resolve, in a fair and equitable manner, all of the outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period[.]

Evaluation Study, REP-12-FS-BPA-01, section 11.2. The first secondary criterion is as follows:

(1) the Settlement would recognize that not all COUs were equally harmed by the costs of the 2000 REP Settlements and that IOUs’ respective residential consumers were differentially affected by BPA’s setting off REP benefits for Lookback Amounts[.]

*Id.*

### **6.4 The 2012 REP Settlement and the Refund Amounts**

#### **6.4.1 Origins of Refund Amounts**

As noted earlier, the Settlement resolves the existing challenges pending before the Court over BPA’s implementation of the REP for a period of 27 years, beginning in FY 2002. The Settlement settles BPA’s past implementation of the REP from FY 2002 to the present, including BPA’s decision to conduct the Lookback. In place of BPA’s Lookback construct, the Settlement contains (among other terms) two primary features: (1) a fixed stream of “paid” REP benefits to the IOUs, and (2) a fixed stream of refunds to the COUs (which are derived from withheld REP benefits).

The fixed stream of “paid” REP benefits to the IOUs was negotiated by representatives of the IOUs and COUs with the intent of reaching a mutually agreeable resolution of all outstanding claims. In determining the level of these future REP benefits, the fixed stream of future REP benefits was set “net” of the outstanding refunds owed for the WP-02 rate period. Murphy and Kallstrom, REP-12-E-JP02-04, at 9. That is, the schedule of REP benefits in Table 3.1 of the Settlement reflects an inherent discount for refunds that were to be paid by the IOUs to the COUs for overcharges associated with the WP-02 rate period. *Id.*

Part of the discount in the IOUs’ REP benefits is identified in section 3.2 of the Settlement and is referred to as “Refund Amounts.” Although the COUs dispute the level of BPA’s Lookback Amount, they generally retained the Lookback refund construct in the Settlement to recognize that between FY 2002 and FY 2006 the COUs as a class experienced differently the effects of the overcharges associated with the 2000 REP Settlements that BPA included in rates. Murphy

and Kallstrom, REP-12-E-JP02-04, at 9-10. Retention of some recognition of past overcharges was understandable, because COUs that were primarily overcharged under the WP-02 rates (FY 2002–2006) were still owed (under BPA’s disputed Lookback calculation) a substantial amount of refunds (approximately \$511 million). *See* FY 2012–2013 Lookback Recovery and Return Study, REP-12-E-BPA-03, at 7. To reflect this differing treatment, the settling parties retained in Table 3.2 of section 3.2 the targeted refund construct with the return of Refund Amounts, the Settlement’s version of BPA’s Lookback Amounts. *See* Settlement, REP-12-A-02A, § 3.2. Under Table 3.2, the COUs will receive \$76.5 million in fixed Refund Amount payments for a period of eight years, beginning in FY 2012 and continuing until FY 2019. *Id.* In total, the COUs will receive an additional \$612 million in Refund Amount payments under the Settlement. *Id.* The \$612 million roughly reflects BPA’s calculation of the outstanding Lookback Amount payments (\$511 million), adjusted for interest earned over eight years. Gendron *et al.*, REP-12-E-BPA-04, at 32. By including the schedule of Refund Amounts in the Settlement, the settling parties were not attempting to “increase customers’ rates for power delivered in the future,” but rather were using the Refund Amounts as a “a mechanism to get the refunds for past overcharges into the right hands.” Murphy and Kallstrom, REP-12-E-JP02-04, at 9-10. With the return of Refund Amounts, the total refund payment BPA will have made to the COUs will be approximately \$1.2 billion. *See* Gendron *et al.*, REP-12-E-BPA-04, at 33.

The total costs of the REP provided under the Settlement are the combined total of the Scheduled Amounts in Table 3.1 and the Refund Amounts in Table 3.2. *See* Bliven *et al.*, REP-12-E-BPA-12, at 35; *see also* Murphy and Kallstrom, REP-12-E-JP02-04, at 9. Combined, the Settlement refers to these amounts as “REP Recovery Amounts.” *See* Settlement, REP-12-A-02A, § 3.3.

#### **6.4.2 Rate Treatment of Refund Amounts and Scheduled Amounts Under the Settlement**

Although the Settlement uses somewhat different terms, BPA would implement the Settlement’s refund construct in ratemaking in essentially the same way BPA has implemented the Lookback Amount construct developed in the WP-07 Supplemental and WP-10 rate proceedings. Gendron *et al.*, REP-12-E-BPA-04, at 11; Bliven *et al.*, REP-12-E-BPA-12, at 20-21. That is, BPA would first set rates to recover the total REP benefits. *Id.* In this instance, the *total REP benefits* would be equivalent to the REP Recovery Amounts, which are comprised of a combination of the amounts identified in sections 3.1 (Scheduled Amounts) and 3.2 (Refund Amounts) of the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 11. Next, BPA would withhold an amount of REP benefits equal to the fixed schedule set forth in the Refund Amount. *Id.* The withheld funds would be distributed to the COUs through credits on power bills. *Id.* The remaining REP benefits, referred to in the Settlement as the Scheduled Amounts, would be the amount of *REP benefits paid* to the IOUs. Bliven *et al.*, REP-12-E-BPA-12, at 21.

One feature of ratesetting will be different under the Settlement than under BPA’s previous approach to the Lookback in order to lessen the administrative burden of implementing the Refund Amounts. As noted above, the determination of individual IOU setoff amounts was based on several factors: the Lookback balance, the expected amortization period, and the size of

the setoff amount compared to the eligible REP benefits. WP-07 Supplemental ROD, WP-07-A-05, at 253-295. Because of these factors, setoff amounts were customized for each IOU and were determined in each rate proceeding. Bliven *et al.*, REP-12-E-BPA-12, at 22-23. The actual setoff of the IOUs' REP benefits occurred outside of ratesetting, when BPA produced bills for the IOUs.

Under the Settlement, this customized process is no longer necessary. *Id.* In order to demonstrate that the Refund Amounts are being set off against the REP benefits of the IOUs, BPA has moved this administrative setoff process into the ratesetting of the PF Exchange rates. *Id.* The setoff factors are no longer a consideration, so for convenience BPA has chosen to reflect the setoff amounts as a part of the utility-specific PF Exchange rates. *Id.* Therefore, BPA will set off the aggregate Refund Amount cost against the aggregate IOU REP benefits, distributing the aggregate setoff amounts to the individual IOUs on a pro rata basis in a manner similar to the allocation of rate protection costs. *Id.* The allocation of the Refund Amount cost is added to each IOU's allocation of rate protection costs and included in each IOU's 7(b)(3) surcharge. *Id.* As a result, BPA can now show each IOU the REP benefits it will be paid within the ratesetting process rather than waiting for a separate determination after rates are finalized. *Id.* Also, this treatment allows the REP Recovery Amounts to be treated as REP costs subject to the 7(b)(2) rate test and requires such amounts to be shown to be less than the rate ceiling.

While the Settlement resembles BPA's previous method for returning Lookback Amounts, it also includes a number of improvements that will ensure repayment. For one, the fixed nature of the Refund Amounts provides a substantial amount of certainty to the COUs. Unlike BPA's previous approach to returning Lookback Amounts to the COUs, the Refund Amounts will not be subject to adjustment by the Administrator. *See Gendron et al.*, REP-12-E-BPA-04, at 11, 32-33. Moreover, the Refund Amounts will be refunded from the IOUs as a class, thereby eliminating the previous concern with refund payments being dependent upon a specific IOU becoming eligible for REP benefits. *Id.* Finally, the Refund Amounts will be returned within a defined period: eight years. BPA could not provide a similar guarantee of repayment for the Lookback Amounts due to variations in the REP benefits of individual IOUs. *See Gendron et al.*, REP-12-E-BPA-04, at 32-33.

Distribution of the Refund Amount to the COUs under the Settlement will also be modified to the benefit of some members of the COU class. The Refund Amounts will be returned to each COU based on its Customer-Specific Tier 1 Refund. *Id.* at 13. This Customer-Specific Tier 1 Refund will be calculated by multiplying 50 percent of the Refund Amount for each year by the PF-02 Customer Percentage set forth in Exhibit B of the Settlement plus 50 percent of the Refund Amount multiplied by the Tier 1 Customer TOCA Share, which is the COU's TOCA divided by the sum of all TOCAs. *Id.* The effect of this new method for distributing the Refund Amounts is to widen the class of COUs that will receive refund credits from BPA.

## **6.5 Issues**

### **Issue 6.5.1**

*Whether the Refund Amounts provided under the Settlement are properly being characterized as REP costs pursuant to sections 5(c) and 7(b) of the Northwest Power Act.*

#### **Parties' Positions**

APAC, WPAG, and Alcoa argue that the Refund Amounts provided for under the Settlement are not being paid by the IOUs. APAC Br., REP-12-B-AP-01, at 11-12; WPAG Br., REP-12-B-WG-01, at 35-38; Alcoa Br., REP-12-B-AL-02, at 27. APAC claims the Refund Amounts do not reflect a reduction in REP benefits to the IOUs and therefore are not a return of the outstanding Lookback Amounts. APAC Br., REP-12-B-AP-01, at 11; APAC Br. Ex., REP-12-R-AP-01, at 11. WPAG similarly argues that the IOUs are not paying for the Refund Amounts, and claims that instead the parties have artificially inflated the PF rate to redistribute refunds among the COUs. WPAG Br., REP-12-B-WG-01, at 38. Alcoa argues that the IOUs (which were the only beneficiaries of the REP overpayments) should bear full responsibility for repaying the COUs. *See* Alcoa Br., REP-12-B-AL-02, at 27.

#### **BPA Staff's Position**

The Refund Amounts are funded by reductions in the IOUs' REP benefits. Bliven *et al.*, REP-12-E-BPA-12, at 20. The Scheduled Amounts provided for in the Settlement reflect a discount for satisfaction of outstanding Lookback Amounts. *Id.* at 21. Both the Agreement in Principle (AIP) and the negotiators who developed the Settlement are clear that the Scheduled Amounts were designed to be a "net" REP figure; they did not address the total costs of the REP that BPA would include in rates. Murphy and Kallstrom, REP-12-E-JP02-04, at 9. BPA has evaluated the Refund Amounts as REP costs for purposes of its evaluation of the Settlement and found, based on that evaluation, that including Refund Amounts in the Settlement does not violate the Northwest Power Act. Bliven *et al.*, REP-12-E-BPA-12, at 24. Furthermore, providing the Refund Amounts to the COUs as described in the Settlement reasonably returns the refunds to the COUs injured by the 2000 REP Settlements. *Id.* at 36.

#### **Evaluation of Positions**

APAC argues that the "Refund Amount" provided under the Settlement is not actually a refund of the Lookback Amounts, because it does not reduce the amounts the IOUs would otherwise receive. APAC Br., REP-12-B-AP, at 11. APAC observes that the AIP signed by BPA, the IOUs, and certain COUs establishes a net present value of total REP benefits of \$2.05 billion. *Id.* APAC claims that after the AIP was finalized, the COUs added the concept of "Refund Amounts" to address perceived inequities within their ranks and to provide a basis for fixing rates for other classes (*e.g.*, the IP rate). *Id.*

Alcoa raises a similar point, claiming that the IOUs (who were the only beneficiaries of the REP overpayments) should bear full responsibility for repaying the COUs. *See* Alcoa Br., REP-12-B-AL-02, at 27.

APAC and Alcoa's arguments are not persuasive. First, APAC and Alcoa are incorrect to assert that IOUs are not funding the Refund Amounts. As noted in the introduction to this section, the agreed-upon fixed stream of future REP benefits provided in the Settlement was set net of the outstanding refunds owed for the WP-02 rate period. Murphy and Kallstrom, REP-12-E-JP02-04, at 9. That is, the schedule of REP benefits in Table 3.1 of the Settlement reflects a discount for refunds that were to be paid by the IOUs to the COUs for overcharges associated with the WP-02 rate period. *Id.* Part of the discount in the IOUs' REP benefits is stated in section 3.2 of the Settlement, and is referred to as "Refund Amounts." As explained by the parties that negotiated the Settlement:

The IOUs pay for the Refund Amount in the form of Scheduled Amounts reduced to reflect their Lookback liabilities that are extinguished under the Settlement Agreement. ... [T]he payments to which the IOUs are entitled under the Settlement Agreement are *the net of a stream of future benefits reduced to reflect a refund to the COUs to offset claimed overcharges from FY 2002 through FY 2011.* The Refund Amounts, which are paid for by the IOUs by these reductions to the Scheduled Amounts, are refunded to COUs under section 3.4 of the Settlement Agreement in a manner that most of the COUs agreed fairly reflected the individual COUs entitlement to refunds.

*Id.* (emphasis added). The parties could have simply used BPA's nomenclature, and referred to the REP Recovery Amounts as "aggregate REP benefits," the Refund Amounts as "Lookback Amounts," and the amount of Scheduled Amounts as "REP benefits paid." *See Bliven et al.*, REP-12-E-BPA-12, at 21. However, they chose not to because it was simply easier to describe the intended outcome in the Settlement rather than the ratesetting rationale and methods used to obtain that outcome. Rather than confuse the Settlement outcomes with BPA's ratesetting rationale and methods, the Settlement uses different terms to accomplish its outcome by referring to "Scheduled Amounts" rather than REP benefits, from which Refund Amounts would need to be subtracted to ascertain the net amounts available for the IOUs. *See* Murphy and Kallstrom, REP-12-E-JP02-04, at 10. But, for purposes of establishing rates, it is clear that Refund Amounts "would need to be added to the Scheduled Amounts to ascertain the forward looking REP benefits." *Id.* JP02 states that it was always intended that, for purposes of Settlement sections 3.3–3.5, the "Refund Amounts are treated just like the refunds BPA is currently paying to COUs." Murphy and Kallstrom, REP-12-E-JP02-02, at 26.

BPA agrees with JP02's characterization of the Refund Amounts. Implementing the Refund Amount construct in rates will occur in much the same way as BPA implements the current Lookback Amounts. Gendron *et al.*, REP-12-E-BPA-04, at 11. Rates will be set to recover the total REP benefits (REP Recovery Amounts). In this instance, the total REP benefits will be the combination of the amounts identified in sections 3.1 (Scheduled Benefits) and 3.2 (Refund Amounts) of the Settlement. *Id.* at 11-12. Of this amount, BPA will withhold an amount of IOU REP benefits equal to the Refund Amount. *Id.* at 12. The withheld funds will be distributed to the COUs through credits on power bills. *Id.* The IOUs will be paid the remaining REP benefits (Scheduled Amounts). *Id.* During the process of computing and allocating the cost of rate protection to the PF Exchange rates, the Refund Amount will be incorporated into the

PF Exchange rates in such a way that the combination of allocated rate protection costs and Refund Amounts will result in the Scheduled Benefits being paid to the IOUs. *Id.*

APAC claims that after the AIP was finalized, the COUs added the concept of “Refund Amounts” to address perceived inequities within their ranks and to provide a basis for fixing rates for other classes. APAC Br., REP-12-B-AP-01, at 11. It is interesting to note that APAC apparently believes it knows more about what the parties intended in the AIP and the Settlement than the parties themselves. The AIP was a framework from which the parties developed the ultimate Settlement and, in that framework, the parties *expressly considered* the notion of the Refund Amounts. In section 2(E) of the AIP, the parties agreed that:

The Settlement Documents may provide for a methodology for allocating the *REP-related cost* of the Settlement to be recovered from the COUs. In no event, however, will such provision alter the REP Settlement Amount to be paid to the Settling IOUs.

AIP, REP-12-E-BPA-01B, at 5 (emphasis added). The parties did not assign a dollar figure to the refund contemplated in section 2(E) because the parties’ focus in the AIP was to determine the net present value of REP benefits the IOUs would receive to settle all claims. In this regard, the AIP did not address the year-to-year amount of “net” REP benefits the IOUs would receive or the amount of REP benefits BPA would include in rates as a result of the Settlement. All the parties agreed to in the AIP was that IOUs would, on a net basis, receive \$2.05 billion net present value in REP benefits under the Settlement over a 20-year term. How these REP benefits would be paid was resolved in the following months as representatives of the COUs and IOUs developed the details of the final Settlement. The AIP, however, was clear that some recognition for past overcharges would be accounted for in the final Settlement, and such costs, when quantified, would in all respects be considered “REP-related costs of the Settlement.”

APAC cites testimony presented in this case that claims that the increase to the PF rate could be eliminated in its entirety and the REP payments to the IOUs under the Settlement would not change. APAC Br., REP-12-B-AP-01, at 11-12. While this observation is mechanically correct, it is of little import. The COUs involved in the negotiation were clear that the agreed-upon value for REP benefits was designed to be “net” REP benefits. Murphy and Kallstrom, REP-12-E-JP02-04, at 9; *see also* AIP, REP-12-E-BPA-01B, at 6. As such, in developing the Scheduled Amounts, the COUs viewed these amounts as reflecting an inherent discount for the claims the COUs had to outstanding refunds for the period FY 2002–2006. Murphy and Kallstrom, REP-12-E-JP02-04, at 9-10. The quantification of those claims came in section 3.2.

Indeed, it would have made little sense for the COUs to agree to a Settlement that would have set rates based on only the “net” amount of REP benefits payable to the IOUs. By doing so, they would be effectively diluting their own refund and sharing it with other customers of BPA, many of whom were not injured by the 2000 REP Settlements. *Id.* at 9. It also would have made no sense for the IOUs to agree to have their agreed-upon value for future REP benefits reduced by an additional \$612 million for Refund Amount payments. Had the IOUs done so, the resulting REP benefit level (assuming a NPV figure) would have been \$1.7 billion, much closer to the COUs’ brief case position. *See* Evaluation Study, REP-12-FS-BPA-01, Tables 4.1 and 4.2. It

defies common sense to argue that the IOUs should have been required to receive a level of REP benefits under the Settlement that essentially codifies the level of REP benefits that the IOUs would receive if they lost most of their issues in litigation. The IOUs have not conceded that they owe any Lookback Amounts; attempting to have the IOUs agree to any quantification simply to address the COUs' redistribution concerns would have seriously jeopardized the Settlement.

APAC argues that the preference customer rates required by the Settlement include collection of a Refund Amount from the preference customers. APAC Br., REP-12-B-AP-01, at 11. APAC claims that except for some possible recovery of Refund Amounts from the Surcharged Rates, the preference customers will pay for the refunds being provided through increased rates. *Id.* This is incorrect. The "Refund Amounts" are not a cost in BPA's rates. Bliven *et al.*, REP-12-E-BPA-12, at 19. Instead, the Lookback Amounts/Refund Amounts are being allocated to the utility-specific PF Exchange rates that BPA will be charging to the IOUs alone. *Id.* at 22-23. In this regard, there is no "line item" in BPA's revenue requirement where Lookback Amount costs (or Refund Amounts) are either allocated to the IOUs or returned to the COUs. *Id.* at 20. The only REP-related costs in the revenue requirement are exchange resource costs and program support costs. *Id.* at 23. There is no "possible recovery of Refund Amounts from the Surcharged Rates;" the REP Surcharge is a recovery of rate protection costs. APAC has cited no evidence in the record where BPA includes the Lookback Amount/Refund Amount as a *cost* in the PF *rate*. APAC will find none. Rather, BPA treats the "Refund Amounts" as part of the costs of the REP, just as aggregate REP benefits are calculated today.

APAC reiterates its concern that the Refund Amounts are to be paid to the COUs from revenues collected from the COUs. APAC Br. Ex., REP-12-R-AP-01, at 11. APAC claims that this circular process renders the Refund Amounts merely a method for redistributing funds among the COUs. *Id.* APAC claims that because the funds come from PF rates, the Refund Amounts cannot be characterized as payments from the IOUs. *Id.* APAC's observation that Refund Amounts BPA pays come from its rates is of little import. BPA cannot make refund payments without first collecting the funds in rates. In this way, all payments BPA makes are in a way a "redistribution" of funds among its customers. Currently, BPA is collecting the funds by withholding REP benefits from the IOUs to provide Lookback Amounts to the COUs. These REP benefits are included in rates just as Refund Amounts will be included in rates under the Settlement. As will be discussed in Issue 6.5.4, BPA's current construct was developed from APAC's own testimony in the WP-07 Supplemental proceeding, but APAC did not claim in that case that its method effectively had the COUs paying for their own refunds. Inasmuch as the COUs are paying for their own refund under APAC's preferred construct in current rates, they are paying the same under the Settlement.

APAC claims that BPA has agreed to adjust its rates solely at the request of its customers—an action for which APAC claims BPA has no statutory authorization. APAC Br., REP-12-B-AP-01, at 11. WPAG raises a similar concern, claiming that the Refund Amount is nothing more than an increase to the PF rate agreed to by some, but not all, of BPA's preference customers in order to redistribute the costs and benefits of the Settlement in a manner that they prefer. WPAG Br., REP-12-B-WG-01, at 38. WPAG asserts that while these preference customers may

have the ability to make such redistributions amongst themselves, they do not have the right to do so through BPA's rates for preference utilities that are not parties to the Settlement. *Id.*

APAC and WPAG do not appear to understand the Settlement or BPA's ratemaking. The Settlement does not establish rates for any party. Rather, the Settlement resolves *one component* of BPA's ratemaking. (BPA would enter the Settlement only once it determined that the actions required by the Settlement are consistent with the law.) Provided that BPA settles that component in a manner consistent with the directives in the Northwest Power Act, no statutory violations will have occurred. In this case, BPA has treated the Refund Amounts as costs of the REP. Bliven *et al.*, REP-12-E-BPA-12, at 24 ("BPA has treated both the Scheduled Amounts and the Refund Amounts as REP benefits both in its ratemaking and for purposes of its analysis of the Settlement."). BPA's analysis has shown that even with these costs in the Settlement, the REP benefits provided under the Settlement are below what would likely occur in the absence of Settlement. *See* Gendron *et al.*, REP-12-E-BPA-04, at 36.

Moreover, the Refund Amounts are not amounts simply pulled from thin air. From BPA's viewpoint, the Refund Amounts have their source in the remaining balance of the Lookback Amount BPA calculated in the WP-07 Supplemental ROD. Bliven *et al.*, REP-12-E-BPA-12, at 36. As noted by Staff, the Settlement provides \$612 million in refunds, which is equivalent to the outstanding Lookback Amount of \$511 million adjusted for interest over eight years. *See* Gendron *et al.*, REP-12-E-BPA-04, at 32. Thus, the REP cost adjustment associated with the Refund Amounts is not without a foundation. Although it is not adoption of BPA's prior determination, it reflects the parties' recognition that between the discount in the IOUs' REP benefits and the Refund Amounts in section 3.2, equity among the COUs has been achieved.

APAC argues that by permitting the majority of the COUs and IOUs to determine the Refund Amounts in the Settlement, BPA "is turning over its ratemaking authority to the settling COUs, allowing them to dictate a particular ratemaking procedure in order to re-balance some inequities among themselves." APAC Br. Ex., REP-12-R-AP-01, at 11. In response, BPA notes first that BPA has not delegated any of the agency's authority to the COUs, IOUs, or any other entity. As stated in Issue 4.5.2, BPA has retained throughout this case the sole responsibility to determine whether or not the Settlement complies with the agency's statutory obligations. The analysis BPA describes in Issue 4.5.2 holds true for BPA's review of the Refund Amounts as well. The parties are not "dictating" anything to BPA. Indeed, the parties have, in many respects, simply included in the Settlement BPA practices that the agency has already found to be lawful. The calculation of rates on the total cost of the REP and the return of Refund Amounts to a subset of COUs are two such examples. Moreover, what the parties call the costs under the Settlement have very little bearing on BPA when setting rates. The record in this case is clear that, from a ratemaking standpoint, BPA always intended to treat all costs of the Settlement, regardless of the label the settling parties put on the payments, as REP costs. The parties did not "dictate" anything to BPA.

APAC and WPAG also misunderstand BPA's ratemaking. APAC asserts that "no additional costs will be recovered by the PF rate increase that will be charged to recover the Refund Amounts." APAC Br., REP-12-B-AP-01, at 11-12. WPAG similarly claims that the Refund

Amount is nothing more than an increase to the PF rate agreed to by some, but not all, of BPA's preference customers in order to redistribute the costs and benefits of the Settlement in a manner that they prefer. WPAG Br., REP-12-B-WG-01, at 38. These assertions are simply incorrect.

First, there will not be a *rate increase* as a result of the Refund Amounts and the Settlement. As Staff explained, the PF rate will *go down* as a result of the Settlement. *See* Bliven *et al.*, REP-12-E-BPA-12, at 33 (IOU REP costs under the Settlement for FY 2012-2013 that are in the PF-12 rate are \$24 million lower than without the Settlement; Evaluation Study, REP-12-FS-BPA-01, section 11.3.) This rate reduction will especially be felt by members of WPAG. As noted in more detail in Issue 6.5.7, some of WPAG's members have not been receiving Lookback Amount credits because these customers purchased power from BPA under rates that were not overcharged. However, under the Settlement, these customers *will* receive a credit. Thus, not only will all of WPAG's members experience an overall lower PF rate; they will also all be receiving a refund from BPA.

Second, from BPA's ratemaking perspective, *all* costs of the Settlement are properly considered to be costs of the REP. This is not only the logical way to approach the payments provided under the Settlement; it is required by the Court in *PGE*. As the Court noted:

whenever BPA engages in a purchase and exchange of power—whether on a yearly basis, under a REP program, or pursuant to a settlement agreement—BPA acts pursuant to its § 5(c) authority, and is thus subject to the Congressionally imposed limitations on that authority as expressed in § 5(c) and § 7(b).

*PGE*, 501 F.3d at 1032. Consequently, it does not matter what BPA or the parties call the payments under the Settlement. If the payments can fairly be ascribed to the REP, BPA must treat them as REP benefits and subject them to the restrictions set forth in Northwest Power Act sections 5(c) and 7(b). That is what BPA has done here. Consistent with the Court's direction, BPA treated the *total* payments provided under the Settlement (Scheduled Amounts *and* Refund Amounts) as REP benefits subject to the provisions of sections 5(c) and 7(b). *See* Bliven *et al.*, REP-12-E-BPA-12, at 21. As noted by Staff:

For purposes of our modeling and projections in the evaluation section of this case, we have treated the Refund Amounts as part of the REP benefits payable to the IOUs before setoff. In this way, we have ensured that the REP Recovery Amounts called for in the Settlement (*i.e.*, what BPA refers to today as REP benefits before setoff) have been considered and tested for compliance with the section 7(b)(2) rate test.

*Id.*; *see also id.* at 35. Based on that analysis, BPA has found that the Settlement's total aggregate REP costs do not violate the Northwest Power Act's statutory provisions and, as such, may be included in rates. *See* Gendron *et al.*, REP-12-E-BPA-04, at 36.

Assuming *arguendo* that APAC and WPAG were correct in their claims that BPA has agreed to adjust its rates at the request of some of its customers, BPA would not understand this concern. APAC Br., REP-12-B-AP-01, at 11; WPAG Br., REP-12-B-WG-01, at 38. WPAG itself (excluding four of its 22 members) is calling for BPA to decrease the PF Demand rate in the

BP-12 proceeding. WPAG Br., BP-12-B-WG-01, at 47-50. While BPA is considering WPAG's request in BP-12, BPA notes here that it frequently changes its rates to accomplish nothing more than a decrease to the PF rate agreed to by some, but not all, of BPA's preference customers, which may raise the rates of others (as long as it is consistent with the law) in order to redistribute the costs and benefits of the Federal system in a manner that they prefer. It sounds as if WPAG is asserting that, as preference customers, they do not have the right to ask BPA to shift costs among customers through BPA's rates to other preference utilities that do not agree with WPAG's request to shift costs. *See, e.g.*, JP01 Br., BP-12-B-JP01-01, at 6-17.

APAC also states that Northwest Power Act section 7(i) requires the Administrator to fully justify the rates being adopted. APAC Br., REP-12-B-BPA, at 12. APAC asserts that increasing rates to return a benefit to the same ratepayers paying the increase seems inherently unjustifiable. *Id.* APAC claims that such a result serves no purpose related to BPA operations. *Id.* Where rates are set by ratepayers, and are wholly unrelated to actual costs to be incurred by BPA, APAC claims the rate increase is by definition arbitrary and capricious. *Id.* For that reason alone, APAC asserts the Administrator cannot adopt the Settlement. *Id.*

BPA strongly disagrees with APAC's arguments. First, the record in this case supports a finding that the Settlement should be adopted. The Refund Amounts provided under the Settlement are not a foreign concept to BPA or to APAC. They are derived from the Lookback Amount construct BPA developed three years ago. The method for returning the Lookback Amounts was designed, in large part, *by APAC*. WP-07 Supplemental ROD, WP-07-A-05, at 280 ("APAC's alternative approach would create a total amount owed to each COU that paid the PF-02 rate based on each customer's annual percentage of BPA's total preference customer load."). Why APAC would now claim that the very construct it advocated three years ago is "inherently unjustifiable" is unclear to BPA. What is clear, though, is that the Lookback construct, which is retained in the Settlement in the form of Refund Amounts, serves the very important and real purpose of returning refunds to the customers that were injured by the 2000 REP Settlements. Returning refunds to the right customers is certainly justifiable and serves BPA's operational purposes.

As to APAC's claim that rates are "being set by ratepayers" in a manner "wholly unrelated to actual costs to be incurred by BPA," BPA has responded above. No rates are being set under the Settlement, and the allocation of costs under the Settlement has been found to be consistent with the directives of the Northwest Power Act. The costs identified as "Settlement costs" are actual costs of the REP (purchases of power from exchanging utilities at their ASCs net of revenues paid by the exchanging utilities at their PF Exchange rates), which BPA has determined do not violate the terms of the Northwest Power Act, and therefore may be collected in rates.

APAC contends that recognizing the IOUs agreed to accept fewer REP benefits to represent forgiveness of the remaining Lookback obligation is not equivalent to asserting that the IOUs are paying the amount to the COUs out of their otherwise available REP benefits. APAC Br. Ex., REP-12-R-AP-01, at 11. Otherwise, APAC claims, once the Refund Amounts were fully distributed after eight years, the REP benefits paid to the IOUs would suddenly escalate. *Id.*

WPAG raises a similar argument in its brief on exceptions. WPAG Br. Ex., REP-12-R-WG-01, at 46.

APAC's and WPAG's view of the Settlement is not convincing. BPA does not see a distinction between the IOUs agreeing to take a lower stream of REP benefits in return for extinguishing the Lookback Amounts and, using APAC's phrase, the "IOUs paying the amount to the COUs out of their otherwise available REP benefits." APAC Br. Ex., REP-12-R-AP-01, at 11. In both instances, the IOUs are entitled to something greater than they are receiving, but are agreeing to take less. APAC characterizes this as "forgiveness[ ]" of the Lookback Amount, but that is not the correct term. Forgiveness implies the IOUs are receiving absolution from paying the Lookback Amounts without a cost to them. That is not so. As noted above, for FY 2012–2013, in adopting the Settlement, the IOUs are taking an immediate reduction in their otherwise available REP benefits. Again, these are REP benefits that BPA would be paying to the residential and small farm consumers of the IOUs. However, the IOUs are agreeing to take less than they are statutorily entitled to (under BPA's view of the REP) for the next rate period and the ensuing 15 years for the certainty afforded by the Settlement. As Staff's analysis indicates, the reduction the IOUs are likely taking is substantial. All the Settlement does is quantify a portion of the reduction the IOUs have taken in the form of Refund Amounts.

APAC and WPAG claim that if the IOUs were truly paying the Refund Amounts, then once they were fully distributed after eight years, the REP benefits paid to the IOUs would suddenly escalate. APAC Br. Ex., REP-12-R-AP-01, at 11; WPAG Br. Ex., REP-12-R-WG-01, at 46. The record in this case does not describe why the Settlement contains the particular tilt in the REP Recovery Amounts established in the Settlement. This is not surprising, because APAC and WPAG raise this issue for the first time in their briefs on exceptions. To the extent these parties intend to argue that the particular "tilt" of REP costs in the Settlement demonstrates for some reason that the IOUs are not paying the Refund Amounts, such arguments have been waived and may not be raised in briefs on exceptions. *See Procedures Governing BPA Rate Hearings*, § 1010.13(b), (c).

But even if such arguments were appropriate, APAC's and WPAG's observation is of little import. These general observations do nothing more than comment on the "tilt" of REP payments the parties adopted in the Settlement. The idea of tilting the REP benefits was first considered in the AIP. *See* AIP, REP-12-E-BPA-01B, § 2(A) ("The Parties will negotiate in good faith a 'tilted' schedule of payments of the foregoing REP benefits."). The parties certainly could have structured the tilt in the Settlement just as suggested by APAC and WPAG. That is, REP benefits paid to the IOUs could have been lower in the early years of the Settlement, and once the Refund Amounts were paid off, jumped to a new level. But simply because the parties could have structured the tilt of the Settlement's REP costs differently does not establish that the IOUs have not agreed to a discount of REP benefits that reflects the repayment of Refund Amounts. The parties that negotiated the AIP and Settlement contend that the REP benefits paid to the IOUs under the Settlement are "net" of refunds. *See* Murphy and Kallstrom, REP-12-E-JP02-04, at 9-10. BPA's own analysis concurs with this assessment, because the IOUs are taking a significant discount in their REP benefits over what BPA would provide to the IOUs in the

no-settlement alternative. Looking at this record in this case, there can be little doubt that the IOUs have paid for the Refund Amounts through reductions in REP benefits.

WPAG claims that BPA's attempt to draw a parallel between the Lookback Payments and the Refund Amounts is inaccurate. WPAG Br., REP-12-B-WG-01, at 36; WPAG Br. Ex., REP-12-R-WG-01, at 44. WPAG claims that the key difference between the two concepts is that under the Lookback construct the IOUs pay for the refunds, while under the Settlement, the preference customers pay for the refunds. WPAG Br., REP-12-B-WG-01, at 36. For support, WPAG argues that the REP benefits the IOUs are entitled to under the Settlement did not change between the AIP and the final Settlement documents. *Id.* at 37-38. Had the IOUs really paid for the Refund Amounts, WPAG contends, the Scheduled Amounts set forth in the Settlement would have been reduced by an additional \$608 million. *Id.*

As already noted above, the REP benefits referred to in the AIP and the Settlement were always intended to be “net” of the amounts withheld for purposes of repaying refunds. Murphy and Kallstrom, REP-12-E-JP02-04, at 9-10. There is nothing in the AIP that suggests that in developing the “net” amount of REP benefits the COUs had given up on recouping past refunds from the IOUs. Far from it; the AIP expressly recognizes that such refunds could be a component of the final Settlement. AIP, REP-12-E-BPA-01B, § 2(E).

WPAG claims that it is “inaccurate” to draw a parallel between the Lookback Amounts and the Refund Amounts. WPAG Br., REP-12-B-WG-01, at 36. The record in this case, however, does not support WPAG's claim. The Lookback Amounts are recovered through reduced REP benefits to the IOUs, and so too are the Refund Amounts. The Lookback Amounts are intended to return refunds to the parties injured by the WP-02 rates, and so too are the Refund Amounts. The outstanding Lookback Amounts are approximately \$511 million, and the total of the Refund Amounts roughly reflects that same amount adjusted for interest over eight years. Gendron *et al.*, REP-12-E-BPA-04, at 32-33. As Staff explained: “[I]n ratemaking, Refund Amounts and Lookback Amounts are both considered REP benefits being recovered from IOUs in order to be paid to COUs. Thus, the ratemaking methodology is unchanged.” Bliven *et al.*, REP-12-E-BPA-12, at 22.

The only place the two amounts are different is in the level of dispute. The COUs oppose BPA's Lookback Amounts, because these refunds come with no guarantees of recovery, are not paid fast enough, and give BPA discretion to preserve 50 percent of the IOUs' REP benefits. *See generally* WP-07 Supplemental ROD, WP-07-A-05, at 263-285. The Refund Amounts, however, come with a cap on REP benefits, guaranteed recovery, and time-certain full payment, as set forth in the Settlement. Settlement, REP-12-A-02A, § 3.1. The Lookback Amounts and Refund Amounts, thus, are tightly related concepts. They both serve the important function of getting refunds “into the right hands.” Murphy and Kallstrom, REP-12-JP02-04, at 10.

WPAG claims that the position of JP02, whose counsel negotiated most of the AIP and the Settlement, is inaccurate. WPAG Br. Ex., REP-12-R-WG-01, at 44-45. WPAG claims that looking at the language in the AIP, it is clear that the REP benefits the IOUs receive under the

Settlement are not “net” of any refunds that would be paid to the COUs. *Id.* at 45. For ease of reference, the language of the AIP is reprinted here:

The Settlement Documents may provide for a methodology for allocating the REP-related cost of the Settlement to be recovered from COUs. In no event, however, will such provision alter the REP Settlement Amount to be paid to the Settling IOUs.

AIP, REP-12-E-BPA-01B, at 4.

WPAG claims that the AIP’s use of the term “may” clearly indicates that as of the date of the AIP, there was no agreement among the preference customers on whether to even include such a refund amount methodology in what became the Settlement. WPAG Br. Ex., REP-12-R-WG-01, at 45. WPAG then argues that the fact the refund amount mechanism was not agreed to in the AIP leads to the conclusion that the amount of any such refund amount had not been agreed to by the preference customers at that point in time. *Id.* WPAG claims this conclusion is substantiated by the fact that the AIP did not include any dollar value for the yet-to-be-agreed-to refund amount mechanism. *Id.*

WPAG is correct insofar as it means that as of the AIP, no agreement among the parties had been reached on the mechanism for reflecting the discount that the IOUs had agreed to in the AIP or how much of that discount should be reflected in future rates. This is understandable, because the point of the negotiations between the COUs and IOUs that led to the AIP was to reach a compromise on what REP benefits would be paid to the IOUs, not what REP costs would ultimately be part of rates. The record in this case demonstrates that in negotiating the \$2.05 billion in the AIP, the COUs expressly viewed this figure as being “net” of a refund payment. Murphy and Kallstrom, REP-12-E-JP02-04, at 9-10.

WPAG appears to suggest that JP02’s testimony is inconsistent with the AIP, but that claim is incorrect. While at the time of the AIP the mechanism for reflecting the IOUs’ discount had yet to be determined, the discount itself had certainly occurred. One need only look to BPA’s analysis in this case to see that the IOUs have agreed to a discount in the REP benefits. The IOUs’ REP benefits under the Settlement are below what BPA believes they would receive under BPA’s traditional REP, as well as under a number of the litigation scenarios. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.4. This discount begins in this rate period, and based on BPA’s projections, grows over time. *See* Bliven *et al.*, REP-12-E-BPA-12, at 48. Section 2(E) of the AIP simply recognizes that there are different ways the parties could reflect this discount in the final Settlement documents.

For example, the settling parties could have provided the discount as a general rate reduction for all ratepayers. In this instance, there would be no need to develop additional mechanisms to “allocat[e] the REP-related cost of the Settlement to be recovered from COUs,” AIP, REP-12-E-BPA-01B, at 5, because all COUs (and other ratepayers) would share equally in the lower REP costs in rates. Conversely, the parties could have developed a targeted refund approach (as BPA has used in the last two rate periods) to ensure those most harmed by the 2000 REP Settlements received compensation. As it turned out, the parties chose a middle approach, which returns

targeted refunds as Refund Amounts (the successor to BPA's Lookback Amounts) to injured COUs, but in a way that delivers some refunds to other COUs that were not overcharged. In either case, the IOUs' REP benefits in the AIP were discounted to reflect the repayment of refunds to the COUs.

WPAG claims that section 2(E) of the AIP expressly states that the REP benefits to be paid the IOUs will not be decreased due to such a refund provision. WPAG Br. Ex., REP-12-R-WG-01, at 45. WPAG concludes this language means that the REP benefits to which the IOUs are entitled under the Settlement are not net of the Refund Amounts. *Id.* WPAG argues that since the \$612 million in Refund Amounts is not being deducted from the \$2.05 billion NPV agreed to in the AIP and retained in the final Settlement, the IOUs are not in fact paying for the Refund Amounts. *Id.* at 45-46.

WPAG is incorrect. The AIP precludes the IOUs' REP benefits from being "altered" by subsequent reductions in the Settlement for the simple reason that the *IOUs' REP benefits had already been discounted to reflect repayment of such refunds*. See Murphy and Kallstrom, REP-12-E-JP02-04, at 9 ("The IOUs pay for the Refund Amount in the form of Scheduled Amounts reduced to reflect their Lookback liabilities that are extinguished under the Settlement Agreement."). The language in section 2(E) prevents nothing more than the COUs from requesting further benefit reductions during the negotiations of the final settlement documents. Inclusion of such language was entirely reasonable. It would have made no sense for the IOUs to agree to the discounted NPV of \$2.05 billion in the AIP, only to have these discounted REP benefits reduced *again* in the final settlement documents. As noted earlier, had the IOUs agreed to a subsequent reduction in their discounted REP benefits, the resulting REP benefits would have reflected a scenario in which the IOUs lose all of their issues in litigation, BPA loses most of its issues in litigation, and the COUs win most of their issues in litigation. See Evaluation Study, REP-12-FS-BPA-01, Table 10.4. WPAG's assertion that the only way to show that the IOUs have paid for the Refund Amounts was for the negotiating parties to discount already discounted REP benefits is inconsistent with the record in this case.

WPAG claims that the Settlement expressly extinguishes any claims by a settling party, and absolves the IOUs of any payment obligation to any settling party, regarding Lookback Payments, Load Reduction Agreement payments, and deemer account balance. WPAG Br., REP-12-B-WG-01, at 38; *see also* WPAG Br. Ex., REP-12-R-WG-01, at 46. Under the Settlement, WPAG claims, the IOUs will have no Lookback Payment obligation to BPA after September 30, 2011. *Id.* WPAG claims that the notion that the IOUs are somehow funding the Refund Amounts does not withstand scrutiny. *Id.*

What does not withstand scrutiny is the parties' contentions that the IOUs are somehow not paying for the Refund Amounts. The IOUs have paid for the Refund Amounts by accepting a discounted stream of REP benefits. This is what the negotiating COUs said they did (*see* Murphy and Kallstrom, REP-12-E-JP02-04, at 9) and is consistent with common sense: the negotiating COUs would not have given up half a billion dollars in refund payments because they were feeling generous to the IOUs. The settling COUs secured a significant discount from

the IOUs in the negotiation of the IOUs' REP benefits *first*. How they reflected that discount in rates was addressed in the Settlement's final documents.

WPAG claims that the key under the traditional section 7(b)(2) ratesetting approach is that the deduction of the Lookback Amounts from each IOU's REP benefits actually reduces the amount of REP benefit each IOU receives, and this reduction funds the Lookback billing credit received by preference customers. WPAG Br. Ex., REP-12-R-WG-01, at 47. Under the Settlement rate construct, WPAG contends, the amount of REP benefits that the IOUs as a class receive is contractually established and does not change. *Id.* As a consequence, WPAG asserts, BPA taking the same actions in the Settlement rate construct does not have the same results as it would under the traditional section 7(b)(2) rate test approach. *Id.* at 48. WPAG argues that, contrary to the traditional section 7(b)(2) approach, these actions, such as increasing the PF Exchange rate under the Settlement rate construct, have no direct impact on the amount of REP benefits disbursed to the IOUs in any year. *Id.*

What WPAG misses is that the "contractually established" REP benefits have already been reduced in the first instance to reflect the resolution of outstanding refunds. WPAG apparently believes that the negotiating parties would have agreed to the \$2.05 billion in REP benefit payments regardless of BPA's (disputed) determination that the COUs were owed \$1 billion in refunds. The record in this case clearly shows that is not the case. *See* Murphy and Kallstrom, REP-12-E-JP02-04, at 9-10. Moreover, all the negotiating parties have done through the AIP and then the Settlement is to work backward from what BPA has been doing in its traditional implementation of the Lookback construct. BPA begins with the total costs of the REP and sets rates to recover these costs. BPA then withholds some REP benefits and provides these as refunds to the COUs. *See* section 6.1.2. The remaining REP benefits are then "paid" to the IOUs. *Id.* In contrast, for purposes of their negotiation, the settling parties started with the harder of the two problems and determined what would be "paid" to the IOUs. Thereafter, they worked backward to determine what aggregate REP costs BPA would include in rates. BPA does not see why the order in which the negotiators resolved the issues involved in the Settlement means the IOUs do not pay the Refund Amounts.

Comparing the Settlement to the alternative presented in the record in this case will help make clear how the IOUs are paying for the Refund Amounts. Under the Settlement, BPA is proposing to set rates to collect the "REP Recovery Amount," which is the total aggregate cost of the REP proposed in the Settlement. *See* Bliven *et al.*, REP-12-E-BPA-12, at 20, 35. For FY 2012–2013, the REP Recovery Amount is approximately \$258.6 million per year. *See* Settlement, REP-12-A-02A, §§ 3.1 and 3.2. Of this amount, \$76.5 million will be returned as Refund Amounts to the COUs pursuant to the methodology described in section 3.4. *Id.*, § 3.4. Thus, the IOUs will receive a net amount of REP benefits of \$182.1 million.

Compare these figures to what BPA would do if the Settlement were *not adopted*. BPA's proposal would set rates to recover \$271 million in REP benefits. Evaluation Study, REP-12-FS-BPA-01, Table 10.6. Of this amount, BPA would return approximately \$78 million a year for the FY 2012–2013 rate period as Lookback Amount payments to individual COUs as credits on

their power bills. *Id.*, Table 10.1. If the Settlement were not adopted, the IOUs would receive the net of these amounts each year, which is approximately \$193 million.

This near-term example demonstrates that the IOUs are paying for the Refund Amounts in two ways. First, the IOUs are paying for the Refund Amounts through an initial discount in the total amount of available REP benefits. If the Settlement were not adopted, BPA would set rates to collect REP benefits of \$271 million for each year of the rate period. The Settlement, however, reduces the annual REP benefit amount to \$258.6 million. This is a \$12 million annual discount the IOUs are taking for no other reason than to achieve the Settlement in this case. This \$12 million annual cost savings (which totals to \$24 million over the rate period) to BPA is shared by *all* of BPA's ratepayers, regardless of whether they were injured by the 2000 REP Settlements. Bliven *et al.*, REP-12-E-BPA-12, at 40.

Second, the IOUs' REP benefits are further reduced under the Settlement to the total of the Scheduled Amounts, which in this case is \$182 million a year. This reduction roughly reflects a similar reduction BPA planned to make to the IOUs' REP benefits in the no-settlement alternative. The parties argue that this is not a real reduction because the IOUs are entitled to only the \$182 million under the Settlement. WPAG Br., REP-12-B-WG-01, at 37-38; APAC Br., REP-12-B-AP-01, at 11-12. The parties are making the wrong comparison. The correct comparison is to look to what the IOUs would be entitled to *without the Settlement*. In this instance, the IOUs *are entitled* to \$271 million a year. Evaluation Study, REP-12-FS-BPA-01, Table 10.6. The IOUs will be taking a reduction of \$88.5 million in REP benefits *per year* under the Settlement, of which \$12 million will be used to lower the PF Public rate and \$76.5 million will be returned to COUs through credits. Although BPA's implementation of the REP is in dispute, the fact remains that until a court rules otherwise, absent settlement BPA would include \$271 million in rates, return only \$78 million through credits, resulting in higher payments to the IOUs and higher rates to the COUs. The IOUs have agreed, though, to forgo these REP benefits in return for certainty in the REP benefits they will receive going forward.

As can be seen, in the near term the IOUs are forgoing \$88.5 million in REP benefits over each of the next two years as a result of the Settlement. This amount is expected to grow over time. Bliven *et al.*, REP-12-E-BPA-12, at 48. Looking only at the expectation of future values, this delta grows to approximately \$256 million *a year* by FY 2022. *See* Evaluation Study, REP-12-FS-BPA-01, Table 10.3.2 (projected FY 2022 no-settlement REP benefits of \$515 million and Settlement REP benefits of \$258.6 million). What the settling COUs have done in the Settlement is simply to quantify a portion of these otherwise payable REP benefits to the IOUs and then include these values in the Settlement as Refund Amounts. As discussed elsewhere, the Settlement is written in terms of results, not a description of how or why BPA allocates costs to achieve those outcomes. BPA treats these additional costs of the Settlement as REP benefits, as required by the Court in *PGE*. BPA's analysis has further determined that the total costs of the Settlement do not violate the provisions of the Northwest Power Act because they are below what is otherwise permissible under almost all of the scenarios considered in this case. Gendron *et al.*, REP-12-E-BPA-04, at 36. In this way, including the Refund Amounts as a cost allocation methodology in ratesetting is no different from BPA's current Lookback construct except that the total amount of REP benefits included in rates would be *reduced* over the next rate period, to

the benefit of all ratepayers. WPAG's and APAC's claim that the IOUs are not paying for the Refund Amounts is unsupported.

### **Decision**

*The Refund Amounts provided under the Settlement are properly characterized as REP costs pursuant to sections 5(c) and 7(b) of the Northwest Power Act.*

### **Issue 6.5.2**

*Whether the Refund Amounts provided under the Settlement result in an inequitable allocation of REP costs to the IP rate.*

### **Parties' Positions**

Alcoa argues that if BPA adopts the Settlement, BPA will be inequitably allocating to the IP rate the cost of Lookback Amounts/Refund Amounts. Alcoa Br., REP-12-B-AL-02, at 25-29. Alcoa asserts that it was not a recipient of the payments made under the 2000 REP Settlements, and therefore should bear no responsibility for returning refunds associated with it. *Id.* Alcoa also claims that allocating Lookback Amounts/Refund Amounts to Alcoa is inequitable because Alcoa paid IP rates that included the costs of the 2000 REP Settlements. *Id.* Alcoa reiterates these arguments in its brief on exceptions. Alcoa Br. Ex., REP-12-R-AL-01, at 24-32.

### **BPA Staff's Position**

Implementing the Settlement in ratemaking will not result in an inequitable allocation of REP costs to the IP rate. The Settlement retains, for the most part, BPA's current method of setting rates and distributing refunds associated with the Lookback. Gendron *et al.*, REP-12-E-BPA-04, at 11-12. Under this method, rates will be set on the total amount of REP benefits permitted by the Settlement or by the rate test. *Id.* Thereafter, BPA would provide individual bill credits to customers that were found to have been harmed by the 2000 REP Settlements, funded by reductions in REP benefits withheld from the IOUs. *Id.* Alcoa has not claimed a right to a refund for the WP-02 or WP-07 rate periods, and therefore is not entitled to a Lookback Amount/Refund Amount credit. Bliven *et al.*, REP-12-E-BPA-12, at 24-25. Alcoa's challenges to BPA's method of providing bill credits should have been raised in the WP-07 Supplemental proceeding. *Id.* at 25-26. Even if Alcoa's arguments were timely, Alcoa is no worse off under the Settlement: the alternative to the Settlement is BPA's Lookback construct, which retains the same treatment as described in Issue 6.5.1, and because Alcoa receives overall lower rates as a result of the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 19.

### **Evaluation of Positions**

#### **A. Introduction**

Alcoa has maintained throughout this case that the Settlement's retention of the Lookback construct (in the form of the Refund Amounts) harms Alcoa by allocating improper costs to the IP rate. Although Alcoa's challenges come in various forms and in different arguments, they can

be summarized as follows: The Lookback Amounts/Refund Amounts are gratuitous increases in rates that allocate more costs of the REP to the IP rate than would occur if the Lookback Amounts/Refund Amounts were not paid to the injured COUs. Alcoa contends that the Lookback Amounts/Refund Amounts repayment construct should be eliminated or, at the very least, structured in such a way that the IP rate is insulated from the effects of BPA's decision to continue to pay Lookback Amounts/Refund Amounts to injured parties.

On one level, BPA can understand Alcoa's concern with the Lookback Amount/Refund Amount construct. The IP rate might be lower if BPA decided to cease providing targeted refunds as Lookback Amounts or Refund Amounts, and instead, embedded these credits into the rates applicable to all parties, or simply established rates based on the "net" or "paid" amount of REP benefits to the IOUs. The problem with such an approach, as explained throughout this discussion, is that it effectively requires the customers that were originally overcharged in FY 2002–2006 to "give up" the refunds otherwise due to them in order to reduce the rates of all BPA customers going forward, including the rates of customers who were not overcharged (such as Alcoa). Requiring customers injured during FY 2002–2006 to give up targeted refunds in order to reduce future rates for *all* ratepayers is like requiring individual taxpayers who overpaid in 2010 to give up their tax refunds in order to reduce the tax rates for *all* taxpayers in 2011. The inequity of such a requirement is apparent.

Alcoa's objections to the Lookback Amounts/Refund Amounts are numerous and complex. As a result, BPA has attempted to organize Alcoa's issues into specific subheadings to in understanding the various elements of Alcoa's arguments.

**B. The Refund Amounts Are Not a "Cost" in the IP Rate; the IP Rate Collects Only its Appropriate Share of REP Costs as Permitted by the Northwest Power Act**

Alcoa argues that the Settlement would inequitably allocate REP Lookback costs to Alcoa and other DSIs. Alcoa Br., REP-12-B-AL-02, at 26. Alcoa asserts that BPA's proposed FY 2012–2013 IP rate includes a portion of the costs of a proposed settlement of REP Lookback costs. *Id.* at 25. This is a common theme throughout Alcoa's brief. Alcoa also asserts that BPA proposes to recover the Lookback Amounts/Refund Amounts through its rates, including the IP rate. *Id.* at 26. This, in Alcoa's view, means the IP rate will bear a portion of the costs of providing the COUs with refunds for their FY 2002–2008 REP overpayments. *Id.*

Alcoa is incorrect to assert that the Settlement allocates "Lookback costs" to the IP rate. Bliven *et al.*, REP-12-E-BPA-12, at 19. Instead, the Lookback Amounts/Refund Amounts are being allocated to the utility-specific PF Exchange rates that BPA will be charging to the IOUs alone. *Id.* at 22-23. In this regard, there is no line item in BPA's revenue requirement on which Lookback Amount costs (or Refund Amount costs) are allocated to either the IOUs or the DSIs and returned to the COUs. *Id.* at 20. The only REP-related costs in the revenue requirement are exchange resource purchase costs and program support costs. *Id.* at 23. Alcoa has cited no credible evidence in the record in which BPA includes the Lookback Amount/Refund Amount as a *cost* in the IP rate. Alcoa will find no proper evidence that Refund Amounts are a cost included in the IP rate. Instead, the Lookback Amounts/Refund Amounts are funded by REP benefit reductions by increasing the PF Exchange rates charged to the IOUs. *Id.* at 22-23.

Hence, such benefit reductions are totally separate from the costs that are included in the development of the PF rates, which costs are then properly included in the IP rate pursuant to the section 7(c) rate directive, which requires that the IP be based on the applicable wholesale rate charged to BPA's preference customers.

Nonetheless, in its brief on exceptions, Alcoa continues to object to BPA's statement that Alcoa has presented no credible evidence that Refund Amounts are included as a cost in the IP rate. WPAG Br. Ex., REP-12-R-WG-01, at 27. Alcoa claims that BPA ignores a data response that Alcoa did not submit into the record of this case, which Alcoa alleges tracks the manner in which Refund Amount costs are allocated to the IP rate. *Id.* Alcoa then complains that "BPA has offered nothing but obfuscation and argument to the contrary." *Id.*

Alcoa's objections lack merit. At its core, Alcoa's objection to the treatment of the Refund Amounts comes down to its position that Refund Amounts are gratuitous increases in BPA costs. Alcoa appears to believe that only REP benefits that actually make it into the hands of the IOUs are appropriately deemed costs of the REP allocable to the IP rate. BPA, however, holds the position that it may set rates to collect an aggregate amount of REP benefits consistent with Northwest Power Act sections 5(c) and 7(b)(2), but withhold some of these REP benefits to fund refunds to injured ratepayers. In its simplest form, BPA views the Refund Amounts as statutory REP benefits first and foremost. The second step is reducing those properly calculated benefits to provide refunds to injured parties. Alcoa, however, views the Refund Amounts as refunds only and refuses to recognize that the Refund Amounts are not an independent "cost" included in rates; they are fundamentally an offset to full measure of REP costs that were included in rates. In other words, Alcoa is essentially double-counting the REP Refund Amounts as a "cost."

This point was made clear in BPA's testimony, where it was stated that, in terms of BPA's ratemaking, BPA has treated the Refund Amounts as costs of the REP, not as a separate cost category. Gendron *et al.*, REP-12-E-BPA-04, at 11. BPA has made this point repeatedly above and reiterates it now: the record in this case contains no evidence that BPA has simply included Refund Amounts as a stand-alone cost item in the IP rate or any other rate. In all instances, the Refund Amounts are treated as costs of the REP. The IP rate will recover its proportional share of the aggregate REP costs of the Settlement, as would be the case if the Settlement were not adopted. That is not the same, however, as saying that the IP rate is being allocated the costs of the Refund Amounts separate and apart from a typical allocation of REP costs.

To support its opposition, Alcoa points to a number of data responses that it claims demonstrate that the Refund Amounts were being allocated to the IP rate. Alcoa Br. Ex., REP-12-R-AL-01, at 27. These materials, however, do not contradict BPA's point. Alcoa claims that these data requests "track" the manner in which Refund Amount costs are allocated to the IP rate. Alcoa Br. Ex., REP-12-R-AL-01, at 27. This argument reveals that Alcoa is simply reiterating its erroneous view that Refund Amounts are severable from REP costs. In reference to BP-AL-02, for example, Alcoa recounts the mechanics of how the REP Recovery Amounts are collected under the terms of the Settlement. This description, however, is irrelevant to the issue of how BPA treats these costs in ratemaking. *See* Evaluation Study, REP-12-FS-BPA-01, section 5.1; Bliven *et al.*, REP-12-E-BPA-12, at 2-4; and Cross-Ex. Tr. at 76-78. For ratemaking purposes,

BPA treats all of the costs of the Settlement (including Scheduled Amounts and Refund Amounts) as costs of the REP. The IP rate is not allocated “Refund Amounts” separately from total aggregate REP benefits. The IP rate is allocated a portion of the total costs of the REP. Alcoa also cites to the Power Rates Study where the REP Surcharge is developed. Alcoa Br. Ex., REP-12-R-AL-01, at 27. Here again, the record supports BPA’s position. The documents cited by Alcoa demonstrate that the Refund Amounts are not separately allocated to the IP rate, but rather are treated as REP costs. In the Power Rates Study Documentation Table 2.4.9, Refund Amounts (referred to as Lookback Amounts) are treated as costs of the REP. *See* Power Rates Study Documentation, BP-12-FS-BPA-01A, Table 2.4.9 (identifying “IOU REP Benefits in Rates” as \$258,678,000).

Alcoa also attaches BPA-AL-09, wherein Alcoa quotes Staff as saying “Rates will be set to recover the total REP benefits. In this instance, the total REP benefits will be the combination of the amounts identified in section 3.1 (Scheduled Amounts) and 3.2 (Refund Amounts) of the Settlement.” Alcoa Br. Ex., REP-12-R-AL-01, at 27, n.95. Here again, Alcoa’s data response supports BPA’s position and underscores Alcoa’s refusal to accept the obvious conclusion to be drawn from the documents that it has submitted: *i.e.*, that BPA is allocating the total costs of the Settlement as REP costs and Refund Amounts are not being allocated to rates as an individual line item, separate and apart from those properly allocable REP costs.

Indeed, Refund Amounts are no more included in the IP rate under the Settlement than Lookback Amounts are included in the IP rate today. Bliven *et al.*, REP-12-E-BPA-12, at 23. In both instances, BPA sets its rates to recover the *total cost* of REP benefits first. *Id.* Under BPA’s Lookback construct, Lookback Amounts are then adjusted *after* REP benefits and rates have been determined pursuant to the Northwest Power Act. *Id.* Under the Settlement, this treatment will continue, the only difference being that BPA will increase the PF Exchange rate (which is not used as a basis for the IP rate) to recover the Refund Amounts rather than recovering them through an administrative setoff. *Id.* at 22. Rates set under the Settlement will continue to be set to recover total REP benefits, which under the Settlement are referred to as REP Recovery Amounts (*i.e.*, the sum of the Scheduled Amounts and the Refund Amounts). *Id.* at 20, 23; *see also* Murphy and Kallstrom, REP-12-E-JP02-04, at 9 (“The ‘REP Recovery Amounts,’ which are the sum of the Scheduled Amounts and the Refund Amounts, are the measure of the costs of future IOU REP benefits.”). All rates will be set to recover these amounts, including the PF and IP rates.

Unfortunately, rather than trying to take an objective view of the documentation provided in the record and reach an accurate understanding of BPA’s rate treatment of Lookback Amounts or Refund Amounts, Alcoa makes the inaccurate claim that the Settlement “is essentially a shell game.” Alcoa Br. Ex., REP-12-R-AL-01, at 25. Alcoa claims that the fact that the Refund Amounts are not a line item in the IP rates (or rates in general) is relevant only to BPA’s efforts to argue that the Settlement approximates the results achieved by application of the statutes. *Id.* Alcoa asserts that the funds that will be paid to the preference customers as refunds must come from somewhere, and BPA’s testimony shows precisely where the funds will come from: BPA’s rates. *Id.* The aggregate REP benefits, including the Refund Amounts, form a part of BPA’s revenue requirement. *Id.* Alcoa then misquotes the Draft ROD: “[a]s BPA explained in the

Draft ROD, “[a]ll rates will be set to recover [the Refund Amounts], including the ... IP rate[.]” *Id.* at 25-26.

Putting aside Alcoa’s false remark that the Settlement “is essentially a shell game,” the latter half of Alcoa’s comment reveals that Alcoa understands the rate treatment of the Refund Amounts. Alcoa is correct that the Refund Amounts will come from BPA rates, as all funds paid by BPA must come. Alcoa is also correct that Refund Amounts form part of the total REP benefits that BPA must include in rates: “[t]he aggregate REP benefits, including the Refund Amounts, form a part of BPA’s revenue requirement.” Alcoa Br. Ex., REP-12-R-AL-01, at 25. Alcoa goes slightly astray in its final sentence when it misquotes the Draft ROD. The Draft ROD did not refer to only Refund Amounts in the sentence quoted by Alcoa. Rather, the Draft ROD stated, “[a]ll rates will be set to recover these amounts, including the PF and IP rates.” Draft ROD, REP-12-A-01, at 206. The reference to “these amounts” referred back to the prior sentence, which read:

Rates set under the Settlement will continue to be set to recover total REP benefits, which under the Settlement are referred to as REP Recovery Amounts (*i.e.*, the sum of the Scheduled Amounts and the Refund Amounts).

*Id.* The Draft ROD properly stated that all rates must share in recovering the total REP benefits (consistent with section 7(b)), which is precisely what BPA has done in the past three rate cases (without protest from Alcoa), and what BPA is proposing to do again in this case. The total REP benefits that BPA must collect in rates under the Settlement are the REP Recovery Amounts.

The mechanics of how total REP benefits are recovered in rates has been explained above. While Alcoa may believe that recovering REP costs involves a “shell game,” the fact remains that Staff’s description of how REP costs are recovered in rates is accurate. The REP is a power exchange, and BPA will continue to treat it as one under the Settlement. The IOUs will continue to sell power to BPA at their ASCs, and BPA will continue to sell power at its PF Exchange rate. These resource costs and loads will continue to be included in BPA’s rate development as required by section 7(b)(1). The only significant difference between rate development under the Settlement and rate development under the no-settlement case will be that the post-7(b)(2) level of total REP benefits will have been established. The post-7(b)(2) level of REP benefits under the Settlement is the REP Recovery Amounts.

BPA understands that Alcoa does not believe that BPA may legally perform the analysis in this case to determine whether the level of total REP benefits provided under the Settlement comports with BPA’s statutes. Other sections of this Record of Decision address Alcoa’s specific concerns. Suffice it to say here, assuming that such an analysis is proper, and further assuming that such analysis supports a finding that the Settlement meets the requirements of the Northwest Power Act (which BPA believes it does), there is no statutory or equitable basis for establishing the IP rate on anything other than the total aggregate costs of the REP.

**C. Establishing the IP Rate Based on the Aggregate Amount of REP Costs Is Not Inequitable; Lookback Amounts and Refund Amounts Are Withheld REP Benefits**

Alcoa argues that it is inequitable to allocate a portion of the Lookback Amounts/Refund Amounts to the rates paid by Alcoa. Alcoa Br., REP-12-B-AL-02, at 26. Alcoa asserts that the DSIs received none of the unlawful exchange benefits paid to the IOUs that resulted in BPA's decision to provide the COUs with Lookback payments. *Id.* at 25-26. Accordingly, Alcoa argues, it should not bear any portion of refunding the COUs' overpayments. *Id.*

Alcoa's arguments are not persuasive. Alcoa has built its case on the premise that Refund Amounts are somehow distinguishable from REP benefits that are otherwise generally included in the IP rate. Bliven *et al.*, REP-12-E-BPA-12, at 24. From a ratemaking perspective, there is no difference. *Id.* BPA has treated both the Scheduled Amounts and the Refund Amounts as REP benefits, both in its ratemaking and for purposes of its analysis of the Settlement. *Id.* Thus, provided that the amount of total REP costs (REP Recovery Amounts) under the Settlement complies with the limitations of section 7(b)(2), which the record in this case demonstrates, there is no ratemaking rationale for excluding the total cost of the Settlement (*i.e.*, the total aggregate REP benefits) from the IP rate. *Id.* In this regard, the IP rate is not being singled out but is treated like all other rates. *Id.*

Moreover, BPA's collection of the Refund Amount obligation does not affect the IP rate at all. *See* Bliven *et al.*, REP-12-E-BPA-12, at 22. Once aggregate REP benefits are established, BPA sets off the Refund Amounts from the aggregate REP benefits payable to the IOUs. *Id.* This step, which previously was performed administratively through setoff adjustments after ratesetting, will now be performed when BPA is calculating the utility-specific PF Exchange rates. *Id.* As Staff makes clear in testimony, the collection of the Refund Amounts *affects only the PF Exchange rates*:

we set off the aggregate Refund Amount cost against the aggregate IOU REP benefits, distributing the aggregate setoff amounts to the individual IOUs on a pro rata basis in a manner similar to the allocation of rate protection costs. The allocation of the Refund Amount cost is added to each IOU's allocation of rate protection costs and included in each IOU's 7(b)(3) surcharge.

Bliven *et al.*, REP-12-E-BPA-12, at 22.

Alcoa's second point that it "received none of the exchange payments to the IOUs resulting from the settlement" is true, but also irrelevant. *Id.* at 24. Again, Staff's proposal is structured such that BPA would not include the IOUs' *refund costs* in the IP rate; Staff would include the costs of REP Recovery Amounts that have cleared the section 7(b)(2) rate test. *Id.* This treatment is no different under the Settlement and the no-settlement alternatives. *Id.* Without the Settlement, BPA would set the IP rate to collect a share of the IOUs' total REP benefits *before* application of any Lookback Amount setoffs. *Id.* The Settlement retains this same treatment. *Id.* Although the Settlement does not use the same terminology BPA used in the Lookback construct, the method for recovering the Refund Amounts and Scheduled Amounts in rates would be the same. *Id.* at 21.

This approach to treatment of the Lookback Amounts/Refund Amounts is also nothing new. The approach set forth in the Settlement has been BPA's chosen method for setting rates (including the IP rate) and applying Lookback Amounts for the past two rate cases. *Id.* at 24. In neither of these cases did Alcoa object to either (1) having the IP rate set on the total aggregate amount of REP benefits, or (2) BPA's decision to refund the Lookback Amounts to the COUs that purchased power at the PF-02 rates. *Id.* It is surprising that now, after the parties and BPA have fully briefed the legal issues with BPA's Lookback construct in the APAC case, Alcoa would choose to raise these issues for the first time in this proceeding. Again, no party is appealing BPA's decision to provide the Lookback Amount refunds to only the COUs that purchased power at the PF-02 rates. Why Alcoa believes now it must challenge that decision is unclear.

Alcoa claims that setting the IP rate to recover the full cost of the REP is "inequitable." Alcoa Br., REP-12-B-AL-02, at 27. This assertion lacks merit. What would have been inequitable would be to include the Lookback Amounts/Refund Amounts as a general rate reduction to all ratepayers, because it would be giving Alcoa and other parties that did not pay the PF-02 rate (and therefore did not incur any overcharges) the full benefit of these future refunds. As noted by the settling parties:

If the Settlement Agreement had not recognized that the Scheduled Amounts payable to the IOUs were decreased due to past overcharges, then refunds due to COUs that incurred overcharges would have been transferred to DSIs and to other COUs that suffered lesser harm.

Murphy and Kallstrom, REP-12-E-JP02-04, at 10. The settling parties' concern in this regard is not imaginary. There are, in fact, COUs that purchased substantial amounts of power from BPA at the PF-02 rates, and therefore were overcharged as a result of the 2000 REP Settlements, but are purchasing substantially *less* power from BPA on a going-forward basis. Providing prospective rate reductions (instead of targeted refunds) would mean spreading these customers' refunds to reduce the rates of *all* of BPA's ratepayers at the expense of those that were actually overcharged. An apt example of such a scenario is presented on the record of this case in the form of Grant County PUD (Grant).

Grant purchased 167 aMW of power a year at the PF-02 rate from BPA during the FY 2002–2006 period. *See* Culbertson, REP-12-E-GC-01, at 2. Grant was the eighth largest contributor to the revenues BPA received at the PF-02 rate, and as such, was entitled to receive the eighth largest amount of Lookback Amount refunds under BPA's Lookback construct, which would have been approximately \$15.3 million under BPA's calculations. *See* Culbertson, REP-12-E-GC-01, at 2; Bliven *et al.*, REP-12-E-BPA-17, at 14. Prospectively, however, Grant will not be a large purchaser of BPA power. Beginning in FY 2012, Grant will be purchasing roughly 5 aMW from BPA, or roughly 3 percent of its contract demand from the PF-02 rate period. Culbertson, REP-12-E-GC-01, at 2. If BPA were to return Lookback Amount overcharges as future reductions in rates to all BPA ratepayers, as requested by Alcoa, customers such as Grant would be substantially harmed, because the value of the prospective rate reduction would be insignificant in comparison to the overcharges these customers experienced. For Grant, the value of the future rate reductions in PF rate purchases would amount to a paltry \$371,178. *See* Culbertson, REP-12-E-GC-01, at 3 (noting that its share of TOCA allocator going forward is

“.07278%”). This is roughly a return of approximately 2 percent of the amount BPA calculates Grant was allegedly overcharged. The other \$14.9 million of Grant’s refund would go to reducing the rates of all other customers, such as Alcoa, even though not all of these customers were injured by the 2000 REP Settlements. Three years ago, BPA found that this result was inequitable and would not appropriately return the refunds associated with the 2000 REP Settlements into the hands of those injured. *See* WP-07 Supplemental ROD, WP-07-A-05, at 266, 279-282. BPA reiterates those findings here. The negotiating parties retained the Refund Amounts specifically to avoid this same inequity from occurring again under the Settlement.<sup>20</sup> BPA sees nothing “inequitable” in setting rates to recover the aggregate cost of the REP, as BPA has done in prior rate cases, or in returning refunds to the entities overcharged in a manner that they deem equitable, funded by reducing REP benefits.

In its brief on exceptions, Alcoa argues that the Lookback Amounts/Refund Amounts are not “statutory REP costs.” Alcoa Br. Ex., REP-12-R-AL-01, at 26. Instead, Alcoa asserts, they represent unlawful settlement payments that BPA made to the IOUs at the expense of the preference customers and any party paying rates that included REP costs. *Id.* Alcoa contends that while it is true that sections 7(b)(2) and (3) do not protect the DSIs from costs of implementing the REP Congress envisioned, those provisions do protect the DSIs from bearing responsibility for repaying unlawful benefits received by the IOUs. *Id.* at 26.

However, as pointed out previously and contrary to Alcoa’s perceptions, Lookback Amounts/Refund Amounts are not separate costs in BPA rates. Alcoa was correct when it noted that “[t]he aggregate REP benefits, including the Refund Amounts, form a part of BPA’s revenue requirement.” *Id.* at 25. Alcoa has gone off the mark by alleging that Refund Amounts or Lookback Amounts are not REP costs, but rather “repayment [of] unlawful benefits received by the IOUs.” *Id.* at 26. They are not. BPA sets rates based on the total aggregate amount of REP benefits permitted by Northwest Power Act sections 5(c) and 7(b)(2). In this case, the Settlement identifies the total aggregate amount of REP benefits as the REP Recovery Amount. Provided that the REP Recovery Amounts do not exceed what sections 5(c) and 7(b) would permit, BPA may recover these amounts in rates as REP costs. This is not only the logical way to approach the payments provided under the Settlement, it is required by the Court in *PGE*. As the Court noted:

whenever BPA engages in a purchase and exchange of power—whether on a yearly basis, under a REP program, or pursuant to a settlement agreement—BPA acts pursuant to its § 5(c) authority, and is thus subject to the Congressionally imposed limitations on that authority as expressed in § 5(c) and § 7(b).

*PGE*, 501 F.3d at 1032. Consequently, it does not matter what BPA or the parties call the payments under the Settlement. If the payments can fairly be ascribed to the REP, BPA must treat them as REP benefits and subject them to the restrictions set forth in sections 5(c) and 7(b). That is what BPA has done here. Consistent with the Court’s direction, BPA treated the *total* payments provided under the Settlement (Scheduled Amounts *and* Refund Amounts) as REP

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<sup>20</sup> Under the 2012 REP Settlement, Grant will be entitled to approximately \$11 million of the total Refund Amounts (\$612 million) under the distribution formula established in section 3.4. *See* 2012 REP Settlement, REP-12-E-BPA-11, § 3.4.

benefits subject to the provisions of sections 5(c) and 7(b). *See Bliven et al.*, REP-12-E-BPA-12, at 21. As noted by Staff:

For purposes of our modeling and projections in the evaluation section of this case, we have treated the Refund Amounts as part of the REP benefits payable to the IOUs before setoff. In this way, we have ensured that the REP Recovery Amounts called for in the Settlement (*i.e.*, what BPA refers to today as REP benefits before setoff) have been considered and tested for compliance with the section 7(b)(2) rate test.

*Id.*; *see also id.* at 35.

**D. The Settlement’s Allocation of REP Costs to the IP Rate Is Equitable Because Alcoa Will Experience a Lower Rate Under the Settlement Than Under No Settlement**

Alcoa’s assertion that the Settlement is “inequitable” for the IP rate is even less persuasive when one considers that the IP rate for the next two years will be *lower* when compared to BPA’s no-settlement alternative. Staff performs an extensive analysis to test whether the Settlement burdens the IP rate with more than the lawful amount of REP costs. *Bliven et al.*, REP-12-E-BPA-12, at 9-16. Based on this analysis, BPA concludes that not only is the IP rate not bearing an unlawful portion of the rate protection costs allocated under section 7(b)(3), but “a larger share of rate protection costs is allocated to the PF [Exchange] rate under the Settlement and a smaller share to the IP and NR rates.” *Bliven et al.*, REP-12-E-BPA-12, at 16; *see also Gendron et al.*, REP-12-E-BPA-04, at 36 (“... by allocating more cost of rate protection to the PF [Exchange] rate, less is allocated to the IP and NR rates, producing lower IP and NR rates than in the no-settlement cases.”).

In other words, the Settlement reallocates a *larger portion* of rate protection dollars *away from* the IP rate than under the no-settlement alternative, resulting in the IP rate being *reduced* by \$1.32/MWh under the Settlement. *See* Evaluation Study, REP-12-FS-BPA-01, Tables 10.5 and 10.6 (showing IP rate under Settlement at \$36.31/MWh \$37.63/MWh under no settlement). Assuming Alcoa purchases 320 aMW over the next two-year rate period, this rate reduction translates into roughly \$7.4 million in savings to Alcoa over the FY 2012–2013 rate period alone. BPA emphasizes here that these savings are not hypothetical or ethereal. Without the Settlement, Alcoa *will be paying a higher IP rate* over the next rate period. Alcoa conceded this very point during oral argument. *See* Till, Oral Tr. at 94. BPA does not understand how a Settlement that results in \$7.4 million in power cost savings to Alcoa over the next two years can reasonably be referred to as “inequitable.”

Alcoa’s claim that the Settlement treats the IP rate “inequitably” is also not persuasive when considering the *alternative* to the Settlement in this case. BPA agrees that in evaluating the Settlement, considerations of equity should be an important component of the Administrator’s decision. Indeed, the criteria for evaluating the Settlement is whether it “provides reasonable rates for non-settling parties and other classes of BPA’s customers.” *Gendron et al.*, REP-12-E-BPA-04, at 27. But whether equity is achieved or not for Alcoa under the Settlement must be measured from a point of reference.

For BPA, that point of reference begins with the *alternative* to the Settlement. If the Settlement were *not adopted*, BPA would continue its current practice of implementing the Lookback construct, which includes setting rates based on aggregate REP benefits and administratively setting off the Lookback Amounts. *See Gendron et al.*, REP-12-E-BPA-04, at 6 (noting that Staff was asked “to prepare the Lookback Study using BPA’s existing implementation methodology, making changes only when absolutely necessary.”). When considering the *alternative* to the Settlement, then, Alcoa is no worse off, because in the absence of Settlement BPA would continue its current method of collecting and returning Lookback Amounts by including aggregate REP benefits in rates and then providing setoffs to fund refunds to the COUs. Indeed, as noted above, from a *rate level perspective*, Alcoa is in fact *better off* under the Settlement when compared to the alternative because the IP rate will be *lower*. *Gendron et al.*, REP-12-E-BPA-04, at 36. Here, Alcoa is clearly being treated “equitably” because it is actually better off, from a rates perspective, off under the Settlement than it would be if no Settlement had been accomplished.

**E. The Settlement’s Treatment of Refund Amounts (and BPA’s Treatment of Lookback Amounts) is Equitable Because the IP Rate Is Not Entitled to a Reduction or Adjustment for Prior Year Power Purchases**

The next tranche of arguments Alcoa levels against the Refund Amounts/Lookback Amounts is Alcoa’s assertion that, like the COUs, Alcoa itself was harmed by the 2000 REP Settlements, and therefore, it would be unreasonable to establish the IP rate based on the total (as opposed to the net) costs of the REP provided under the Settlement. *Alcoa Br.*, REP-12-B-AL-02, at 27-28. For example, Alcoa contends that during the vast majority of the FY 2002–2008 Lookback period, Alcoa paid rates for power that either included 2000 REP Settlement overpayments or greatly exceeded the statutorily mandated IP rate. *Id.* at 27. Alcoa contends that calculating the IP rate based on the total aggregate amount of REP benefits (the REP Recovery Amounts under the Settlement or total REP benefits under no settlement) rather than the REP benefits “net” of Lookback Amounts/Refund Amounts (*i.e.*, the Scheduled Amounts or REP benefits paid) is inequitable because the IP rate was in fact harmed as a result of the 2000 REP Settlements. *Alcoa Br.*, REP-12-B-AL-02, at 27-29, 31. Alcoa then provides a number of arguments wherein Alcoa asserts that it paid an IP rate that included “illegal REP settlement costs[.]” *Id.* at 28.

What is strange about Alcoa’s argument is that Alcoa has made it clear in this case and in past proceedings that it is not seeking a refund determination from BPA for the WP-02 rate period. In the WP-07 Supplemental proceeding, the proceeding BPA expressly designated as the forum for determining whether BPA had overcharged parties as a result of the 2000 REP Settlements, Alcoa stated that it was *not* requesting a refund from BPA. *Speer*, WP-07-E-AL-04, at 6. Instead, Alcoa stated it was bound by a settlement it had struck with BPA to “accept the level of rates” BPA had established in the WP-02 rate case. *Id.* Alcoa has not requested BPA to do otherwise in this case. In its brief in this proceeding, Alcoa again reiterates that its “settlement with BPA relating to its 2002–2006 contract definitively settled the amount BPA could charge Alcoa for power.” *Alcoa Br.*, REP-12-B-AL-02, at 29.

At the same time, however, Alcoa seems to be arguing that even though it has not asked (and is not asking) BPA to determine whether Alcoa was overcharged during the WP-02 rate period,

BPA nonetheless should set *future* IP rates under this Settlement as if Alcoa and other DSIs had in fact been overcharged as a result of the “illegal REP settlement costs[.]” Alcoa Br., REP-12-B-AL-02, at 27.

Initially, BPA interpreted Alcoa’s argument as meaning Alcoa believes that it was overcharged during FY 2002–2006, and therefore Alcoa was demanding its rate reflect a reduction associated with the Lookback Amounts or Refund Amounts. In its brief on exceptions, however, Alcoa argues that it is not proposing that the IP rate should receive a rate credit or reduction. Alcoa Br. Ex., REP-12-R-AL-01, at 27. Alcoa claims BPA is “miss[ing] the point.” *Id.* Alcoa asserts that it has not requested that its rates should receive a refund or some form of credit as a part of the Lookback Amount/Refund Amount construct. *Id.* Indeed, Alcoa contends that it has previously agreed that it would not challenge rates that applied to the period prior to September 30, 2006. *Id.* at 27-28. Instead, Alcoa claims its argument is based on equity. *Id.* Because Alcoa did not receive any benefits as part of the unlawful 2000 REP Settlements, it claims it should not be expected to contribute to the repayment of the unlawful REP benefit amounts. *Id.* at 28. Alcoa asserts that neither BPA’s testimony nor the Draft ROD provides a compelling justification for saddling Alcoa and the DSIs with responsibility for redressing unlawful settlement payments received by the IOUs. *Id.*

BPA must admit that it is missing the point of Alcoa’s argument again. The source of BPA’s confusion is Alcoa’s conflicting statements on this issue. Alcoa claims that it is not seeking a refund determination from BPA, but at the same time, Alcoa demands that the IP rate be set prospectively based on a subcomponent of REP costs that would have the effect of giving the IP rate a rate credit. Alcoa claims that it is not “proposing that the IP rate should receive a rate credit or reduction.” Alcoa Br. Ex., REP-12-R-AL-01, at 28. Yet, by setting rates based on the “net” amount of REP benefits paid to the IOUs (as opposed to the aggregate amount permitted by section 7(b)(2)) as proposed by Alcoa, the IP rate would be “reduced.” Alcoa understands this very well, and has demanded that BPA remove REP costs from its rates to reduce it:

Lookback [Amounts] / Refund Amounts should not be allocated to the IP rate.  
BPA should adjust its FY 2012–2013 IP rate by eliminating the allocation of the  
Lookback [Amounts] / Refund Amounts.

Alcoa Br., REP-12-B-02, at 29.

As noted above, if BPA were to adopt Alcoa’s proposal of crediting all rates with the Refund Amounts (or Lookback Amounts) as opposed to providing targeted refunds, then COUs that paid the unlawful PF-02 rates would receive substantially less in refunds than what they paid in overcharges. While Alcoa may believe such a result is equitable, those overcharged in the first instance would certainly disagree.

Alcoa also claims that it is not seeking a refund from BPA and is willing to live with its settlement with BPA over the FY 2002–2006 rates, but then asserts in a number of ways that it really was harmed by the 2000 REP Settlements. Alcoa Br. Ex., REP-12-R-AL-01, at 27-28.

For example, Alcoa asserts:

Because Alcoa was paying rates that were impermissibly high during the FY 2002–2008 Lookback period, allocating Lookback costs to the IP rate would exacerbate the injuries Alcoa suffered during that period.

Alcoa Br., REP-12-B-AL-02, at 27. Further:

The IP rate itself included impermissible and excessive REP overpayments.

*Id.* at 29. And further:

The proposed approach injures the DSIs in two manners. First, the COUs and IOUs propose to bypass the PF rate schedule altogether by scheduling negotiated Lookback “refunds” to COUs rather than adjustments to the PF rate. This formulation inadvertently (or perhaps intentionally) *prevents any recovery by the DSIs of overpayments that they made under the IP rate schedules when they were paying rates that included the excessive amounts of REP payments found illegal in PGE.*

*Id.* at 31 (emphasis added). Alcoa reiterates this point again in its brief on exceptions: “the unlawful settlement payments made to the IOUs were at Alcoa’s expense.” Alcoa Br. Ex., REP-12-R-AL-01, at 26, n.93.

BPA does not understand how Alcoa can say it is not requesting a refund (or a determination of whether it was overcharged at all) for the FY 2002–2006 rate period, but then say that the IP rate that BPA charged it during this period included “illegal REP Settlement costs,” “excessive amounts of REP payments,” and “unlawful settlement payments” that resulted in “injuries Alcoa suffered during the [WP-02 rate] period.” Alcoa Br., REP-12-B-AL-02, at 27, 28, 31; Alcoa Br. Ex., REP-12-R-AL-01, at 26, n.93.

To BPA the matter is simple. If Alcoa is not claiming it was overcharged, then there is no compelling equitable basis for BPA to conclude that setting the IP rate on anything *other than* the IP rate’s share of the total costs of the REP is appropriate. If Alcoa is claiming it was overcharged, then BPA must determine whether Alcoa’s claim has any merit. To that end, BPA has interpreted Alcoa’s references to having been charged an IP rate that included “excessive amounts of REP payments” and its objection to the Settlement on the basis that it “prevents any recovery by the DSIs of *overpayments that they made under the IP rate schedules* when they were paying rates that included the excessive amounts of REP payments found illegal in *PGE*” as express contentions by Alcoa that it was somehow overcharged as a result of the 2000 REP Settlements, and therefore is entitled to some form of prospective adjustment. Rather than leave these assertions on the record unrebutted, BPA must consider whether Alcoa has a claim to prior refunds. As explained below, BPA concludes Alcoa has no such claim.

*I. Alcoa agrees that it is not entitled to a refund for the FY 2002–2006 period*

As a legal matter, Alcoa’s claim that its rates included “illegal REP settlement costs” is defective because Alcoa and BPA have settled the issues involving Alcoa’s power service for the FY 2002–2006 period. As such, Alcoa cannot at this point claim that BPA included “illegal REP

settlement costs” in the IP rate Alcoa paid during the WP-02 rate period. As noted by Alcoa in its brief in this proceeding, Alcoa and BPA have settled Alcoa’s power rates for the WP-02 rate period. Alcoa Br., REP-12-B-AL-02, at 27. Alcoa thus has *settled* the IP rate established by BPA in the WP-02 ROD, and it may not now claim that BPA included improper costs in its rate for FY 2002–2006. Alcoa did not appeal this decision in the *Golden NW* case, and the Court did not remand to BPA the IP-02 rate. *Golden NW*, 501 F.3d at 1053. Thus, the IP rate BPA charged Alcoa was not “illegal” in any sense. Alcoa agreed to pay this rate (albeit without agreeing to any method or principle in its development), and the Court did not state it was otherwise unlawful.

Alcoa contends that BPA’s reference to Mr. Speer’s testimony in the WP-07S proceeding is misleading. Alcoa Br. Ex., REP-12-R-AL-01, at 29. Alcoa admits that Mr. Speer observed that Alcoa agreed not to challenge rates in effect prior to September 30, 2006, as part of the Compromise Approach settlement. *Id.* Alcoa then quotes language from the Compromise Approach Settlement agreement, which provides that neither party:

[W]ill ... assert in any subsequent BPA power rate case or appeal thereto that either this agreement, or the decisions in § 15.5 of BPA’s 2002 Power Rate ROD, create any procedural or substantive precedent or create any agreement to any underlying principle or methodology. This paragraph survives the expiration of this agreement.

*Id.*

Premised on the above language, Alcoa requests BPA to “withdraw its assertion that Alcoa has somehow waived arguments concerning the treatment of Lookback Amounts/Refund Amounts premised on the resolution of the 2002–2006 contract settlement.” *Id.*

Alcoa misunderstands BPA’s argument and the Compromise Approach language. BPA is not arguing that Alcoa has agreed, through the Compromise Approach language, to live with whatever “treatment” of Lookback Amounts (or Refund Amounts) BPA comes up with in rates. BPA’s point was that the legal effect of the Compromise Approach was to preclude Alcoa from claiming it was overcharged for the 2002–2006 period. Upon reviewing the Draft ROD, BPA realized its arguments could have been better stated and has revised this Final ROD to make this point more clear. If Alcoa disagrees with this interpretation of the Compromise approach language, and believes it can now assert it may “recover ... *overpayments that [Alcoa] made under the IP rate schedules...*” for the FY 2002–2006 period, then *it* may be in violation of the Compromise Approach agreement. Alcoa expressly agreed that it would *not* challenge “in any forum” BPA’s decision in the WP-02 ROD regarding “the sale of power to serve residential and small farm loads of the investor-owned utilities, or the rates for such sales, for the FY 2002–2006 period.” Alcoa Br. Ex., REP-12-R-AL-01, Exhibit 3, § 3. By repeatedly accusing BPA of improperly allocating costs of the 2000 REP Settlements to its Compromise Approach rate, Alcoa may be acting inconsistent with this provision of the Compromise Approach. In any event, BPA believes the Compromise Approach definitively settled for the FY 2002–2006 period Alcoa’s and BPA’s respective obligations. If Alcoa disagrees, then BPA is at a loss as to what the Compromise Approach resolved.

Moreover, the language cited by Alcoa does not preclude BPA from observing that Alcoa is not entitled to a refund for the FY 2002–2006 period. As the specific language makes clear, neither BPA nor Alcoa may point to the Compromise Approach or section 15.5 of the WP-02 ROD (which describes the Compromise Approach) as precedent or agreement as to “any underlying principle or methodology.” Alcoa Br. Ex., REP-12-R-AL-01, at 29. BPA has not relied on the Compromise Approach to support any “principle or methodology” in this case or in any other case. Indeed, no “principle or methodology” used in developing the Compromise Approach or section 15.5 of the WP-02 ROD is considered in this case at all. Rather, BPA has pointed out the simple fact that Alcoa, through its settlement with BPA in the Compromise Approach, has settled its issues with the IP rate for the FY 2002–2006 period. Just as BPA cannot legally claim that Alcoa must pay more for the power it purchased during this period, Alcoa cannot legally claim that it was overcharged and should be entitled to prospective reductions in its rate. The Compromise Approach does not prohibit BPA from making that observation in this case.

2. *Alcoa has waived its challenge to BPA’s Lookback Amount determinations and the method and manner of returning Lookback Amounts.*

To the extent Alcoa seeks to challenge BPA’s Lookback Amount construct, which established which customers were overcharged, by how much, and how BPA would return those amounts to the injured customers, Alcoa has waived its arguments. Before addressing this issue, though, BPA must make a few clarifications. First, Alcoa throughout its briefs has lumped together the Lookback Amounts and Refund Amounts in making its arguments against the rate treatment of these REP costs. In most instances, the issues involving the Lookback Amounts are equally applicable to the Refund Amounts, and therefore use of either term is appropriate. There is one important distinction between these two concepts, however, in regard to waiver and finality. BPA’s decision to supply Lookback Amounts to COUs as refunds on power bills, rather than prospective reductions in rates, was a final decision BPA reached in the WP-07 Supplemental ROD. *See* WP-07 Supplemental ROD, WP-07-A-05, at 266, 279-281. In addition, BPA’s final decision as to which customers were eligible for a targeted billing credit was also made in the WP-07 Supplemental ROD. *Id.* These decisions were not appealed in the APAC case, and BPA has not decided to revisit them here. *See* Gendron *et al.*, REP-12-E-BPA-04, at 6 (noting that Staff was asked “to prepare the Lookback Study using BPA’s existing implementation methodology, making changes only when absolutely necessary.”). Because these issues were decided in a final agency decision without protest from Alcoa, it is BPA’s view that Alcoa has likely waived its specific challenges to BPA’s collection and distribution of *Lookback Amounts*. As will be explained below, a different analysis applies to Alcoa’s challenges to the Settlement and BPA’s decision to distribute Refund Amounts, which involve new agency actions.

Second, the issue of whether Alcoa has waived or not waived its right to challenge the Lookback Amounts and BPA’s prior Lookback construct is largely moot now that BPA has adopted the Settlement. BPA’s prior decisions are being replaced with this decision as discussed in Chapter 8. BPA has retained the discussion of waiver below to demonstrate that, when compared to the *alternative* to the Settlement, Alcoa’s claims of inequity are not persuasive.

Turning now to Alcoa's specific claims against the Lookback Amounts, to the extent Alcoa wishes to challenge BPA's treatment of Lookback Amounts in rates charged in FY 2009–2011, the calculation of the Lookback Amounts, including which entities are entitled to these refunds, and the method and manner of returning Lookback Amounts, Alcoa's arguments have been waived. BPA's procedural rules are clear that parties must raise all issues in their briefs to preserve the issues for appeal: "(b) Waiver of issues or arguments. Parties whose briefs do not raise and fully develop their positions on any issue shall be deemed to take no position on such issue. Arguments not raised are deemed to be waived." *Rules of Procedure Governing Rate Hearings*, § 1010.13(b), 51 Fed. Reg. 7611, at 7618 (1986). Failure to raise these issues before BPA at the appropriate time results in their waiver on appeal. *See Marathon Oil Co., v. U.S.*, 807 F.2d 759, 767-68 (9th Cir. 1986) ("As a general rule, we will not consider issues not presented before an administrative proceeding at the appropriate time.").

The appropriate time for Alcoa to raise concerns with the IP-02 and IP-07 rates and BPA's Lookback repayment method was in the WP-07 Supplemental proceeding. BPA's decisions on the repayment of the Lookback Amounts were addressed in the WP-07 Supplemental ROD. *See* WP-07 Supplemental ROD, WP-07-A-05, Chapter 8 ("Calculation of Lookback Amounts"), at 166-256, and Chapter 9 ("Lookback Recovery and Return"), at 256-300. BPA's decision on the disposition of the Lookback Amounts was clear: "BPA will return the FY 2002–2007 overcharges to the COUs that paid the PF-02 preference rates through individual bill credits[.]" WP-07 Supplemental ROD, WP-07-A-05, at 266, 282. Alcoa did not object to this decision. *Id.*

BPA followed through with this decision by establishing in the studies accompanying the WP-07 Supplemental ROD the list of customers that were overcharged and entitled to refunds. FY 2002–2008 Lookback Study, WP-07-FS-BPA-08, at 325, Table 15.10. Once again, Alcoa is not among the listed parties. On appeal in the APAC case, no party challenged BPA's decisions on these issues. As such, Alcoa has no clear legal grounds to argue either (1) that it is entitled to a Lookback Amount, or (2) that BPA's method for returning refunds to customers is improper.

Alcoa claims that it is not a sufficient defense to say that Alcoa did not assert a right to direct recovery of the Lookback amounts. *See* Alcoa Br., REP-12-B-AL-02, at 29. Again, BPA is not "recovering" the Lookback Amounts from Alcoa, but setting rates to recover the aggregate amount of REP benefits from *all* rates, including the IP rate. Bliven *et al.*, REP-12-E-BPA-12, at 19-23. To the extent that Alcoa means to challenge this method of setting rates and recovering Lookback Amounts, its claim is barred. The time to raise these issues was in the WP-07 Supplemental ROD, not now. This case presents a perfect example of why raising issues before the agency at the time they are considered is so critical. When BPA was fully engaged in determining whether rates were overcharged as a result of the 2000 REP Settlements for the WP-02 and WP-07 rate periods, and if so, how to return such overcharges, Alcoa did not argue for BPA to make such a determination for the IP rate. *See* Speer, WP-07-E-AL-04, at 6. Based on this position, and the fact that Alcoa did not raise this issue on appeal before the agency, BPA did not have to address in the WP-07 Supplemental ROD whether and to what extent the IP rate was or was not overcharged.

Alcoa claims that BPA has unpersuasively asserted that Alcoa has waived its right to raise arguments concerning the collection of Lookback Amounts/Refund Amounts from the IP rate because it should have raised those concerns in prior rate cases. Alcoa Br. Ex., REP-12-R-AL-01, at 28. Alcoa claims BPA's position is factually and legally deficient. *Id.* First, Alcoa claims it was not paying the IP rate during the WP-07S rate period. *Id.* Beginning in October 2006, BPA did not physically sell Alcoa power at the statutory IP rate (or sell Alcoa physical power at any rate, for that matter). *Id.* Instead, Alcoa obtained power through a Monetary Benefit contract, which required Alcoa to purchase power at market rates that greatly exceeded the IP rate. *Id.* BPA, in turn, provided Alcoa with "monetary benefits" designed to partially offset Alcoa's market purchases. *Id.* Alcoa claims that due to BPA's "imposition" of the "monetary benefit" construct, Alcoa had no direct interest in the development of the WP-07S rates, including the treatment of Lookback amounts, because it was not paying the IP rate developed in that proceeding. *Id.*

BPA will address Alcoa's arguments on Refund Amounts later in this section. As to Lookback Amounts, Alcoa's arguments are not persuasive. Alcoa claims that its failure to raise these issues before BPA earlier was due to the fact it had no "direct interest in the development of the WP-07 [Supplemental] rates" because of the particular nature of the contract between BPA and Alcoa during the WP-07 rate period. Alcoa Br. Ex., REP-12-R-AL-01, at 28. According to Alcoa, the monetary benefits contract developed between BPA and Alcoa resulted in BPA paying Alcoa rather than Alcoa purchasing power from BPA at the IP rate. *Id.* BPA agrees with Alcoa's statement that Alcoa was not purchasing power from BPA during the WP-07 rate period. This fact, however, tells only part of the story. As noted by Alcoa's witness, the payments Alcoa received under the Monetary Benefit contract were tied to the floor that was established by the IP rate. Speer, REP-12-E-AL-01, at 13. Thus, the IP rate was not irrelevant to what Alcoa paid under its Monetary Benefit contract. Alcoa is incorrect in asserting that it had no "direct interest" in the development of the WP-07 Supplemental rates.

Second, nothing in the Monetary Benefit contract precluded Alcoa from protecting its interest in the WP-07 Supplemental case by objecting to the rate treatment of the Lookback Amounts. BPA's Lookback repayment construct was not a one-time rate case fix, but a long-term approach to recovering Lookback Amounts from the IOUs. The method of returning Lookback Amounts as targeted refunds was expressly described as applying for multiple rate periods, and would, at the very least, extend over *seven years* (FY 2015). *See* WP-07 Supplemental ROD, WP-07-A-05, at 266. Alcoa was thus on notice that BPA was making a long-term determination regarding the return of Lookback Amounts as targeted refunds, and should have made its concerns known at that time. Instead, Alcoa chose to remain silent. Indeed, Alcoa did raise some concerns initially in its initial testimony, but it did not pursue these issues further with BPA. *See* Speer, WP-07-E-AL-04, at 6. Having chosen to leave this issue unaddressed, Alcoa cannot now claim that it would have done things differently.

Alcoa next argues that it is currently a participant in the *Avista* appeal, which addresses WP-07 Supplemental rate issues, and a participant in the *PGE II* appeal, which addresses WP-10 rate issues. Alcoa Br. Ex., REP-12-R-AL-01, at 30. While noting that the WP-07 Supplemental ROD non-rate issues have been fully briefed in the *APAC* appeal, Alcoa claims that BPA has

stipulated that the non-rate issues in WP-07 Supplemental do not include BPA’s “2007 Supplemental Wholesale Power Rate Case Final Proposal, FY 2002–2008, Lookback Study Volumes I-III.” *Id.* Thus, Alcoa claims that it is not precluded from raising issues concerning BPA’s treatment of Lookback amounts in the litigation in *Avista* and *PGE II*. *Id.*

Alcoa’s representations regarding the parties’ stipulation are seriously flawed. The stipulation that Alcoa cites discusses the parties’ stipulation regarding what issues would be briefed in *APAC*, *IPUC*, and the yet-to-be filed challenges to BPA’s WP-07 rates (*i.e.*, *Avista*). In the background section of this filing, the parties identified a number of documents that BPA had issued on September 22, 2008, as part of BPA’s final decision in the WP-07 Supplemental rate case. *See* Joint Motion to Adopt Stipulated Briefing Schedule, *APAC*, Nos. 08-74725, *et al.*, Dkt Entry No. 64, at 2-3 (Stipulation). One of the references was to the “2007 Supplemental Wholesale Power Rate Case Final Proposal, FY 2002–2008, Lookback Study Volumes I-III” (Lookback Study). *Id.* at 3. Alcoa claims that by including a reference to the Lookback Study in the background section of the Stipulation, BPA and the parties have “stipulated that the non-rate issues in the WP07S do not include the ‘2007 Supplemental Wholesale Power Rate Case Final Proposal, FY 2002–2008, Lookback Study Volumes I-III.’” Alcoa Br. Ex., REP-12-R-AL-01, at 30. Parsing through Alcoa’s double negative, it appears that Alcoa is contending that BPA and the parties stipulated that the Lookback Study issues were “rate issues” and therefore must be addressed in the *Avista* (rather than *APAC*) case as a result of this stipulation. Alcoa’s contention is flatly wrong.

First, Alcoa’s contention is plainly inconsistent with the parties’ stipulation. In section B of the stipulation, where the parties’ *actual stipulation* is described, the parties outline the stipulated briefing plan. Stipulation at 3-4. In part (2) of the stipulated briefing plan, the parties describe the issues to be addressed in *APAC*: “Only the alleged ‘non-rate’ issues addressed in the WP-07 [Supplemental] ROD will be briefed in *APAC v. BPA*.” *Id.* at 4.

The parties then identify what issues were “rate issues” that would have to wait to be appealed after FERC granted final approval of BPA’s rates (*i.e.*, *Avista*):

The rate issues in the WP-07 [Supplemental] ROD include the adoption of the 2008 Section 7(b)(2) Implementation Methodology and Section 7(b)(2) Legal Interpretation and their application to BPA’s FY 2009 rates in the WP-07S rate case. Those issues will be addressed by the parties in any appeals arising from petitions for review filed after final approval of BPA’s FY 2009 rates by the Federal Energy Regulatory Commission (FERC), rather than in this case or *Idaho Public Utilities Commission v. BPA*.

*Id.*

Noticeably absent from the parties’ list of “rate issues” is any reference to the Lookback Study that Alcoa claims the parties “stipulated” would be reviewable in the *Avista* appeal. Alcoa misreads the stipulation.

The parties' actions in the *APAC* litigation also disprove Alcoa's reading of the stipulation. The very issues the Lookback Study addresses, such as whether to conduct the Lookback, how to calculate the Lookback, how to recover Lookback Amounts from the IOUs, and how much Lookback Amount refunds to supply to the COUs, were all addressed in briefs filed by the parties in *APAC*. See generally Evaluation Study Documentation, REP-12-E-BPA-01A, at 278-1648. BPA does not understand what issues would have remained within the scope of the *APAC* appeal if the stipulation were to read as Alcoa argues. All of BPA's Lookback Amount calculations, implementation, and distribution decisions were documented in the Lookback Study. Thus, under Alcoa's reading of the stipulation, all of the very issues that BPA and the litigants have spent a year briefing in the *APAC* case violate the stipulation. However, Alcoa admits that "non-rate issues have been fully briefed in the *Ass'n of Pub. Agency Customers v. BPA*." Alcoa's confusing reading of the stipulation is plainly wrong. Alcoa has missed its opportunity to challenge BPA's Lookback Amount construct, and no creative reading of the background section of an innocuous stipulation can revive it.

Alcoa also claims that it may raise these issues in *PGE II*. This is incorrect. Alcoa did not raise in the WP-10 rate cases any concerns with BPA's treatment of Lookback Amounts. See WP-10 ROD, WP-10-A-02, at 379-421. Thus, it cannot resurrect such issues now. See *Rules of Procedure Governing Rate Hearings*, § 1010.13(b), 51 Fed. Reg. 7611, at 7618 (1986); *Marathon Oil Co., v. U.S.*, 807 F.2d 759, 767-68 (9th Cir. 1986).

Alcoa next contends that even if it waived its ability to address Lookback issues in the WP-07S proceeding, it has not waived them as to this proceeding. Alcoa Br. Ex., REP-12-R-AL-01, at 30. BPA partially agrees with Alcoa on this point. The WP-07 Supplemental ROD and the Lookback Studies, all of which establish the basis for the Lookback Amounts, do not address the treatment of Refund Amounts. The Settlement is a new final action by BPA, and Alcoa should be permitted to raise its issues with any aspect of the Settlement, including the Refund Amounts. To that end, BPA has considered Alcoa's argument and evidence as to the Settlement and Refund Amounts to consider whether the IP rate should be assessed the full cost of the REP.

With respect to Lookback Amounts (which Alcoa commingles with Refund Amounts), BPA stands by its analysis that Alcoa has waived its arguments. Alcoa's claim that BPA and parties routinely change position in rate proceedings is inapposite. Alcoa Br. Ex., REP-12-R-AL-01, at 30-31. That argument presumes the action the agency has taken is subject to being revisited in future rate proceedings. Most of the decisions BPA reached in the WP-07 Supplemental ROD related to the Lookback construct (*i.e.*, the non-rate issues identified in the Stipulation) were clearly not subject to being revisited in each and every future rate proceeding. This is not surprising, because the Lookback construct was not a "routine" ratemaking exercise for BPA. It was generated in response to a remand by the Court. If the Settlement had not been adopted, BPA would have continued to implement the decisions it reached in the WP-07 Supplemental ROD as to the Lookback construct in each and every rate proceeding until the Lookback Amounts were paid off (or until the Court held otherwise). The only Lookback-related issue BPA "left open" to be considered in each future rate proceeding was the amount of REP benefits to withhold from the IOUs in order to repay the Lookback Amounts. See WP-07 Supplemental ROD, WP-07-A-05, at 266 ("BPA will reduce future REP benefits with the objective of

returning the remaining Lookback Amounts to the COUs within seven years ... for FY 2009 the amount of REP benefits provided to any IOU will not fall below 50 percent of the REP benefit amount otherwise due. ... The 50 percent limitation will be subject to reconsideration in future rate proceedings.”). Had the Court affirmed BPA’s decision in the WP-07 Supplemental ROD, BPA does not believe that its decision to implement the WP-07 Supplemental ROD’s Lookback decisions in future rate proceedings (other than determining the amount of REP benefits to withhold from the IOUs) would have been challengeable. Again, BPA reiterates here that these issues are largely moot now that BPA has adopted the Settlement and replaced its previous construct under the Lookback with the Settlement. *See* Chapter 8.

As to the Settlement, a similar analysis will also be applicable if it is affirmed by the Court. BPA’s new answer to the Court’s decisions is this record and the Settlement. If any party believes that this Settlement does not comport with the law, then it must raise those issues here. BPA concurs with Alcoa’s argument that not every issue, no matter how small, should result in full-throttled litigation. But, where BPA is proposing to take an action that will govern the implementation of a component of BPA’s rates for multiple rate periods, such as in this case, the time and place to raise issues with such a proposal is when the agency is first considering the action. If this were not the case, then no action of BPA would ever be considered final because parties could always have a change of heart (as Alcoa has had in this case) and could raise new issues well after the agency has addressed and/or litigated all of the relevant concerns.

3. *Although Alcoa may raise concerns with Refund Amounts in this case, its claim that the Refund Amounts are inequitable to the IP rate is not persuasive because BPA would have continued this treatment with the Lookback Amounts (which Alcoa would likely have been unable to challenge) and because Alcoa has been dilatory in making its concerns known.*

Alcoa apparently recognizes that its claim for any form of refund is defective, and therefore, couches its claims against the Lookback Amounts/Refund Amounts as based in equity. Alcoa Br. Ex., REP-12-R-AL-01, at 28. Alcoa claims that equity dictates that BPA not saddle Alcoa with paying for the total costs of the REP because Alcoa was not a recipient of the 2000 REP Settlement payments. *Id.* BPA has already responded that not receiving the benefits of the 2000 REP Settlements is irrelevant. Many customers did “not receive” the benefits of the 2000 REP Settlements, but nonetheless must still pay rates based on the full costs of the REP. *Id.* Unless Alcoa is entitled to some remuneration for past overcharges, which it is not, BPA sees nothing inequitable with assessing Alcoa its share of the total costs of the REP, as has been done without protest from Alcoa for two rate periods.

As noted above, BPA agrees that Alcoa may raise concerns with the Refund Amounts in this case. However, simply because Alcoa is permitted to raise its new arguments regarding the Settlement and its inclusion of Refund Amounts does not mean BPA must ignore the fact that Alcoa has been less than diligent in making its objections to BPA’s Lookback construct known. Indeed, prior to this case, no one would have known that Alcoa bears the substantial concern that has caused it to forcefully object to the Settlement in this case. These objections were quite surprising, since the Settlement simply codifies the less-controversial aspects of BPA’s

Lookback construct (*i.e.*, providing targeted refunds to those injured most by the 2000 REP Settlements). From an equity standpoint, BPA does not find much merit in Alcoa’s last-minute challenges to the rate treatment of refunds that have gone unchallenged for two rate periods. Again, BPA’s observation on Alcoa’s silence is not to claim that Alcoa has waived its right to challenge the Settlement and its use of Refund Amounts; rather, BPA is making the factual observation that Alcoa has not raised concerns with this treatment in the past.

Indeed, in considering the “equity” arguments presented in this case, it would be equally *inequitable* to the parties that have been diligently pursuing their issues in BPA’s cases to now find that BPA’s past practice of providing targeted refunds was, in fact, mistaken. When BPA and the parties were engaged in the epic battle over who was overcharged and how to return such overcharges, Alcoa stated that it was not going to engage in that fight, but rather live with the results of its settlement. Speer, WP-07-E-AL-04, at 6. When BPA was specifically considering whether to provide the Lookback Amounts as prospective reductions in rates versus targeted refunds, Alcoa said nothing. However, three years later, when BPA and regional parties have shifted their focus from determining overcharges to considering the Settlement, Alcoa presents its new story that not only was it adversely affected by the 2000 REP Settlements, but BPA should recognize this disputed fact in the prospective implementation of the Refund Amount recovery. *See* Alcoa Br., REP-12-B-AL-02, at 29 (“The IP rate itself included impermissible and excessive REP overpayments. Accordingly, Lookback Amounts/Refund Amounts should not be allocated to the IP rate. BPA should adjust its FY 2012–2013 IP rate by eliminating the allocation of the Lookback Amounts / Refund Amounts.”). BPA is unsympathetic to Alcoa’s claims of inequity when it appears Alcoa has waited to make its new issues known until almost all issues were resolved among the majority of the litigants.

Moreover, as noted above, BPA has evaluated Alcoa’s “equity” arguments, in part, from the perspective of the alternative to the Settlement, that is, BPA’s current Lookback construct. Continuing with that comparison, BPA does not find compelling Alcoa’s arguments that it is being treated “inequitably” under the Settlement, considering (1) that this same treatment would have continued under the no-settlement alternative and (2) Alcoa’s ability to challenge BPA’s Lookback Amount construct, had the Settlement not been adopted, is questionable.

4. *The record in this case demonstrates that Alcoa was not overcharged.*

Finally, regardless of whether Alcoa may or may not challenge the Lookback Amounts, the evidence presented on the record supports a finding that Alcoa’s IP rate was not overcharged during the FY 2002–2006 period, and therefore, Alcoa is *not* entitled to any adjustment for Lookback Amounts (under BPA’s construct) *or* Refund Amounts (under the Settlement). Alcoa claims that it purchased physical power directly from BPA between October 2003 and September 2006. Alcoa Br., REP-12-B-AL-02, at 26. Alcoa asserts that because the Ninth Circuit held in *Golden NW* that the PF rate during that period was impermissibly high because it included 2000 REP Settlement costs, the IP rate, which is predicated on the PF rate, was also impermissibly high due to the illegal 2000 REP Settlement costs. *Id.* at 27. Alcoa asserts that because Alcoa’s rates already included illegal 2000 REP Settlement costs, it should not bear responsibility for repaying those same illegal 2000 REP Settlement costs. *Id.* at 28.

Although Alcoa’s view that “if the PF rate was too high, so too was the IP rate” has a simplistic appeal, it is not consistent with the way BPA ratemaking works or with the record in this case. First, Alcoa assumes in its argument that if the PF rate included an inappropriate amount of REP costs, the IP rate also must have been overcharged. Alcoa Br., REP-12-B-AL-02, at 26-28. This is incorrect. Section 7(b)(2) protects only the *PF* rate from REP costs; the IP rate receives no such protection. Gendron *et al.*, REP-12-E-BPA-04, at 35. Although the IP rate does receive a benefit by being linked to the PF Public rate after it has been reduced by rate protection, as Alcoa contends, the 7(b)(3) Supplemental Rate Charge is excluded from the section 7(c)(2) linking. *Id.* This result occurs because of the manner in which the IP rate interacts with the PF Public rate pursuant to section 7(c) and the 7(b)(3) surcharge. Bliven *et al.*, REP-12-E-BPA-12, at 11. When the rate test triggers and reallocates costs away from the PF Public rate, for every one dollar of cost that is removed from the PF Public rate class because of section 7(b)(2), an equivalent dollar of cost is removed from the IP rate class because of section 7(c). *Id.* at 11-12. But for every one dollar of cost that is reallocated away from the PF Public rate class because of 7(b)(2), about one dollar of cost is allocated to all other power sold because of 7(b)(3). *Id.* at 12. The end result is that the IP rate is mostly insulated from the effects of the section 7(b)(2) rate test and moves little in response to how the rate test is implemented. *Id.* at 11. This effect can be observed in the scenarios constructed by Staff.

For example, compare Scenario 15, a case favorable to the COUs, and Scenario 16, a case favorable to the IOUs, with the Reference Case. First, the net present value of REP benefits for the Reference Case is \$3.07 billion, for Scenario 15 \$2.49 billion, and for Scenario 16 \$3.66 billion. Evaluation Study, REP-12-FS-BPA-01, Table 10.4. The two scenarios are about equally variant from the Reference Case, with Scenario 15 \$0.6 billion lower and Scenario 16 \$0.6 billion higher. However, the comparison of the IP rate shows the effects discussed above. A comparison of the PF Public rates confirms the expected effects: Scenario 15 results in an average \$1.89 lower PF Public rate and Scenario 16 results in an average \$1.71 higher PF Public rate, both as compared to the Reference Case. Evaluation Study Documentation, REP-12-FS-BPA-01A, Tables 10.4.3.5.3-4, 10.4.3.6.57-58, 10.4.3.6.63-64. However, the IP rate changes little: Scenario 15 results in an average \$0.33 higher IP rate and Scenario 16 results in an average \$0.25 lower IP rate. *Id.* In these comparisons, while the REP benefits and the PF Public rate are moving significantly, the IP rate moves much less, and in the opposite direction from the PF Public rate. Thus, Alcoa is mistaken in drawing its broad conclusion that simply because the Court in *Golden NW* found that the PF rate included unlawful REP benefits (and therefore was unlawfully high), that the IP rate also included unlawful REP costs (and therefore was also unlawfully high).

Alcoa agrees with BPA’s argument that section 7(b)(2) does not protect the IP rate from REP costs. Alcoa Br. Ex., REP-12-R-AL-01, at 26. However, Alcoa contends, the Northwest Power Act does not contemplate the mechanism employed in the Settlement. *Id.* It is unclear from Alcoa’s brief precisely what “mechanism” is not permitted by the Northwest Power Act. If Alcoa means the notion of returning refunds to the injured customers, BPA addresses this concern in Issues 6.5.3, 6.5.4 and 6.5.5. Whether viewed as part of BPA’s general authority to respond to the Court’s remand, as an allocation of “benefits” under section 7(g), or as part of

BPA's general equitable power to put injured parties in the place they would have been but for BPA's unlawful act, BPA has ample authority under the law to provide targeted refunds to those most injured by BPA's unlawful acts. *See* Issues 6.5.3, 6.5.4 and 6.5.5.

Second, the factual record in this case does not support a finding that Alcoa was overcharged during the WP-02 rate period. Although it was not raised as an issue in the WP-07 Supplemental rate proceeding, as a part of BPA's findings regarding the level of overcharges contained in the PF-02 rates, BPA established revised rates for all classes of service, including the IP rate. Bliven *et al.*, REP-12-E-BPA-12, at 26. That is, BPA calculated two sets of rates: (a) revised rates that would be used for service provided for the remainder of the rate WP-07 rate period and (b) revised rates for the WP-02 rate period, which were necessary to accommodate the Lookback. In establishing the latter revised rates, a revised IP-02 rate was calculated in the WP-07 Supplemental rate proceeding. *Id.* The base IP-02 rate was revised to \$29.44/MWh, FY 2002–2008 Lookback Study Documentation Volume 1, WP-07-FS-BPA-08A, at 173, compared to the original base IP-02 rate established in the WP-02 rate proceeding of \$23.50/MWh, WP-02 Wholesale Power Rate Development Study Documentation, WP-02-FS-BPA-05A, at 93. The revised \$29.44/MWh rate reflects the IP rate BPA would have set had the “illegal REP settlement costs” been removed from the IP rate and replaced with REP benefits that would have been allowed after applying the section 7(b)(2) rate test and reallocation of costs pursuant to section 7(b)(3). Bliven *et al.*, REP-12-E-BPA-12, at 26. Comparing the base IP-02 rate of \$23.50/MWh, which contained some of the alleged “illegal REP settlement costs,” with the revised base IP-02 rate of \$29.44/MWh, which contained the allowable REP benefit costs, BPA can see no basis for conceding that there were any overcharges or “illegal” REP costs in the IP-02 rates. *Id.* at 27. Although this outcome may seem counterintuitive, the unique interaction between section 7(b)(3) and the IP rate makes it possible. As explained by Staff:

it is not surprising that the IP-02 rate was not overcharged: even though the PF-02 rate was revised downward after replacing the 2000 REP Settlement costs with allowable REP benefits, the IP rate was subject to a larger 7(b)(3) surcharge due to the rate protection that resulted in reducing the PF-02 rate.

Bliven *et al.*, REP-12-E-BPA-12, at 27.

Alcoa further argues that requiring Alcoa to bear responsibility for “illegal REP settlement costs” between October 2006 and September 2008 would be even more inequitable. Alcoa Br., REP-12-B-AL-02, at 28. Alcoa contends that in 2005, BPA and Alcoa entered into a contract (the Monetary Benefits contract) under which Alcoa purchased market-based power and BPA provided monetary benefits intended to partially offset the difference between Alcoa's market purchases and the much lower IP rate. *Id.* Alcoa contends that although the allegedly “impermissibly high” IP rate formed a “floor” in the Monetary Benefits contract, Alcoa's net power rates under the monetary benefit construct greatly exceeded the IP rate. *Id.* Alcoa asserts that between October 2006 and September 2008, Alcoa's rates exceeded the IP rate by over \$18 million. *Id.* Nevertheless, Alcoa claims, the “floor” was premised on a rate that included impermissible 2000 REP Settlement costs. *Id.*

BPA is unclear why Alcoa is making these arguments in this case. The calculation of refunds and overcharges associated with the FY 2007–2008 period was addressed as part of the WP-07 Supplemental case. But again, Alcoa did not request BPA to calculate such a refund in the WP-07 Supplemental case for the FY 2007–2008 period. WP-07 Supplemental ROD, WP-07-A-05, at 286-295. More importantly, Alcoa’s concerns with “bearing the responsibility” of refunds from the FY 2007–2008 period are unnecessary. BPA has already paid back in full the refunds associated with the overcharges for the FY 2007–2008 period. *Id.* As noted in the WP-07 Supplemental ROD:

BPA will return the FY 2007–2008 overcharges by providing the COUs with up-front cash payments from funds collected in rates but not paid to the IOUs for FY 2007–2008. BPA has advanced \$170.9 million of this amount already to those COUs that signed Standstill and Interim Relief Payments Agreements.

*Id.* at 266. Thus, from BPA’s perspective, there are no outstanding refunds owed for the FY 2007–2008 period, and the Settlement does not purport to provide any additional refunds for this period. The Refund Amounts, which have their origins in the Lookback Amounts, address outstanding refund amounts associated with overcharges from the *WP-02 rate period*. Gendron *et al.*, REP-12-E-BPA-04, at 13.

Alcoa claims that its alleged overpayments for power during the Lookback period are relevant to rate design under the Settlement because Staff asserts that Alcoa would receive a “windfall” if Alcoa is not charged with a portion of the Lookback Amounts/Scheduled Amounts. Alcoa Br., REP-12-B-AL-02, at 28. Alcoa asserts that such a conclusion is “demonstrably false” because Alcoa did not receive any of the REP overpayments that resulted in the Lookback Amounts/Refund Amounts; indeed, Alcoa alleges, the IP rate Alcoa paid between October 2001 and September 2006 directly included a portion of the illegal REP settlement costs that gave rise to the Lookback Amounts/Refund Amounts. Alcoa Br., REP-12-B-AL-02, at 28-29. BPA has already responded above to Alcoa’s mischaracterizations of the Lookback payments and its claims that it was overcharged in the WP-02 and WP-07 rate periods. Moreover, the fact the IP rate included the costs of the 2000 REP Settlements is not determinative of whether the IP rate was *overcharged*. To make this determination, BPA would have to substitute the unlawful 2000 REP Settlement payments with lawful REP benefits. BPA has performed that calculation in this case, as noted above, and has found that the IP rate for this period was not overcharged.

BPA acknowledges, however, that Staff’s use of the term “windfall” in testimony was probably the wrong word choice. A better way of describing the Settlement would have been to say that BPA believes that setting rates to recover aggregate REP benefits and then returning the Refund Amounts to the COUs is appropriate because it returns overcharges “into the right hands.” Murphy and Kallstrom, REP-12-E-JP02-04, at 10. In BPA’s view, getting the refunds “into the right hands” means into the hands of the parties that are entitled to them; Alcoa is not one of those parties.

## **F. Conclusion**

In conclusion, Alcoa’s equity arguments are not persuasive. From an equity standpoint, Alcoa is not being harmed by BPA’s adoption of the Settlement because BPA will be setting the IP rate

based upon an appropriate share of the aggregate REP costs that BPA may include in rates pursuant to the Northwest Power Act's directives. Thereafter, BPA will assign the cost of providing the refunds to the IOUs by reducing their REP benefits. This is no different from BPA's current method of implementing the Lookback. Compared to the no-settlement alternative, where BPA would do precisely the same type of ratemaking calculation, Alcoa is not only no worse off, but is in fact better off because the Settlement results in a lower overall IP rate. Alcoa's contention that BPA should, prospectively, treat the IP rate as if it were previously subject to "illegal REP settlement costs" during the WP-02 rate period is unsupported. Legally, Alcoa's arguments are infirm: Alcoa has no legal basis to claim it was overcharged because of the settlement it signed with BPA, and because it has likely waived its right to claim an adjustment for a Lookback Amount refund for the WP-02 rate period (the period for which Refund Amounts are being returned). Factually, Alcoa's arguments that it was overcharged are unsupported because the implementation of section 7(b)(2) does not protect the IP rate from REP costs, and because the available evidence in this record presents a strong case that Alcoa not only was not overcharged, but likely was undercharged.

### **Decision**

*The Refund Amounts provided under the Settlement do not result in an inequitable allocation of the costs of the REP to the IP rate.*

### **Issue 6.5.3**

*Whether the Refund Amounts provided under the Settlement comply with the Court's decisions in Golden NW and PGE.*

### **Parties' Positions**

Alcoa claims that the return of the Refund Amounts to the COUs under the Settlement violates the Court's mandate in *Golden NW*. Alcoa Br., REP-12-B-AL-02, at 30. Alcoa asserts that the Court instructed BPA to make prospective adjustments to rates. *Id.* The Settlement, however, provides refunds to a class of BPA customers that does not include Alcoa, which Alcoa claims was also injured by the 2000 REP Settlements found invalid by the Court in *PGE*. *Id.*

### **BPA Staff's Position**

This is a legal issue not addressed by Staff.

### **Evaluation of Positions**

Alcoa contends that the Ninth Circuit's remand instructions did two things: (1) remanded the decision on over-recovery to BPA (not to some of the parties to the dispute); and (2) mandated that, on remand, BPA should *set rates* consistent with the opinion. Alcoa then asserts that BPA has recognized that the Ninth Circuit instructed BPA to redress the illegal 2000 REP Settlements through rate adjustments. Alcoa Br., REP-12-B-AL-02, at 30 (emphasis in original). Instead of

following the Court’s simple remand instructions, Alcoa asserts, BPA proposes to adopt a Settlement negotiated by most, but not all of, the COUs and IOUs. *Id.*

Alcoa’s arguments are not persuasive. First, Alcoa’s general objection to BPA’s decision to evaluate a settlement proffered by parties that represent 93 percent of the region’s load is without merit. BPA is not acting unlawfully by considering the parties’ proposal. As stated elsewhere in this ROD, no unlawful delegation has occurred because BPA has retained the ultimate authority to determine whether or not the Settlement complies with all relevant provisions of the Northwest Power Act and whether the Settlement properly responds to the Court’s decisions in *PGE* and *Golden NW*. See Issue 4.5.2.

Furthermore, the fact that BPA did not come up with the idea for the Settlement is not in any way unlawful. Courts *routinely* affirm agency decisions that are based on settlements developed by private parties. For example, in *Mobil Oil Corp. v. Federal Power Comm’n*, 417 U.S. 283, 297 (1974), the United States Supreme Court found that it was appropriate for the Federal Power Commission to adopt a settlement proposal that was submitted by a private party in litigation over the FPC’s establishment of an area rate structure for interstate sales of natural gas produced in Southern Louisiana. The settlement was admitted into the record, and the Commission “weighed its terms by reference to the entire record in the Southern Louisiana area proceeding since 1961, and further supplemented that record with extensive testimony and exhibits directed at the proposal’s terms.” *Id.* at 312-313. The Commission then adopted the terms of the settlement. *Id.* One of the parties to the proceeding objected, claiming that the Commission was without power to adopt as a rate order a settlement proposal that “lacks unanimous agreement of the parties to the proceeding.” The Supreme Court responded that such a contention “has no merit.” *Id.* at 312.

The Supreme Court then quoted with approval the appellate court’s finding that “if there is a lack of unanimity, it may be adopted as a resolution on the merits, if FPC makes an independent finding supported by ‘substantial evidence on the record as a whole’ that the proposal will establish ‘just and reasonable’ rates for the area.” *Id.* at 314. The Court concluded that “[t]he choice of an *appropriate structure* for the *rate order* is a matter of *Commission discretion*, to be tested *by its effects*. The choice is not the less appropriate because the Commission did not conceive of the structure independently.” *Id.* at 314 (emphasis added).

The administrative law principles recognized by the Court in *Mobil Oil* are instructive to the issues in this case. Parties to this proceeding have presented into the record a Settlement that would resolve longstanding and contentious litigation. BPA did not simply accept these parties’ recommendations, but rather “weighed its terms” by reference to the extensive record developed in this case and BPA’s statutory duties under the Northwest Power Act. *Gendron et al.*, REP-12-E-BPA-04, at 26-38; see also Evaluation Study, REP-12-FS-BPA-01, Chapter 10. Based on this evaluation, BPA finds that the “substantial evidence on the record as a whole” supports a finding that the Settlement complies with all relevant sections of the Northwest Power Act and the Court’s holdings in *PGE* and *Golden NW*. *Gendron et al.*, REP-12-E-BPA-04, at 26-38. BPA’s adoption of the Settlement, then, is in no way unlawful simply because BPA “did not conceive of the structure independently.” *Mobil Oil*, 417 U.S. at 314.

Alcoa claims that the Court mandated that, on remand, BPA should *set rates* consistent with the opinion. Alcoa Br., REP-12-B-AL-02, at 30. Alcoa then asserts that BPA has recognized that the Ninth Circuit instructed BPA to redress the illegal 2000 REP Settlements through rate adjustments. *Id.* Alcoa claims that the Refund Amounts are not prospective rate adjustments, as contemplated by *Golden Northwest*. *Id.* Instead, Alcoa asserts, BPA will “refund to the COU Parties for each Fiscal Year such Refund Amounts” outside of the PF rate schedule. *Id.*

Alcoa correctly notes that the Court ordered BPA to set rates consistent with its opinion. What exactly that instruction meant is the subject of a serious debate that BPA and the parties have spent the better part of three years litigating. BPA’s position is explained at length in the WP-07 Supplemental ROD, WP-07-A-05, at 16-57, and in its brief filed in the APAC case. The parties’ opposing views are also expressed in that decision and in the briefs filed with the Ninth Circuit. *Id.* It is not BPA’s purpose here to re-litigate all of the very issues that BPA and the parties to the litigation are trying to solve through the Settlement. BPA believes that the Court’s instruction gave BPA authority to conduct the Lookback and to provide refunds, but many parties disagree. To the extent Alcoa asserts that the Court ordered BPA to make “prospective rate adjustments,” its claim is without merit, because the Court’s opinion says no such thing. BPA incorporates its previous responses to this issue from the WP-07 Supplemental ROD and its brief in APAC, for the limited purpose of showing that retaining the refund concept in the Settlement is not contrary to the Court’s remand instruction. *Id.*

Moreover, the Court’s instruction in *Golden NW* in no way precludes BPA from adopting the Settlement. BPA *will* be setting rates consistent with the Court’s opinion, so BPA will be complying with the Court’s mandate. Alcoa reads the Court’s mandate as prescribing a particular method for setting rates, without the possibility of recompensing parties for past overcharges. Alcoa over-reads the Court’s mandate. In following the Court’s mandate, BPA is not precluded from considering “any matters left open by [the] mandate of the court.” *In re Sanford Fork & Tool Co.*, 160 U.S. 247, 256 (1895); *see also United States v. Cote*, 51 F.3d 178, 182 (9th Cir. 1995). In this regard, following the Court’s mandate requires “respect for what the higher court decided, not for what it did not decide.” *United States v. Kellington*, 217 F.3d 1084, 1093 (9th Cir. 2000) (*quoting Biggins v. Hazen Paper Co.*, 111 F.3d 205, 209 (1st Cir. 1997)). Here, the Court did not address, as Alcoa contends, whether BPA may consider providing refunds for past overcharges or whether BPA must provide only prospective adjustments to rates. These issues were “matters left open by [the] mandate of the court” and therefore were properly addressable by BPA. *In re Sanford Fork & Tool*, 160 U.S. at 256.

It is surprising that Alcoa has waited until the parties have presented a formal settlement that resolves all issues to raise its new concerns with BPA’s response to the Court’s decisions. BPA expressly addressed the treatment of the Lookback Amounts (the precursor for the Refund Amounts) in rates in the WP-07 Supplemental ROD. *See* WP-07 Supplemental ROD, WP-07-A-05, at 266, 279-282. BPA decided to provide the Lookback Amount refunds to parties that were injured by the PF-02 rates as refunds on power bills rather than prospective rate reductions for all parties. This decision was made in the WP-07 Supplemental ROD (with no objection from Alcoa) and implemented again in the WP-10 rate case (again with no objection from

Alcoa). Litigation over these issues has been ongoing, many briefs have been filed, and yet Alcoa has sat back in silent acquiescence until this case.

Alcoa argues that BPA has recognized that the Ninth Circuit instructed BPA to redress the illegal 2000 REP Settlements through rate adjustments, but Alcoa's claims are seriously misleading. Alcoa Br., REP-12-B-AL-02, at 30. First, the "evidence" Alcoa relies on to make this claim is an answer counsel for Alcoa elicited from BPA's technical staff, who are not lawyers, on the meaning of the Court's opinion. In asking these legal questions of BPA technical staff, Alcoa prefaced its question with the following statement:

I recognize that the panel isn't made up of attorneys. I'm not asking you to offer legal opinions here, but just staff's understanding of the implications of the litigation that flowed out of the 2000 REP settlement.

Cross-Ex. Tr. at 123. Thus, Staff is only offering its lay understanding of the Court's opinion. These lay opinions do not constitute the agency's position on legal matters, particularly matters that the agency has laid out in painstaking detail in a prior ROD.

Alcoa's argument is even less persuasive when considering that Staff's answer does not support the contention Alcoa is trying to make. The cross-examination transcript reads as follows:

Q. So it's your understanding that the 9th Circuit remanded the matter back to Bonneville to *set rates in accordance with the opinion, correct?*

A. (Mr. Bliven) *Yes.*

Cross-Ex. Tr. at 124 (emphasis added). As the transcript makes clear, Staff merely agreed that the Court instructed BPA to set rates in accordance with the Court's opinion. Here, Staff is echoing exactly what the *Golden NW* Court stated: "We therefore remand to BPA to set rates in accordance with this opinion." *Golden NW*, 501 F.3d at 1053. However, Alcoa has somehow interpreted that benign statement to mean BPA "recognized that the Ninth Circuit instructed BPA to redress the illegal 2000 REP Settlements through rate adjustments." Alcoa Br., REP-12-B-AL-02, at 30. Alcoa's reading of the transcript, albeit creative, is unsupported.

Alcoa argues that the negotiated Lookback refunds are not adjustments to rates, pursuant to the Ninth Circuit's express instructions, but are instead premised upon some assessment of damages arrived at by the parties themselves. Alcoa Br., REP-12-B-AL-02, at 31. That assessment, Alcoa asserts, excludes one customer class (the DSIs) entirely from recovery. *Id.*

BPA has already addressed Alcoa's misunderstanding of the Court's opinion. BPA will not repeat those arguments here. As to the source of the Refund Amounts, Alcoa is wrong to assert that it has no basis in the record of this case. As discussed by Staff:

the Settlement includes the paying of approximately \$76 million in refunds a year to the COUs over the next eight years, resulting in a total of approximately \$612 million in additional refund payments. This amount roughly reflects the amount of disputed Lookback Amounts that will remain as of the end of FY 2011 (\$510 million, adjusted for interest for a period of eight years).

Gendron *et al.*, REP-12-E-BPA-04, at 32. While the parties do not agree that this is the only measure of harm to the COUs, they chose to work from BPA's outstanding Lookback Amount figure to determine the Refund Amounts. These amounts, which BPA has heavily documented, are most certainly supported by the record in this case.

As to Alcoa's comment that the Settlement excludes one customer class (the DSIs) entirely from recovery, that is Alcoa's and the DSIs' own doing. As explained in Issue 6.5.2, Alcoa chose to remain silent when BPA and the region were considering the manner and extent of overcharges associated with the 2000 REP Settlements. Had Alcoa made its intention known at the time, BPA would have had the opportunity to consider whether and to what extent Alcoa had been injured by the 2000 REP Settlements. Alcoa chose not to, and as such, is not entitled to any refunds (retroactively or prospectively). Even so, BPA has performed an analysis in this case to see whether Alcoa was in fact injured, and based on the record evidence, BPA finds that Alcoa was most likely not overcharged, but likely *undercharged* during the WP-02 rate period. *See* Issue 6.5.2. Alcoa's claims for refunds (or having its rate set as if owed refunds) under the Settlement are unsupported.

Alcoa claims BPA has not "responded" to Alcoa's argument regarding the Court's instruction in *Golden NW* and instead "resorts" to a fallback position that Alcoa should have raised this issue in an earlier proceeding. Alcoa Br. Ex., REP-12-R-AL-01, at 42-43. Alcoa is incorrect. First, BPA *did* respond to Alcoa's arguments on the instructions from the Court. BPA did so both in the above discussion and through its incorporation of BPA's previous position on this issue in the WP-07 Supplemental ROD. While Alcoa may believe these are new issues, BPA and the litigating parties know very well they are not. There is nothing new in regard to Alcoa's concerns with the Court's remand instructions. Rather than regenerate in this ROD material BPA has already thoroughly addressed previously, BPA simply incorporated by reference into this ROD *the 40 pages of analysis* BPA dedicated to these issues in the WP-07 Supplemental ROD. WP-07 Supplemental ROD, WP-07-A-05, at 16-57. Eleven of these pages directly address BPA's view of the Court's remand instruction and whether that instruction permits BPA to conduct a Lookback-type analysis. *See* WP-07 Supplemental ROD, WP-07-A-05, at 19-30. Alcoa has not responded to BPA's stated positions from the WP-07 Supplemental ROD, and as such, has not rebutted BPA's arguments.

Alcoa then asserts that "monetary refunds" are not "prospective rate adjustments" and consequently, BPA's actions have an adverse impact on the IP rate. Alcoa Br. Ex., REP-12-R-AL-01, at 42-43. BPA responds above to Alcoa's concerns with the Court's remand. As to Alcoa's claim that targeted refunds harm Alcoa's IP rate, BPA responds in Issue 6.5.2.

Alcoa then makes much of the fact that in precisely one sentence in the 330-plus page Draft ROD BPA noted that the COUs do not agree that "that [the Refund Amounts are] the only measure of damages...." *See* Draft ROD, REP-12-A-01, at 219. Alcoa then runs with this one offhand reference to "damages" to claim that "damages are not rates" and BPA's attempt to cloak the damages as rates does not comply with the court's remand instructions in *Golden NW*. Alcoa Br. Ex., REP-12-R-AL-01, at 44. Alcoa's argument is without merit. In the one reference Alcoa mentions, BPA was referring to the fact that the COUs were not admitting that Refund

Amounts constituted the sum total of the *harm* they believe occurred to them as a result of the 2000 REP Settlements. Rather, they were accepting the Refund Amounts as part of the Settlement. BPA used the term “damages” in the colloquial sense, not the legal. The COUs believe they were harmed by paying BPA’s PF-02 rates, and therefore, were “damaged” in the sense they were *overcharged*. Their claim, however, is for *refunds*, not damages.

Alcoa asserts that BPA ignores a number of ratemaking conventions that: (a) are expressly required by statute; and/or (b) BPA has adopted based on its understanding of the law. Alcoa Br., REP-12-B-AL-02, at 31. Alcoa then states it is not *BPA* that has calculated the correct *rates* pursuant to the Court’s remand. *Id.* Rather, Alcoa claims, it is the IOUs and COUs that have developed formulas for the return of negotiated Lookback damages to some, but not all of, the parties injured by BPA’s prior erroneous settlements. *Id.*

BPA has responded elsewhere in this ROD to whether the Settlement complies with the rate directives and other provisions of the Northwest Power Act. *See* Chapter 4 (addressing section 5(c)), Chapter 5 (addressing section 7(b) and 7(c)), Chapter 7 (addressing compliance with *PGE* and *Golden NW*), and chapter 9 (addressing settlement authority). As to whether the *settling parties* will be setting rates under the Settlement, Alcoa is flatly wrong. No rates are set under the Settlement. Rather, rates will continue to be set in each rate period by *BPA*. The return of the Refund Amounts is also not a new invention of the parties. As stated above, BPA has been engaging in these payments for three years, returning hundreds of millions of dollars to regional parties, without a single objection from Alcoa. As to Alcoa’s claim that the Refund Amounts do not address all “parties injured by BPA’s prior erroneous settlement,” BPA disagrees. Alcoa, if injured, has done nothing to preserve its rights. But even more, BPA’s analysis in this case shows that Alcoa was not, in fact, injured. Its call for rate adjustments and refunds that it is not entitled to are without merit.

### **Decision**

*The Refund Amounts provided under the Settlement comply with the Court’s decisions in Golden NW and PGE.*

### **Issue 6.5.4**

*Whether governing statutes prohibit BPA from returning Refund Amounts in accordance with the terms of the Settlement.*

### **Parties’ Positions**

Alcoa argues that if BPA adopts the Settlement and makes Refund Amount payments consistent with the Settlement’s terms, BPA will be violating its own statutes. Alcoa Br., REP-12-B-AL-02, at 29.

WPAG and APAC raise similar concerns with the Settlement’s treatment of Refund Amounts. WPAG claims that BPA lacks the authority to aid in the redistribution of refunds required by the

Settlement. WPAG Br., REP-12-B-WG-01, at 38. WPAG claims BPA has cited no authority to support the proposition that it can increase the PF rate to all preference customers and then redistribute that amount in a manner that benefits some of these customers far more than others. *Id.* APAC raises a similar argument, claiming BPA is adjusting rates solely at the request of its customers—an action that APAC claims BPA has no statutory authority to take. APAC Br., REP-12-B-AP-01, at 11.

### **BPA Staff’s Position**

This is a legal issue that Staff did not address.

### **Evaluation of Positions**

Alcoa, WPAG, and APAC present a consistent theme in their briefs that BPA is without statutory authority to increase the PF rate to collect Refund Amounts. Alcoa Br., REP-12-B-AL-02, at 29; WPAG Br., REP-12-B-WG-01, at 38; APAC Br., REP-12-B-AP-01, at 11. These arguments have been built from the same two faulty premises that have been repeated throughout this section. Those faulty premises are that (1) Refund Amounts are a separate “cost” item in BPA’s rates; and (2) Refund Amounts are not a REP cost.

First, as discussed at length in Issue 6.5.1, Refund Amounts are not a “cost” in BPA’s rates. Refund Amounts are a reduction in REP benefits to the IOUs, and BPA’s ratemaking ensures that these reductions are borne only by the IOUs. *See* Issue 6.5.1. The record provides no other answer.

Second, the Refund Amounts are not distinguishable from REP benefits that are otherwise generally included in rates. *See* Issue 6.5.1; *see also* Bliven *et al.*, REP-12-E-BPA-12, at 24. From a ratemaking perspective, there is no difference. Bliven *et al.*, REP-12-E-BPA-12, at 24. BPA has treated the REP Recovery Amounts (Scheduled Amounts plus Refund Amounts) as REP benefits in its ratemaking and for purposes of its analysis of the Settlement. *Id.* Understanding the genesis of REP Recovery Amounts is important; they are the result of exchange resource purchase costs minus revenues recovered through the PF Exchange rate. Thus, provided that the total cost of the Settlement complies with the limitations of section 7(b)(2), which the record in this case shows that it does, then there is no ratemaking rationale for excluding the total cost of the Settlement (*i.e.*, the total aggregate REP benefits) from the IP and PF rates. *Id.* BPA describes in more detail how the IOUs pay for the Refund Amounts in Issue 6.5.1. Assuming that the Refund Amounts are a cost of the REP, which BPA believes them to be, there is no statutory prohibition on BPA’s collecting these costs in rates.

Alcoa, WPAG, and APAC, however, attack the Settlement on the grounds that the method for returning these funds to the COUs is allegedly unlawful and inconsistent with BPA’s statutory authorities. It is to those issues BPA now turns.

Alcoa argues that the IP rate developed pursuant to the Settlement, including the FY 2012–2013 IP rate, will be inflated because of BPA’s “unusual” treatment of Lookback refund amounts, which fails to adjust the base PF rate by the refunds granted the COUs. Alcoa Br., REP-12-B-

AL-02, at 29. This allegedly “unusual” treatment was fully explained in the WP-07 Supplemental ROD and implemented again in the WP-10 rate case, all without a murmur of protest from Alcoa. WP-07 Supplemental ROD, WP-07-A-05, at 279-282; WP-10 ROD, WP-10-A-02, at 379-421. Moreover, BPA strongly disagrees that returning refunds into the hands of the parties that were overcharged is “unusual.” Indeed, the Supreme Court and other Courts have permitted it many times.

The Supreme Court articulated this view in *United Gas Improvements Co. v. Callery Properties, Inc.*, 382 U.S. 223, 229 (1965), where it upheld a decision by the Federal Power Commission to issue refunds after a rate decision had been overturned, despite a previous holding that the Commission “has no power to make reparation orders.” The Court found instead that, in this instance, “an agency, like a court, can undo what is wrongfully done by virtue of its order.” *Id.*, quoting *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944). Because the Commission “could properly conclude that the public interest required the producers to make refunds,” the Court upheld the action as a proper response to the remand. *Id.* Even though the Court had previously held in *Hope Natural Gas* that the Natural Gas Act (NGA) did not provide any statutory authority for the Commission to make reparation orders, the Court in *United Gas v. Callery* held that where the agency’s order is overturned by the reviewing court, “an equitable power to order refunds may fairly be implied.” *Id.* at 234 (Harlan, J., concurring).

Other opinions are in accord. The D.C. Circuit has held, for example: “If a successful appeal of an erroneous FERC decision ... could not be enforced retroactively, a [utility’s] incentive to vindicate its rights under [law] through judicial review would be similarly diminished. We do not believe Congress intended [this] result.” *Natural Gas Clearinghouse v. FERC*, 965 F.2d 1066, 1074 (D.C. Cir. 1992). In a separate case, the Court described the *Clearinghouse* opinion as follows: “*Clearinghouse* involved a FERC order interpreting whether a section of the Natural Gas Act (NGA) dealing with periodic rate adjustments called for the periodic adjustment of depreciation expenses.” *Pub. Utilities Comm’n of State of Cal. v. FERC*, 988 F.2d 154, 162 (D.C. Cir. 1993). There, FERC’s initial order was reversed and remanded. On remand, FERC adopted a different view and ordered that its new interpretation be applied retroactively to permit the pipeline company to bill its shippers for “recoupment” payments. *Id.*

Finding that “the NGA is silent as to the effect of a judicial invalidation of a FERC decision,” the court applied “the general principle of agency authority” to uphold FERC’s authority to order “recoupment of losses caused by its error.” *Clearinghouse*, 965 F.2d at 1073-1074. Similarly, the *Pub. Utilities Comm’n* court, evaluating an “illegal order” which “induced, even if it did not compel,” a pipeline company to adopt a “gas inventory charge,” held that FERC on remand had the authority to “order[] recoupment of losses caused by its errors” to prevent “pipelines [from being] ‘substantially and irreparably injured’ by FERC errors [leaving] judicial review ... powerless to protect them from much of the losses so incurred.” 988 F.2d at 162-163, quoting *Clearinghouse*, 965 F.2d at 1074-1075.

As these authorities make clear, when an agency is addressing a past unlawful error, providing targeted refunds to the parties injured is not “unusual” or prohibited. Such refunds are a

common occurrence in an industry that must set rates and charge customers years before courts rule on the ultimate legitimacy of those rates.

Alcoa claims that BPA may not adopt the Settlement without violating its own statutory authority and engaging in retroactive ratemaking, which is contrary to widely adopted economic principles that the parties to the Settlement would normally apply as matters of common law. Alcoa Br., REP-12-B-AL-02, at 29. WPAG and APAC raise similar concerns with the Settlement’s treatment of Refund Amounts. WPAG claims that BPA lacks the authority to aid in the redistribution of refunds required by the Settlement. WPAG Br., REP-12-B-WG-01, at 38. WPAG claims BPA has cited no authority to support the proposition that it can increase the PF rate to all preference customers and then redistribute that amount in a manner that benefits some of these customers far more than others. *Id.* APAC claims BPA is adjusting rates solely at the request of its customers—an action that APAC claims BPA has no statutory authority to take. APAC Br., REP-12-B-AP-01, at 11.

These arguments are without merit. First, BPA will address Alcoa’s arguments regarding retroactive ratemaking in the next issue. Second, nothing in BPA’s governing statutes prohibits BPA from issuing refunds to injured customers. These parties have cited no provision of the Northwest Power Act, or any other BPA statute, that expressly restricts BPA’s authority to provide refunds to customers that were overcharged. Alcoa argues that the Northwest Power Act’s plain language makes clear that Congress intended the agency to set prospective rates:

The Administrator *shall establish* a rate or rates of general application for electric power sold to meet the general requirements of ... customers within the Pacific Northwest ... [s]uch rate or rates *shall recover* the costs of that portion of the Federal base system resources needed to supply such loads until such sales exceed the Federal base system resources. Thereafter, such rate or rates *shall recover* the cost of additional electric power as needed to supply such loads....

Alcoa Br., REP-12-B-AL-02, at 33, *citing* 16 U.S.C. § 839e(b)(1). However, this language does not establish that BPA can take no other actions to remedy past violations of law. Rather, it simply says that BPA must establish rates to recover its costs in the manner prescribed by section 7(b), which is what BPA will do under the Settlement. As noted before, BPA will establish rates to recover the *total* costs of the REP, which in this case under the Settlement will mean the REP Recovery Amount. Bliven *et al.*, REP-12-E-BPA-12, at 23. Staff conducts an extensive analysis on these total costs to test whether they violate any provision of the Northwest Power Act. Evaluation Study, REP-12-FS-BPA-01, Chapter 10. The record in this case demonstrates that in almost all instances the Settlement produces greater rate protection to the COUs than would be provided absent a settlement. *Id.* In BPA’s judgment, the Settlement protects the position of the COUs and provides REP benefits to the IOUs in a manner that conforms to the requirements of the Northwest Power Act. *See* Gendron *et al.*, REP-12-E-BPA-04, at 36-37. Because the costs of the REP under the Settlement have satisfied the requirements of the Northwest Power Act, BPA is then free to “establish ... rates” to recover these amounts consistent with section 7(b) of the Northwest Power Act.

Other provisions of the Northwest Power Act, moreover, make clear that BPA may allocate the “cost and benefits” not otherwise allocated under the Act in an equitable manner. Section 7(g) provides:

the Administrator shall equitably allocate to power rates, in accordance with generally accepted ratemaking principles and the provisions of this chapter, all costs and benefits not otherwise allocated under this section, including, but not limited to, conservation, fish and wildlife measures, uncontrollable events, reserves, the excess costs of experimental resources acquired under section 839d of this title, the cost of credits granted pursuant to section 839d of this title, operating services, and the sale of or inability to sell excess electric power.

16 U.S.C. § 839e(g). As noted in the discussion of Issue 6.5.1, the refunds associated with the Refund Amounts are being equitably allocated to the parties that were overcharged as a result of the 2000 REP Settlements. Alcoa and certain members of WPAG are not among those parties. Alcoa has not contended that it was overcharged and has not asked BPA to calculate the extent of those overcharges, and BPA has found that, even if it did ask, the results would likely show that it was *undercharged*. See Issue 6.5.2.

WPAG claims that the aforementioned argument stands for the proposition that BPA is allocating Refund Amounts as a *cost* in rates under section 7(g). WPAG Br. Ex., REP-12-R-WG-01, at 51. WPAG claims that BPA does not have the authority under section 7(g) to allocate the Refund Amounts under this provision because the Refund Amounts are not a cost to BPA. *Id.* at 51-53.

WPAG seriously mischaracterizes BPA’s argument. BPA has steadfastly maintained throughout this ROD that Refund Amounts are *not a cost in rates*. See Issues 6.5.1 and 6.5.2. Instead, BPA has treated the entire cost of the Settlement as REP costs, and has subjected them to compliance with sections 5(c) and 7(b)(2). See section 6.4.2. The aggregate REP costs of the Settlement are being allocated under section 7(b), not section 7(g). See Bliven *et al.*, REP-12-E-BPA-12, at 48 (“costs of 2012 REP Settlement are categorized as ‘exchange resource costs’ and allocated pursuant to 7(b) and excluded from the 7(b)(2) Case of the rate test.”); see also *id.* at 54. There is no evidence in the record supporting WPAG’s contention.

As to BPA’s statement above, BPA was making the point that section 7(g) permits BPA to *distribute* the Refund Amounts in an equitable manner. To that end, BPA specifically stated “the *refunds* associated with the Refund Amounts are *being equitably allocated to the parties that were overcharged* as a result of the 2000 REP Settlements. *Alcoa and certain members of WPAG are not among those parties.*” How WPAG could interpret this statement to mean “the Refund Amounts are *costs* that are not otherwise allocated pursuant to the provisions of the Regional Act” is unclear. WPAG Br. Ex., REP-12-R-WG-01, at 51.

In any event, the record is clear that the Settlement’s costs go into rates as REP benefits, and as such are subject to sections 5(c) and 7(b)(2) of the Northwest Power Act. See section 6.4.2. The Settlement REP Recovery Amounts are included in rates only because they have been tested by application of section 7(b)(2) and found to be allowable in rates thereunder. But, when BPA is

withholding REP benefits in order to fund Refund Amounts (as BPA is doing today with Lookback Amounts), BPA distributes these as credits on power bills. In terms of BPA's authority to distribute refunds, section 7(g) permits BPA to "equitably allocate" the "costs and benefits" not otherwise allocated under section 7. 16 U.S.C. § 839e(g). Whereas the collection of REP costs is subject to section 7(b)(2), the payment of refunds is not. As noted above, refunds to customers are unquestionably a "benefit" not "otherwise allocated" under the provision of the Northwest Power Act. Thus, BPA has authority under section 7(g) to *distribute* these credits in the form of Refund Amounts to customers, as described in the Settlement, provided that such distribution is "equitable." For the reasons discussed throughout this Chapter 6, distributing the Refund Amounts to those customers that were most harmed by the 2000 REP Settlements is unquestionably equitable. BPA has been using this authority for three years to provide targeted distributions of Lookback Amount credits, and BPA will continue to use that same authority in the future under the Settlement with Refund Amounts.

Moreover, even if the Northwest Power Act does not provide BPA a clear statutory basis for implementing the Refund Amounts, which BPA believe it does, BPA's actions would still be within the agency's general powers to construct a remedy to past violations of statute. It is a well-established principle of law that an agency's discretion is at its zenith when it is constructing remedies to past violations of law. *See Pub. Util. Comm'n of Cal. v. FERC*, 988 F.2d 154, 163 (D.C. Cir. 1993) ("*CPUC*"). Within that broad authority is the discretion to rely upon the "familiar principle of equity to regard as being done that which should have been done." *See Central Maine Power Co. v. FPC*, 345 F.2d 875, 876 (1st Cir. 1965); *see also Plaquemines Oil & Gas Co. v. Federal Power Comm'n*, 450 F.2d 1334, 1337-1338 (D.C. Cir. 1971). Federal agencies, just like courts, may call upon these equitable powers to construct a remedy that is consistent with the law as well as fundamental principles of fairness and justice. *See Niagara Mohawk Power Corp. v. FPC*, 379 F.2d 153, 160 (D.C. Cir. 1967). As the Court in *Niagara* observed:

The principles of equity are not to be isolated as a special province of the courts. They are rather to be welcomed as reflecting fundamental principles of justice that properly enlighten administrative agencies under law. The courts may not rightly treat administrative agencies as alien intruders poaching on the court's private preserves of justice. Courts and agencies properly take cognizance of one another as sharing responsibility for achieving the necessities of control in an increasingly complex society without sacrifice of fundamental principles of fairness and justice.

*Id.*

In exercising these powers, BPA recognizes that it does not have a broad equity charter. *Id.* at 160, n.22. Rather, BPA's purpose is simply to establish a rough equity under the Settlement such that those that were most injured by BPA's previous unlawful acts will be rightfully compensated. BPA believes adopting remedies to past overcharges in rates is logically within the scope of the administrative discretion entrusted to BPA under the Northwest Power Act. *Id.* at 158.

In this case, BPA finds that the Settlement properly addresses an inequity that would arise if future refunds were not distributed in a general manner to the parties that were most injured. This inequity was first identified in BPA's WP-07 Supplemental ROD, without dispute from Alcoa, WPAG, or APAC (it was actually proposed by APAC), and would continue under the Settlement if the parties had not developed the Refund Amounts. *See* WP-07 Supplemental ROD, WP-07-A-05, at 279-82. Providing targeted refunds under the Settlement through the Refund Amounts properly addresses this inequity by recognizing that not all parties were injured in the same way as a result of the 2000 REP Settlements. For the COUs that paid the WP-02 PF rates, undoing BPA's prior legal mistake means providing some sort of remuneration for these overcharges. The Settlement does just that by including targeted refunds through the Refund Amounts. BPA views this aspect of the Settlement as an appropriate exercise of BPA's general equitable powers to place the parties injured by BPA's previous actions in the position they would have been in had BPA not committed the legal error of entering the 2000 REP Settlements. *Pub. Util. Comm'n of Cal. v. FERC*, 988 F.2d 154, 168 (D.C. Cir. 1993); *see also AT&T Corp. v. F.C.C.*, 448 F.3d 426, 433 (D.C. Cir. 2006); *Exxon Co. v. FERC*, 182 F.3d 30 (D.C. Cir. 1999); *United Gas Improvements Co. v. Callery Properties, Inc.*, 382 U.S. 223, 229 (1965). The settling parties have arrived at a value that they believe adequately compensates these parties, and as noted above, these amounts have a direct correlation to the Lookback Amounts BPA has previously calculated. BPA finds no error in the Settlement's continuation of the return of refunds to the COUs.

Moreover, BPA, as a Federal agency, also may use its common law right to set off debts to withhold payments to the IOUs to fund the Refund Amounts credits to the COUs. The courts have long recognized that the government may use the common law to set off debts and payments. *See U.S. v. Munsey Trust Co.*, 332 U.S. 234, 239 (1947); *Dunn & Black, P.S. v. U.S.*, 492 F.3d 1084, 1092, n.10 (9th Cir. 2007). The authority to set off debts extends between separate contracts that the debtor may have with the government. *See Cecile Industries, Inc. v. Cheney*, 995 F.2d 1052, 1054 (Fed. Cir. 1993). As such, in the absence of explicit statutory guidance, an agency may use its authority under the common law right of setoff to collect overpayments. *See Applied Companies v. U.S.*, 144 F.3d 1470, 1476 (Fed. Cir. 1998). In this case, BPA may also use its common law setoff authority to "withhold" REP benefits under the Settlement to fund refunds to the COUs. *See also CP Nat'l Corp. v. Bonneville Power Admin.*, 928 F.2d 905, 914 (9th Cir. 1991) (permitting BPA to recover overpayments in REP benefits from CP National).

APAC claims that the Refund Amounts included in the Settlement were intended to solve "perceived inequities" within the ranks of the COUs. APAC Br., REP-12-B-AP-01, at 11. Those "perceived inequities" are very real. Not all parties experienced the harms of the original 2000 REP Settlements equally. Some customers bore the full brunt of the costs of the 2000 REP Settlements by paying higher rates, while others were not injured at all. WP-07 Supplemental ROD, WP-07-A-05, at 279-282. In considering how to remedy these injuries, it makes sense that those that were harmed the most receive the largest share of the refund.

It is strange that APAC would challenge BPA's authority to address the inequity of providing overall lower rates for all ratepayers as opposed to targeted refunds to customers that were

injured. BPA's present method for returning the Lookback Amounts, as described in the WP-07 Supplemental ROD, is directly related to these same "perceived inequities[.]" WP-07 Supplemental ROD, WP-07-A-05, at 279-82. APAC's opposition is even more bizarre considering that BPA's current practice of setting rates based on the total cost of the REP, and then providing targeted refunds to the injured COUs, is due in large part to the arguments APAC made in the WP-07 Supplemental rate case. In the WP-07 Supplemental proceeding, Staff *initially* proposed to set rates to collect the *net* amount of REP benefit the IOUs would receive. *Id.* at 279-80. That is, BPA would calculate the lawful amount of REP benefits provided under the Northwest Power Act and then reduce these benefits to recover the outstanding Lookback Amounts. *Id.* This lower level of REP benefits would be used to set rates, and *all* BPA ratepayers would experience lower rates as a result. APAC, however, challenged BPA's proposal. *Id.* at 280. In persuasive arguments, APAC pointed out that Staff's proposal did not return the Lookback Amount to those customers that suffered the harm created by the inclusion of the 2000 REP Settlement costs in the PF-02 rates. *Id.*, *citing* Wolverton, WP-07-E-AP-01, at 86. BPA adopted APAC's targeted approach with a minor modification. *Id.*

APAC claims that the inequities which APAC originally attacked in the WP-07 Supplemental were those that denied payment to the consumers who had actually suffered the increased rates under the 2000 REP Settlements. APAC Br. Ex., REP-12-R-AP-01, at 12. APAC claims that the "current adjustments" to seemingly benefit some pre-Subscription customers and perhaps cure other inequities among COUs do not appear to address APAC's original concerns. *Id.*

First, APAC's concern with the distribution of the Refund Amounts to *all* COUs, including pre-Subscription customers, as provided in section 3.4 of the Settlement, is a new argument. This issue was not addressed in APAC's initial brief, and indeed, has not been raised by any party throughout this case. APAC's challenges to the distribution of Refund Amounts to pre-Subscription customers have been waived. *See Procedures Governing BPA Rate Hearings*, § 1010.13(b), (c).

Second, assuming *arguendo* that APAC's claim is appropriately raised, it is not persuasive. BPA does not agree that the proposed treatment of Refund Amounts under the Settlement is unreasonable simply because it does not address all of "APAC's original concerns." While BPA concurs that it is not perfect, the Settlement provides substantial advantages over BPA's previously proposed method. As noted before in the introduction to this Chapter 6, BPA recovered the Lookback Amounts from individual IOUs through reductions in each IOU's REP benefits. *See* sections 6.1–6.2; *see also* Gendron *et al.*, REP-12-E-BPA-04, at 11. The individualized nature of the Lookback Amounts made their recovery highly dependent upon the amount of REP benefits the IOU receives from BPA. Gendron *et al.*, REP-12-E-BPA-04, at 11. Over the past three years, some IOUs have made substantial strides in paying off their Lookback Amounts, while another, Idaho Power, has made no progress at all. *Id.* The lack of certainty over the recovery and payment of the Lookback Amounts was one of the chief criticisms that parties such as APAC leveled against BPA's Lookback repayment construct. Evaluation Study Documentation, REP-12-E-BPA-01A, at 681-687 (APAC noting the uncertainty associated with BPA's Lookback construct in its Opening Brief in the APAC litigation); *see also* WP-07 Supplemental ROD, WP-07-A-05, at 263-276.

Under the Settlement, this uncertainty is all but gone. The Refund Amounts provided under the Settlement are treated as an *aggregate* refund obligation of the IOUs as a group. Gendron *et al.*, REP-12-E-BPA-04, at 11. Unlike the Lookback Amounts, the Refund Amounts are *not* an individual refund obligation of any one IOU. *Id.* In this way, the Refund Amounts are superior to the Lookback Amount construct BPA developed in the WP-07 Supplemental ROD because the uncertainty over the source of funding for the recovery and return of refunds to the COUs is removed. *Id.* The Refund Amounts will also be returned under a *fixed* schedule. *See* Settlement, REP-12-A-02A, Table 3.2. These payments will not be subject to change by the Administrator or subject to the “50 percent” rule that APAC has vigorously challenged in the APAC litigation and in the WP-10 rate case. Evaluation Study Documentation, REP-12-E-BPA-01A, at 681-687.

Moreover, the COUs will be able to retain these payments *without dispute*. This is a key feature of the Settlement. As things stand now, not a single COU or IOU ratepayer of BPA knows whether or not the rates it has paid, the REP benefits it has distributed to its residential consumers, or the refunds it has received are lawful. Stiffler *et al.*, REP-12-E-BPA-13, at 5. And the problem only grows with time. *Id.* With each new attempt by BPA to “fix” the latest set of problems with its implementation of the REP, a new wave of litigation will likely be filed. *Id.* The end result is that, until the Court finally rules on almost every bone of contention among the many parties, the region will face continuing uncertainty in both the level of the PF rate and the amount of REP benefits payable to the IOUs. *Id.*

In short, the “perceived inequities” APAC derides are the very inequities that APAC championed three years ago in the WP-07 Supplemental rate proceeding to such effect that BPA adopted APAC’s position. These inequities are still valid considerations under the Settlement. The Settlement properly addresses these inequities by retaining the method originally advocated by APAC of setting rates based on the total aggregate REP benefits and returning targeted refunds pursuant to the terms of the Settlement. Whether viewed as an equitable allocation under 7(g) of the Northwest Power Act or as part of BPA’s inherent equitable authority to place parties in roughly the same position they would have been in without BPA’s legal error, BPA’s actions are lawful.

### **Decision**

*BPA’s governing statutes do not prohibit BPA from returning Refund Amounts in accordance with the terms of the Settlement.*

### **Issue 6.5.5**

*Whether the Settlement’s requirement that BPA provide targeted refunds through the Refund Amounts, rather than lower prospective rates, violates the rule against retroactive ratemaking.*

## **Parties' Positions**

Alcoa claims that the Settlement's Refund Amounts construct requires BPA to engage in retroactive ratemaking. Alcoa Br., REP-12-B-AL-02, at 32.

## **BPA Staff's Position**

This is a legal issue not previously addressed by Staff.

## **Evaluation of Positions**

Alcoa asserts that by issuing Refund Amounts rather than prospective rate adjustments, BPA would be engaging in retroactive ratemaking in "clear contravention to its statutory authority." Alcoa Br., REP-12-B-AL-02, at 32. Alcoa then relies on cases involving the Federal Energy Regulatory Commission's authority to require retroactive adjustments to rates. *Id.*

Alcoa's arguments are not persuasive. As exhaustively discussed in the WP-07 Supplemental ROD, BPA's decision to consider past overcharges (and provide refunds to the injured customers) is an appropriate response to the Court's remand order and is not prohibited by the rule against retroactive ratemaking. WP-07 Supplemental ROD, WP-07-A-05, at 16-56. BPA incorporates by reference its previous responses here. *Id.* There, BPA stated, in part, that Federal Power Marketing Agencies like BPA are not subject to a prohibition on retroactive ratemaking due to the requirements of the Flood Control Act as that statute has been consistently applied by the courts:

[N]either the filed rate doctrine nor, by extension, the prohibition of retroactive action, applies to BPA because Federal power marketing administrations (PMA) such as BPA are "required by the plain language of [the Flood Control Act] to protect the public fisc by ensuring that federal hydro-electric programs recover their own costs and do not require subsidies from the federal treasury." *U.S. v. City of Fulton*, 475 U.S. 657, 668 (1986). In *Central Electric Power Cooperative, Inc. v. Southeastern Power Administration (SEPA)*, 338 F.3d 333, 335 (4th Cir. 2003), the Fourth Circuit reversed the district court's holding that a "rate schedule was arbitrary and capricious because it imposed a surcharge on plaintiffs in order to recover revenue shortages incurred during a prior period." The appellate court held that "the Flood Control Act authorizes [SEPA, FERC, and the DOE] to recover such losses and affords them considerable discretion in structuring rate schedules in order to do so." *Id.* The court noted that "PMAs must sometimes set rates specifically aimed at recovering revenue shortages sustained during prior rate periods" and that "PMAs would be unable to meet the requirements of the Flood Control Act if they were prohibited from devising rates aimed at addressing unexpected revenue shortfalls." *Id.* at 337.

*Id.* at 24. BPA also specifically noted that FERC has endorsed the view that Federal Power Marketing Agencies are not subject to a prohibition on retroactive ratemaking:

The prohibition against retroactive ratemaking contained in the Federal Power Act does not apply to PMAs, including Southeastern, that operate subject to a

different statutory and regulatory scheme. Indeed, the Flood Control Act 1944, as amended, 16 U.S.C. § 825s (1988), and the relevant regulations, including Department of Energy Order RA 6120.2 at 4-5, expressly allow costs not recouped in one time period to be recovered in another, later time period so as to ensure recovery of both the costs of producing power and [recovering] the Federal investment.

*Id.* at 25, quoting *Southeastern Power Admin.*, 55 F.E.R.C. ¶¶ 61,016, 61,045 (1981). In other situations, FERC has also approved rates that SEPA and the Southwestern Power Administration have designed to recover revenue shortfalls incurred under previous rate schedules. *Southwestern Power Admin.*, 18 F.E.R.C. ¶¶ 61,052, 61,088 (1982); *Southeastern Power Admin.*, 23 F.E.R.C. ¶¶ 61,403, 61,895 (1983). The Administrator also noted that “BPA has availed itself of surcharges to recover past underrecoveries of costs. In the early 1980s, BPA included deferral adjustments in prospective rates to compensate for seven consecutive years of deferral of payments to the U.S. Treasury.” WP-07 Supplemental ROD, WP-07-A-05 at 25 (citing, e.g., 1983 Final Administrator’s ROD, WP-83-A-02, at 171).

However, Alcoa ignores this explicit authority for the proposition that Federal Power Marketing Administrations are not subject to the prohibition on retroactive rate-making and the fact that historically BPA has engaged in retroactive ratemaking in the past when necessary to recover its costs. When faced with this explicit authority for the position taken by BPA, Alcoa even goes so far as to make the following observation:

While acknowledging that the rule against retroactive ratemaking is alive and well in rate-setting jurisprudence, BPA contends that the rule does not apply to it because Federal Power Marketing Administrations (“PMAs”) like BPA are exempt due to their wide discretion in recovering their costs under the Flood Control Act (“FCA”). Again, BPA’s arguments are interesting, but irrelevant to the current situation.

Alcoa, Br. Ex., REP-12-R-AL-01 at 47 (footnote omitted). Why BPA’s reliance on explicit case law is merely “interesting” and “irrelevant” in light of Alcoa’s allegations that BPA is subject to the prohibition on retroactive ratemaking is unclear.

Citations to legal authority aside, the issue of whether a retroactive ratemaking prohibition should apply to Federal Power Marketing Agencies like BPA can also be resolved by application of logic and common sense. All utilities, even those subject to a prohibition on retroactive ratemaking, recover all of their costs. Otherwise, they could not continue their business operations for very long. The prohibition on retroactive ratemaking is simply a tool that allows regulatory agencies to determine who should bear a particular loss. In the case of IOUs, regulators sometimes find that a cost that should have been recovered in a prior rate period must be borne by the shareholders of the company rather than by their consumers. BPA hopes that Alcoa understands that BPA must recover all of its costs, both because it’s a good way to operate a business and because BPA’s governing statutes require it. The statutes also require that those costs be recovered through generation of revenue from power sales and other revenue generating activities. The statutory framework is, in part, a simple recognition that BPA has no

shareholders to which it can allocate costs that were not recovered in a prior rate period and BPA cannot lawfully recover those costs by withdrawing funds from the general Treasury.

Furthermore, it is not clear from Alcoa's arguments, and it is not manifest anywhere else, why retroactive ratemaking is even implicated here. As noted above, retroactive ratemaking occurs when a utility attempts to retroactively change prior rates or recover a cost in a current rate period that should have been recovered in a prior rate period. Regulators have the authority to disallow such ratemaking treatment, thus preventing the recovery of such costs from consumers and requiring utilities to look to some other source. Here, all costs have been recovered, including the overcharges to preference customers resulting from the defective 2000 REP settlement. Thus, the problem here is not with cost recovery. Instead, BPA is now making sure that affected preference customers are restored to the position that they would have occupied absent the payment of unlawful REP benefits which were included in, and which improperly inflated, the preference rate. BPA is accomplishing that goal by offsetting allowable REP benefits over time in an amount that is sufficient to compensate preference customers for the costs that were unlawfully included in the preference rate. Thus, BPA is providing a form of relief for those who were adversely affected through REP benefit adjustments, or offsets, so that preference customers are made whole by those who benefitted from the improper payments. Not only is this fair and equitable, it does not really involve cost recovery so much as it involves cost reallocation. Thus, retroactive ratemaking concerns do not even appear to be at issue here.

Yet none of this deters Alcoa from continuing its attack primarily by distorting the positions that BPA has taken on this issue. For example, Alcoa states:

BPA continues to defend the treatment of the Lookback refunds in the Settlement. Specifically, BPA maintains that issuing refunds to specific customers, rather than adjusting prospective rates, is not unusual. In defense of its position, BPA cites a number of cases that, while interesting, are irrelevant to the situation at issue in the REP-12 proceeding. The main case relied on by BPA, *United Gas Imp. Co. v. Callery Properties, Inc.*, 382 U.S. 223 (1965), dealt with a rate proceeding before the Federal Power Commission ("FPC") concerning gas producers in south Louisiana.

*Id.* at 44. First of all, *Callery* is not the "main case" relied on by BPA in connection with the issue of retroactive ratemaking. Instead, BPA relies mainly on the cases cited above, which explicitly held that BPA and other power marketing agencies are not subject to a prohibition on retroactive ratemaking. Nonetheless, Alcoa goes on to make a number of arguments regarding why it believes BPA's reliance on *Callery* is misplaced. First, Alcoa states that "[t]he rule outlined in *Callery* did not create a blanket rule for all future rate-setting decisions by agencies operating under federal laws." *Id.* at 45. BPA has never maintained that it did. BPA merely relied on *Callery* for the general administrative law precepts related to an executive agency's ability to provide appropriate relief when it is appropriate under the circumstances:

Moreover, "administrative agencies have broad discretion in fashioning remedies. This is particularly true when an agency is responding to a judicial remand. Courts have found that an agency can give effect to a judicial decision by taking

action that it could not otherwise take under normal circumstances.” *In the Matter of QualComm Incorporated*, FCC Order #FCC00-189, June 8, 2000.

The Supreme Court articulated this view in *United Gas v. Callery Properties*, 382 U.S. at 229 (1965), where it upheld a decision by the Federal Power Commission to issue refunds after a rate decision had been overturned, despite a previous holding that the Commission “has no power to make reparation orders.” The Court found instead that, in this instance, “an agency, like a court, can undo what is wrongfully done by virtue of its order” (quoting *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944)). *Id.* Because the Commission “could properly conclude that the public interest required the producers to make refunds,” the Court upheld the action as a proper response to the remand. *Id.* Even though the Court had previously held in *Hope Natural Gas* that the Natural Gas Act (NGA) did not provide any statutory authority for the Commission to make reparation orders, the Court in *United Gas v. Callery* held that where the agency’s order is overturned by the reviewing court, “an equitable power to order refunds may fairly be implied.” *Id.* at 234 (Harlan, J., concurring).

WP-07 Supplemental Record of Decision, WP-07-A-05, at 21. Thus, the Court was focused on the power of agencies, in general—not the Federal Power Commission specifically—in holding the administrative agencies have “broad discretion” to fashion remedies in response to the judicial order and specifically countenanced the ability to provide refunds when an agency’s decision is overturned by the Court.

Alcoa also posits that BPA’s analysis is flawed in that *Callery* was “a FPC case under the Natural Gas Act, in which the Commission is exercising its independent regulatory authority is irrelevant to a Northwest Power Act case where BPA has received specific remand instructions from a Court that invalidated a prior settlement.” Alcoa Br. Ex., REP-12-R-AL-01, at 45. A fair reading of the case, as described above, reveals that the court was not referring solely to the authority of the Federal Power Commission under the Federal Power Act or limiting its holding to decisions made by regulatory agencies rather than implementation of a court’s remand order to an agency. To the contrary, the court made specific reference to administrative agencies responding to court orders and found that administrative agencies, in general, have broad latitude when implementing a court order. *Callery*, 382 U.S. at 229 (1965). Thus, the opinion speaks broadly to the effect that an agency is empowered to take measures to correct a rule of its own making and that, in instances where a court finds an administrative decision legally defective, “an equitable power to order refunds may fairly be implied.” *Id.* Alcoa’s strained and narrow reading of the case is unsupportable.

Nonetheless, Alcoa offers two additional, and equally misplaced, reasons why it believes *Callery* is inapposite. Alcoa claims the cases are distinguishable because “the WP-02 rate case, at issue in [*Golden NW*] and *PGE*, was a final decision under the [Northwest Power Act], whereas the rates at issue in *Callery* were not.” Alcoa Br. Ex., REP-12-R-AL-01 at 45. This argument has no merit, however, because as mentioned above, the Court was not fixated narrowly on Federal Power Commission authorities, but was clearly being guided by principles of administrative law generally applicable to executive agencies. Inexplicably, Alcoa cites language from *Callery* that

appears to support BPA's position: "While the Commission 'has no power to make reparation orders,' its power to fix rates under § 5 being prospective only, it is not so restricted where its order ... has been overturned by a reviewing court." *Id.* In this instance, too, the 2000 REP settlement was overturned by a ruling court. Alcoa does not explain why responding to the court's remand order would not implicate a similar degree of flexibility with respect to BPA's actions.

Alcoa also maintains that BPA's analysis is flawed because "the [Northwest Power Act] sets forth specific rate setting directives that govern this proceeding and were not at issue in the cases cited by BPA, which did not involve BPA or the [Northwest Power Act]." Alcoa Br. Ex., REP-12-R-AL-01, at 45. It is true that the exact facts of this case were not presented in *Callery*. However, this is not particularly novel in the law, where the vast majority of cases require that attorneys and courts extrapolate general principles from cases that were decided on different facts and apply those principles accordingly. In this instance, *Callery* may not be "on all fours" with the present case. It need not be, however, because the Court clearly was relying on and enunciating principles of administrative law applicable to executive agencies in general. BPA therefore believes that the case is sufficiently instructive that it may be relied upon for the rather unremarkable conclusion that an executive agency responding to a court's remand order may take actions that are designed to reasonably carry out the instructions set forth by the court in that order. Alcoa's apparent view to the contrary would have a crippling effect on the ability of courts to provide meaningful review of agency actions and on the agencies charged with carrying out the orders of a reviewing court.

Alcoa also makes much of the fact that "[s]ubsequent decisions support interpreting *Callery* to apply only to decisions that are not final" and concludes from that "*Callery* does not endorse the Settlement's billing credit construct because the order in the WP-02 rate case was final upon FERC approval." *Id.* In this connection, Alcoa cites *Dist. of Columbia v. Dist. of Columbia Pub. Serv. Comm'n*, 905 A.2d [sic] 249 (D.C. 2006), where the court stated that "once a regulatory body has authorized a public utility to charge a particular rate, having found that rate to be reasonable, it may not require the utility to pay refunds to its customers based on its subsequent finding that the rate was excessive-even if it concludes that it made an error when it approved the rate in the first place." *Id.* at 257 (citing *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co.*, 284 U.S. 370 (1932)). Alcoa further also points out that the court stated that "[i]n *Callery*, the Supreme Court merely held that even though a regulatory agency may have no power to make reparation orders, it still may order a refund on remand to effectuate an appellate court reversal of its original rate order, which never became final." *Id.* at 259 (citing *Callery*, 382 U.S. at 229). Alcoa then takes the position that *Callery* is inapplicable because "[i]n the WP-02 case, the rates were deemed final upon approval by FERC." Alcoa Br. Ex., REP-12-R-AL-01, at 45 (citing *Golden NW*, 501 F.3d at 1042-43). In support of this contention, Alcoa cites to a Ninth Circuit opinion that Alcoa claims found that a BPA rate order has not been "deemed final" until FERC denies any petitions for rehearing. *Id.*, citing *PacifiCorp v. FERC*, 795 F.2d 816, 820 (9th Cir.1986). However, Alcoa then states that "[t]his is in accordance with the statute, which provides for judicial review of final rate determinations." *Id.* citing 16 U.S.C. § 839f(e)(1)(H).

Alcoa's logic in this instance tortures the statutory framework to reach an unsupportable conclusion. "Final rates" developed by BPA are "final" only in the sense that the agency has made its "final" decision, triggering other levels of review; these rates are not, as Alcoa seems to believe, final in the sense that they are no longer reviewable by the Court. The rates themselves are "final" only after that review, in its entirety, has taken place. Once BPA concludes its section 7(i) ratemaking process, the Administrator's final decisions on the rates are sent to the Commission, which typically grants interim approval. The statute itself, however, does not state that the Commission's approval under the limited standard provided by section 7(a) of the Northwest Power Act results in the rates "deemed final." The statutory language states only that the rate shall "become effective" upon the Commission's finding that the rates are in compliance with cost recovery requirements of Section 7(a). 16 U.S.C. § 839e(a)(2). Thus, the rates are "final" only in the sense that they have been confirmed by Commission and BPA is now free to use the rates in its power marketing activities. To the extent that the 9th Circuit has used language to the effect that the rates are "deemed final" upon FERC approval, the Court was talking only in terms of the appellate review requirements articulated in section 9(e) of the Northwest Power Act, which permits the Court to review only "final" agency actions. This means only, in the case of rates, that neither BPA nor Commission will be undertaking any additional actions at the administrative level, so that the rates can appropriately be reviewed by the Court. In other words, at that point there has been a "final" agency action that triggers Section 9(e) appellate review. The *PacifiCorp* case cited by Alcoa makes this abundantly clear:

This court has held, and the parties do not dispute, that under the jurisdictional provisions of Regional Act section 9(e)(5), we have jurisdiction to review only final actions in BPA rate proceedings. "[S]ection 839f(e)(4)(D) precludes us from treating rate determinations as final actions before FERC has confirmed and approved the rates." *Central Lincoln Peoples' Utility District v. Johnson*, 735 F.2d at 1109. In this proceeding, which is akin to a rate proceeding, the methodology did not become final until FERC denied the petitioners' petition for rehearing. Therefore, our jurisdiction has properly been invoked in petition number 85-7103, and the remaining petitions are dismissed. *California Energy Commission v. Johnson*, 767 F.2d 631, 635 (9th Cir. 1985).

*PacifiCorp v. FERC*, 795 F.2d 816, 820 (9th Cir.1986). To suggest, as Alcoa does, that this appellate review framework results in "final rates" prior to judicial review having actually transpired, as specified in section 9(e) of the Northwest Power Act, is wrong. Such a result would render the Ninth Circuit's review powers practically meaningless and deny the Court the power to order refunds that it has claimed on more than one occasion that it may issue. See *Pub. Util. Comm'n of Or. v. Bonneville Power Admin.*, 767 F.2d 622, 631-32 (9th Cir. 1985); *Atlantic Richfield Co. v. Bonneville Power Admin.*, 818 F.2d 701, 705 (9th Cir. 1987).

Alcoa also incorrectly claims that BPA is acting inconsistently: "BPA cannot have it both ways. BPA cannot claim to apply principles from cases arising under other statutes in instances where it helps BPA's position, but claim not to be governed by them in other instances, such as when discussing the prohibition on retroactive ratemaking. The cases cited by BPA do not apply to BPA's rate-setting under the [Northwest Power Act]." *Alcoa Br. Ex.*, REP-12-R-AL-01, at 47. BPA is not claiming that the FPA is applicable to the situation being dealt with in this

proceeding. As indicated above, BPA is only stating that general principles of administrative law are applicable here and in the Federal Power Act setting because both BPA and FERC are executive agencies subject to those same principles. Also, despite Alcoa's assertion that BPA is not adhering to its own rate directives, Alcoa has been opaque with respect to exactly how the rate mandates are violated by BPA's correcting an unlawful injury identified by the Court with instructions to provide appropriate relief to adversely affected parties. Alcoa's sole source for its sweeping conclusion that the "plain language" of the Northwest Power Act requires only "prospective" ratemaking is the following citation:

The Administrator shall establish a rate or rates of general application for electric power sold to meet the general requirements of ... customers within the Pacific Northwest ... [s]uch rate or rates shall recover the costs of that portion of the Federal base system resources needed to supply such loads until such sales exceed the Federal base system resources. Thereafter, such rate or rates shall recover the cost of additional electric power as needed to supply such loads....

Alcoa Br. Ex., REP-12-R-AL-01, at 48, *citing* 16 U.S.C. § 839e(b)(1). All that this provision says, though, is that BPA's rates must be set to recover the costs attributable to "that portion of the Federal based system resources" needed to serve BPA's Pacific Northwest customers. The provision goes on to say that when Federal base system resources are insufficient to serve that load, then the rates will be set to recover the costs of "additional electric power" needed to serve BPA's Pacific Northwest customers. Again, the focus is on BPA being able to set rates to recover costs associated with serving the "general requirements" of BPA's Pacific Northwest customers. Alcoa's overreaching interpretation is at odds with the true import of the provision, which requires that BPA charge regional customers for resources in a particular order. The provision has nothing at all to do with retroactive ratemaking and the situation now being addressed, where a reviewing court set aside the 2000 REP settlement, declared the rates upon which they were based invalid, and required BPA to develop an appropriate remedy. To conclude that BPA cannot right what the Ninth Circuit has determined to be a prior wrong would undermine BPA's ability to respond in a fair and judicious manner. BPA does not believe that either Congress or the Ninth Circuit intended such a result.

Again, BPA incorporates herein by reference all of the arguments related to retroactive ratemaking made in the WP-07 Supplemental ROD only to respond to Alcoa's specific objections. At this time, however, BPA sees no reason to burden this record beyond the brief summary provided above in support of the common sense proposition that an administrative ratemaking rule that is sometimes applicable to the rates of IOUs would preclude the Administrator from responding appropriately to a remand order entered by the United States Court of Appeals for the Ninth Circuit.

Alcoa asserts that the negotiated Lookback refund construct is also inexplicably at odds with the prohibition on retroactive ratemaking consistently applied by the public utility commissions (PUCs) in all of the states in BPA's service area. Alcoa Br., REP-12-B-AL-02, at 33. Alcoa notes that the PUCs, which regulate the IOUs that negotiated the Settlement, consistently require that rates be adjusted only prospectively, and that any refunds due to customers be returned prospectively to a customer class and not to specific members of a class based on their original

overpayment. *Id.* at 33. Accordingly, Alcoa claims that one would expect that the IOUs, sensitive to the state law to which they are subject, would negotiate a settlement that avoids retroactive ratemaking. *Id.* Alcoa concludes that the Administrator should reject a ratemaking convention that not only fails to accord with BPA's own ratemaking requirements, but that is also universally at odds with the rate standards that are employed by the PUCs that regulate the IOUs. *Id.* at 33-34.

Once again, Alcoa's objections are not persuasive. Alcoa does not indicate, in any way that is remotely clear, why the proposed Settlement could require the IOUs to engage in retroactive ratemaking or why there might be an IOU ratemaking issue with respect to BPA's decision to provide COUs with refunds through a billing credit. The reality is that each IOU participating in the REP through the Settlement will continue to receive the net REP benefits to which they are entitled, a task delegated to BPA by statute. Undoubtedly, the IOUs and the PUCs will continue to work together, as they have since the program's inception, to assure that those benefits are passed through to the appropriate customer class, *i.e.*, residential and small farm consumers. How this construct would constitute retroactive ratemaking remains something of a mystery.

Moreover, Alcoa fails to make clear why, even if one were to accept Alcoa's view that retroactive ratemaking is implicated with respect to IOU rates, implementation of BPA's REP Program would violate the retroactive ratemaking standard that is applicable to IOUs. The prohibition on retroactive ratemaking essentially allows, but does not absolutely require, the PUCs to disallow any costs in rates under review that should have been recovered in a prior rate period. When disallowed, such costs must be shouldered by someone other than consumers, in most instances, the IOUs' shareholders. Nonetheless, BPA's understanding that the PUCs will sometimes allow the ratepayers to bear such retroactive costs if it is appropriate to do so under the circumstances. Thus, it is not clear that retroactive ratemaking is implicated, what costs could be considered allocable to shareholders, or even if some such disputed cost arose, the PUCs would not allow it to be rate based in spite of its retroactive nature. In the final analysis, Alcoa's concerns are, at best, highly speculative. Alcoa's professed concerns are particularly baffling in light of the fact that the IOUs typically keep their regulators informed regarding their activities with respect to the REP and interactions with BPA in that connection. BPA would have expected the IOUs, not the DSIs, to raise any concerns about regulatory approvals if there was any indication that the Settlement could be placed in jeopardy due to PUC action or inaction. In the absence of such indications from the IOUs, who would be directly affected, BPA must conclude that Alcoa's purported concerns lack substance.

Second, whether the Settlement's terms comply or do not comply with state prohibitions against retroactive ratemaking is not an issue BPA is addressing in this proceeding. The question BPA must answer, and the question set forth in the Federal Register notice, is whether the Settlement comports with *BPA's* statutory duties and authorities:

At the conclusion of the REP-12 proceeding, the Administrator will determine, after reviewing all evidence and arguments contained in the record, whether the terms of the proposed 2012 REP Settlement comport with BPA's statutory duties and authorities.

75 Fed. Reg. 78,694, at 78,702 (2010). BPA’s statutory duties do not include evaluating whether the Settlement complies with the state laws of each of the parties to the Settlement. Rather, BPA believes the evaluation of the state law issues is best left in the hands of the parties that are experts in these areas; namely, the IOUs and state PUCs. In this instance, all of the IOUs and the state PUCs for Oregon, Washington, and Idaho have signed the Settlement. BPA assumes these parties performed the necessary due diligence to ensure that the Settlement’s terms complied with all relevant state law requirements. If the Settlement failed any aspect of these state laws, BPA further assumes the specific IOU would not have signed the Settlement or, conversely, the state PUC would not have approved it.

Third, Alcoa’s contention that the Administrator should reject the Settlement because it is retroactive ratemaking is without merit. The alternative to the Settlement is BPA’s previous implementation of the Lookback. The Administrator previously laid out his rationale as to why the Court’s rulings and the applicable law permit the Lookback construct that BPA has implemented for two rate periods without protest from Alcoa. WP-07 Supplemental ROD, WP-07-A-05, at 16-56. Alcoa’s call for BPA to end targeted refund payments and to spread refunds prospectively through future rate reductions for all parties requires BPA not only to reject the Settlement but also to reject BPA’s previous positions on these issues. BPA declines to do so. If BPA does not adopt the Settlement, then BPA’s proposal is to simply continue its current Lookback construct, which has been fully briefed in the APAC case (none of which challenges the method of providing Lookback refunds). *See Gendron et al.*, REP-12-E-BPA-04, at 6 (noting that Staff was asked “to prepare the Lookback Study using BPA’s existing implementation methodology, making changes only when absolutely necessary.”).

Alcoa’s claims of retroactive ratemaking have been fully addressed in the WP-07 Supplemental ROD, and BPA incorporates by reference its previous arguments herein for the limited purpose of responding to Alcoa’s arguments. Alcoa has presented no compelling reasons why BPA must depart from those findings.

### **Decision**

*The Settlement’s requirement that BPA provide targeted refunds through the Refund Amounts rather than lower prospective rates does not violate the rule against retroactive ratemaking.*

### **Issue 6.5.6**

*Whether BPA’s rate treatment of the Refund Amounts provided under the Settlement complies with section 7(c) of the Northwest Power Act.*

### **Parties’ Positions**

Alcoa argues that by not including Refund Amounts in the calculation of the PF rate, the IP rate is not “equitable in relation to the retail rates charged by the [COUs] to their industrial [consumers] in the region.” Alcoa Br., REP-12-B-AL-02, at 32. Alcoa claims that Refund Amounts provided under the Settlement will flow through to the industrial consumers of the

COUs, thereby reducing these consumers' rates. *Id.* Alcoa argues that BPA has ignored its obligation under section 7(c) to ensure that the IP rate set under the Settlement will be “equitable in relation to” the rates COUs charge their industrial consumers. *Id.*

### **BPA Staff's Position**

The IP rate is being properly set. The equitable relationship described in section 7(c)(1)(B) of the Northwest Power Act is generally achieved by establishing the rate applicable to DSIs in accordance with the formula articulated in section 7(c)(2), which requires that rate be based on BPA's “applicable wholesale rates” plus a typical margin. Bliven *et al.*, REP-12-E-BPA-12, at 29. The applicable wholesale rate is currently the PF Public rate, which includes the full cost of the REP. Staff is properly “linking” the IP rate to the PF Public rate. *Id.* Moreover, Staff adds the “typical margin” as required by section 7(c)(2) and BPA's IP-PF Link ROD. *Id.* Staff does not support deviating from this standard based on Alcoa's unsupported hypotheses regarding the way BPA's customers might allocate any refund associated with the REP.

### **Evaluation of Positions**

Section 7(c) establishes the specific standards for setting the IP rate applicable to DSI sales. 16 U.S.C. § 839e(c). Specifically, section 7(c)(1) provides:

The rate or rates applicable to direct service industrial customers shall be established ... for the period beginning July 1, 1985, at a level which the Administrator determines to be equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial consumers in the region.

16 U.S.C. §§ 839e(c)(1), (1)(B). Section 7(c)(2) essentially sets forth a formula that delineates the factors to be considered when establishing the IP rate at a level that is “equitable in relation to the retail rates [of the industrial consumers of BPA's preference customers].” Section 7(c)(2) states:

The determination under paragraph (1)(B) of this subsection shall be based upon the Administrator's applicable wholesale rates to such public body and cooperative customers and the typical margins included by such public body and cooperative customers in their retail industrial rates but shall take into account— (A) the comparative size and character of the loads served, (B) the relative costs of electric capacity, energy, transmission, and related delivery facilities provided and other service provisions, and (C) direct and indirect overhead costs, all as related to the delivery of power to industrial customers, ...

16 U.S.C. § 839e(c)(2)(A)-(C). Equity for the IP rate thus is established based on a formula rate that is equal to BPA's “applicable wholesale rates” plus a typical margin. (A value for power reserves supplied by DSIs is also included in the IP rate pursuant to section 7(c)(3).) Bliven *et al.*, REP-12-E-BPA-12, at 29. This formula is intended to place DSI customers roughly in parity with the industrial consumers of BPA's public body and cooperative customers.

Alcoa contends that by issuing refunds rather than adjusting the PF rate, the IP rate is not “equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial consumers in the region.” Alcoa Br., REP-12-B-AL-02, at 32. Alcoa asserts that the Refund Amounts will reduce the COUs’ net power costs. *Id.* Alcoa claims that it has presented testimony indicating that it is likely that a portion of the Refund Amounts will flow through to the COUs’ industrial consumers, thereby reducing their net rates. *Id.* Alcoa argues that neither BPA nor the COUs have rebutted Alcoa’s witness’s testimony. *Id.* Alcoa claims BPA conceded that it could request from the COUs information on how the Lookback refunds and Refund Amounts impact the rates of their industrial consumers, but did not. *Id.* As such, Alcoa concludes, BPA has ignored its obligation to ensure that the IP rate set under the Settlement satisfies the “equitable in relation to” standard set out in 16 U.S.C. § 839e(c)(1)(B). *Id.*

Alcoa’s arguments are not persuasive. First, the requirement in section 7(c)(1)(B) that the DSIs’ rate be set “equitable in relation to” the rates COUs charge their industrial consumers must be read in conjunction with section 7(c)(2). Section 7(c)(2) is explicit that “the determination under paragraph (1)(B) of this subsection *shall be based upon*” the formula identified in section 7(c)(2). Thus, the “equitable in relation to” phrase of section 7(c)(1)(B) is not a stand-alone standard as contended by Alcoa. Rather, it must be viewed in light of the specific means of meeting that standard, as described in section 7(c)(2). In section 7(c)(2), Congress was explicit that BPA establish the 7(c) rate based on (1) “the Administrator’s applicable wholesale rates to such public body and cooperative customers” plus (2) “the typical margins included by such public body and cooperative customers in their retail industrial rates . . . .” 16 U.S.C. § 839e(c)(2). So long as BPA has established the IP rate consistent with these criteria, no violation of section 7(c) has occurred.

Alcoa asserts that BPA’s treatment of the Refund Amounts violates the first criterion in section 7(c)(2) because Refund Amounts will likely flow through to the COUs’ industrial consumers, thereby reducing the COUs’ industrial consumers’ net rates. This argument is not persuasive, because what the COUs’ industrial consumers pay their utilities for power is not relevant to the statutory calculation in the first criterion of section 7(c)(2). The plain language of section 7(c)(2) directs BPA to use the “Administrator’s applicable wholesale rates” to the COUs, not the rates the COU charges its individual industrial consumers. 16 U.S.C. § 839e(c)(2). In this instance, BPA is using the proper statutory calculation. The applicable wholesale rate is the weighted average of the PF Public rate and the NR rate, with the weighting based on the relative sales to COUs in each rate pool. Bliven *et al.*, REP-12-E-BPA-12, at 29; *see also* 1986 IP-PF Rate Link ROD, IP-PF-86-A-02, at 6. Because there is no preference customer NR load, the IP rate is based solely on the PF Public rate at this time. Clark *et al.*, BP-12-E-BPA-38, at 4. As noted in the previous issue, the applicable PF Public rate will be set to recover the total REP costs of the Settlement. Bliven *et al.*, REP-12-E-BPA-12, at 21. The IP rate, in turn, will be “linked” to this PF rate. Gendron *et al.*, REP-12-E-BPA-04, 35-36. In this way, the IP rate will be “based upon” the wholesale power rates the Administrator charges the COUs and, thus, the first criterion in section 7(c)(2) will have been satisfied.

Alcoa contends that by issuing refunds rather than adjusting the PF rate, the Settlement requires BPA to “disguise the real PF rate” with the result that the IP rate is not “equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial consumers in the region.” 16 U.S.C. § 839e(c)(1)(B). Alcoa Br. Ex., REP-12-R-AL-01, at 42. In effect, Alcoa claims that because BPA is setting rates on the full cost of the REP, but then providing targeted rate credits to some, BPA is in some way not basing the IP rate on the “applicable wholesale rate” required by section 7(c)(2). Alcoa’s argument lacks merit. First, Alcoa’s argument is inconsistent with the plain language of section 7(c). Section 7(c)(1)(B) specifically provides that the IP rate will be based on the “Administrator’s applicable wholesale rates to [the COUs].” 16 U.S.C. § 839e(c)(2). BPA’s wholesale power rate to the COUs is set to recover BPA’s total costs as required by sections 7(a) and 7(b). Part of the costs the PF rate recovers is associated with the REP. Whatever rate credits or refunds BPA may apply after it sets its rates is not relevant to the calculation of the “applicable wholesale rate” language in section 7(c)(2). The rate discussed in section 7(c)(2) is a general rate that applies broadly to the COUs as a class: “Administrator’s applicable wholesale rates *to such public body and cooperative customers . . .*” *Id.* (emphasis added). If Congress had intended BPA to base the IP rate on the actual wholesale power *costs* that a certain subset of BPA’s customers actually pay on their power bills (net of all credits and refunds), then Congress would have said as much. It did not.

Instead, Congress chose a much more straightforward approach of requiring BPA to develop the rate for industrial firm power by basing it on the “applicable wholesale rate” for sales to BPA’s preference utility customers. The approach advocated by Alcoa would require tinkering with that rate to correct a perceived “inequity.” The problem with this point of view is that it would replace the clear line drawn by Congress with a fuzzy line that would potentially be subject to alteration any time a party argued that some aspect of the “applicable wholesale rate” creates an inequity of any kind. For example, many of BPA’s customers serve their loads through a combination of power purchased from BPA and power derived from other resources. It is probable that utilities pass the costs of the latter resources (whether more or less expensive) to their industrial customers. Yet, it is clear that, by requiring BPA to base the IP rate on the “applicable wholesale rate,” Congress did not intend for BPA to consider that type of externality in connection with developing the IP rate.

Similarly, in this instance, BPA has been required to issue refunds to specific preference utility customers who were overcharged under the prior 2000 REP settlements that was set aside by the Ninth Circuit. BPA has concluded that issuing a rate credit, as proposed by Alcoa, would reward customers who were not overcharged, or not significantly overcharged, at the expense of customers who were overcharged to a much larger degree. Thus, BPA determined that the best way of issuing those refunds fairly would be through a billing credit rather than prospective reductions in all rates. That variation in total power costs of preference utilities, however, does not require BPA to stray from the clear congressional command that BPA rely on the generic preference rate applicable to BPA’s preference customers serving industrial load as the initial step in developing the rate for industrial firm power.

Indeed, BPA does not even know how it would calculate the “applicable wholesale rate” under Alcoa’s interpretation. BPA provides many rate credits and other reductions under the Northwest Power Act to the applicable PF rate. These reductions come in many forms, such as an irrigation discount, low density discount, or as noted in this case, a Refund Amount. *See* Power Rate Schedules, BP-12-A-02B, at 42, 46. Most importantly, not all BPA customers receive these credits. In calculating the “applicable wholesale power rate” under Alcoa’s view of the statutory language, whose power rate (net of all credits and refunds) should BPA use? The applicable wholesale power rate (net of all credits) that is paid by those that receive the irrigation discount? Low density discount? The Refund Amounts? Or should BPA calculate the “applicable wholesale power rate” based on the customer that pays the lowest power bill to BPA? While Alcoa may find these options attractive, and consistent with its overarching objective of reducing its IP rate, they are not consistent with the plain language of section 7(c)(2).

In this case, the “applicable wholesale rate” is the PF rate that includes an appropriate share of the total cost of the REP. The IP rate is being linked to this rate, as required by sections 7(c)(1)(B) and 7(c)(2). BPA has followed the law.

Although not clear from Alcoa’s brief, Alcoa also appears to be positing that BPA’s failure to recognize the Refund Amounts in the calculation of the rates the COUs charge their industrial consumers violates the second criterion in section 7(c)(2), which requires that the DSIs’ rate reflect “the typical margins included by such public body and cooperative customers in their retail industrial rates.” Alcoa Br., REP-12-B-AL-02, at 32.

But here again, Alcoa’s argument is fundamentally flawed. Only a limited number of costs are included in the margin, specifically those costs that fall within the general category of “other overhead costs,” a category that is described more specifically in the Power Rates Study, BP-12-FS-BPA-01, Appendix A. BPA assumes that Refund Amounts are not likely to be functionalized to this category. For example, a utility might view any REP refund as a reduction in purchased power costs, which would be included in production costs for purposes of the margin study. Production costs are not included in the industrial margin. *Id.* Alcoa seems to concur that Refund Amounts can reasonably be characterized as a power cost. *See* Bliven *et al.*, REP-12-E-BPA-12, at Attachment 11 (Alcoa responding “Yes. I believe that BPA’s power costs and refunds of BPA’s power costs are functionalized as a cost of power.”). However, this is not the only possible outcome. As noted below, utilities might be equally likely to use the Refund Amounts to supplement financial reserves or to provide financing for capital projects of various kinds. Even if the refunds are returned to industrial consumers, BPA agrees with Alcoa that the refunds would be functionalized as a cost of power. BPA has never included the utilities’ power costs in calculating the typical margin.

By asking to include Lookback Amounts/Refund Amounts in an evaluation of the “equitable in relation to” formula established in section 7(c), Alcoa requests BPA to approach the IP rate in an entirely new and unexplored direction where BPA would begin looking at the retail rates being paid by industrial consumers of BPA’s COU customers. BPA doubts this is where Alcoa would want to go. Based on 2009 Energy Information Agency reports, the average industrial rate paid

by industrial consumers of COU customers in 2009 was almost \$42/MWh. Looking at the limited data on the BP-12 record, the average production cost (power cost) of COU customers in the survey is \$38/MWh. Power Rates Study, BP-12-FS-BPA-01, at A-7. This amount is based on data from only 18 of the 37 surveyed customers that provided production cost data. It is inappropriate to factor just one element of power costs, Lookback Amounts/Refund Amounts, into the IP rate without looking at what portions of power costs should or should not be included.

Alcoa argues that its proposal is unrebutted by Staff. Alcoa Br., REP-12-B-AL-02, at 32; Alcoa Br. Ex., REP-12-R-AL-01, at 42. Staff, however, did respond to Alcoa (*see* Bliven *et al.*, REP-12-E-BPA-12, at 27-30), although the Staff that deal with the IP rate and the margin study work in the BP-12 proceeding, where this issue is more properly raised. BPA is responding here to Alcoa because the timing of the two dockets did not allow this issue to be transferred into the proper docket, and BPA believes that Alcoa has a right to be heard on the issue. However, without respect to which docket this issue should be addressed in, the question of basing the IP rate on the power costs of COU industrial consumers would be a major change in BPA's ratesetting practice. Issues such as this are best raised between rate cases when a free exchange of ideas, data, and discussion can occur without being subject to the procedural requirements of the 7(i) process, such as what is or is not in the record, what data is needed to build a proper record, and *ex parte* restrictions. BPA often depends upon workshops to fully discuss the merits and ramifications of new ratesetting methodologies. *See, e.g.*, Lovell *et al.*, BP-12-E-BPA-37, at 30-31 (suggesting that a proposal by WPAG to credit secondary revenues after the fact rather than using rate case forecasts be discussed prior to the BP-14 rate proceeding).

In any event, only those Refund Amounts that could properly be characterized as being related to "other overhead costs" would have an impact on the industrial margin calculation. For purposes of this proceeding, Staff recommends no adjustment to the industrial margin calculation that is being developed as part of the BP-12 rate proceeding. Instead, Staff believes that any impacts on the industrial margin will flow through as a natural consequence of the way the industrial margin is calculated, without the need for any further intervention.

Alcoa also seems to argue, in the alternative, that the "applicable wholesale rate" should be adjusted downward to account for Alcoa's conclusion that any Refund Amounts will be used to offset purchased power costs. As noted above, it is not clear that considerations regarding how *retail* utilities manage and account for costs has any bearing on the level of the *wholesale* rate at which such utilities purchase power from BPA. However, assuming *arguendo* that inclusion of Refund Amounts would be proper in the calculation of the IP rate under section 7(c), which they are not, the record in this case does not support a finding that the Refund Amounts were actually distributed to the industrial consumers of the COUs. Alcoa claims that it has presented testimony indicating that it is likely that a portion of the Refund Amounts will flow through to the COUs' industrial consumers, thereby reducing their net rates. Alcoa Br., REP-12-B-AL-02, at 32; Alcoa Br. Ex., REP-12-R-AL-01, at 42. Alcoa asserts that neither BPA nor the COUs have rebutted the Alcoa witness's testimony. *Id.* Alcoa claims that Staff concedes that it could request from the COUs information on how the Lookback refunds and Refund Amounts impact the rates of their industrial consumers, but did not gather such information. *Id.*

Alcoa offers only conjecture, however, that the industrial consumer rates are being reduced by the Lookback Amounts/Refund Amounts. The only basis for Alcoa's assertion that Lookback Amounts and Refund Amounts were flowing through to the COUs' industrial consumers was the following observation by Alcoa's witness, Mr. Speer:

Since BPA's COUs are non-profit entities and base their rates on cost, rates to the industrial [consumers] of COUs include both the cost of the proposed PF rate and cost deductions achieved by the Refund Amounts.

Speer, REP-12-E-AL-01, at 6.

This general observation, however, is of little probative value, since it reflects an opinion, employing principles of deduction, regarding what the factual evidence should show if it actually existed. On two separate occasions, Staff asked Alcoa to provide such factual data to support this statement. In both instances, Alcoa did not provide any additional information. In one response, Alcoa generally observed without factual support that COUs charge "cost based rates" and thus, reductions in power costs are "passed through to the COU's [consumers]." Bliven *et al.*, REP-12-E-BPA-12, at Attachment 8. In its second response, Alcoa relied on this same logic without reference to any specific examples or data supporting this statement. *Id.* at Attachment 9. There is nothing particularly wrong with Alcoa's logic as a starting point. The problem is that a deduction such as Alcoa's is not a substitute for factual evidence, and it could be given significant weight only if supported by such evidence.

Moreover, to the extent Alcoa's general observations can be described as valid evidence, Staff presents equally valid evidence rebutting Alcoa's testimony. As noted above in discussing the industrial margin, it is possible that at least some utilities may view the Refund Amounts as a reduction in purchased power costs, as suggested by Alcoa's reasoning. Staff notes that in its experience, "we believe that not all refunds are being passed through by the serving COUs. We believe that some refunds have been used to build up the financial reserves of certain COUs and some refunds have been spent on capital projects." Bliven *et al.*, REP-12-E-BPA-12, at 28. While Staff's testimony, like Alcoa's, is speculative, it nonetheless provides a counterpoint to Alcoa's suggestion that logic compels a conclusion that Refund Amounts are being used exclusively to offset purchased power costs. Thus, Alcoa's testimony has been rebutted.

In summary, because Refund Amounts and Lookback refunds do not adjust the applicable wholesale rates, and they are not costs appropriate to include in the typical margin, BPA's decision to exclude these refunds in the calculation of the IP rate under section 7(c)(2) is proper. Moreover, even if inclusion of Refund Amounts in the IP rate were appropriate, the record in this case does not support a finding that these refunds are actually being distributed to the industrial consumers of the COUs.

### **Decision**

*BPA's rate treatment of the Refund Amounts provided under the Settlement complies with section 7(c) of the Northwest Power Act.*

### **Issue 6.5.7**

*Whether the Settlement resolves, in a fair and equitable manner, outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period, thereby satisfying primary criterion (3) and secondary criterion (1).*

#### **Parties’ Positions**

APAC argues that BPA’s decision to adopt the Settlement fails to meet the third primary criterion and the first secondary criterion BPA set forth as its measure of whether to adopt the Settlement. APAC Br. Ex., REP-12-R-AP-01, at 3-4. APAC claims the Refund Amount construct in the Settlement is not an “effective refund of amounts owed by the IOUs” and only serves to resolve “issues within the COU group.” *Id.* at 4.

WPAG argues that the Settlement’s resolution of the outstanding issues with the Lookback is inequitable to its members because they will be paying for the full cost of the Settlement, but only receiving a partial credit back in the form of Refund Amounts. WPAG Br., REP-12-B-WG-01, at 35. WPAG argues that as a matter of principle, the WPAG utilities believe that the Settlement should bring to an end all liabilities regarding Lookback Amounts, for both IOUs and preference customers. WPAG Br. Ex., REP-12-R-WG-01, at 50.

#### **BPA Staff’s Position**

The Settlement satisfies primary criterion (3) and secondary criterion (1). Gendron *et al.*, REP-12-E-BPA-04, at 29. The Settlement resolves, in a fair and equitable manner, all of the outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period. *Id.* Lookback Amounts are discharged and no longer exist as an individual obligation of each settling IOU, but instead the Refund Amounts are treated, for ratemaking purposes, as a corporate obligation of the IOUs as a class. *Id.* The Settlement secures the payment of an additional \$612 million more in refund payments to the COUs plus the retention of all past refund payments without dispute, for a total refund payment of \$1.2 billion. *Id.* at 33. The Settlement is also reasonable to the COUs with pre-Subscription agreements. Bliven *et al.*, REP-12-E-BPA-12, at 30-40.

#### **Evaluation of Positions**

BPA’s third primary criterion for review of the Settlement is as follows:

(3) the Settlement would resolve, in a fair and equitable manner, all of the outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period.

Evaluation Study, REP-12-FS-BPA-01, section 11.2.

APAC claims BPA has failed to meet the third primary criterion BPA Staff established because the Settlement is neither “fair and equitable” nor “reasonable.” APAC Br. Ex., REP-12-R-AP-01, at 3-4. APAC claims that the net present value of the Settlement imposes upon the COUs costs of REP benefits that are too high compared to the likely outcomes of litigation. *Id.*

APAC states that the settling COUs surrender too many benefits provided by the statute in exchange for a fixed amount of REP benefit costs. *Id.* Finally, APAC asserts, the putative refund of the Lookback Amounts through the Refund Amounts in the Settlement is not an effective refund of amounts owed by the IOUs; rather, APAC claims, it is an adjustment adopted to resolve issues within the COU group and should not be relied upon as any disposition of the IOU liability. *Id.*

BPA has already responded to APAC's claims regarding the NPV of the Settlement in Chapter 3. BPA has also responded to APAC's claim that the Refund Amounts are not being paid for by the IOUs' in the discussion of Issue 6.5.1. BPA here responds to APAC's concern that the COUs are "surrender[ing] too many benefits" for the fixed amount of REP benefit costs. APAC Br. Ex., REP-12-R-AP-01, at 3-4. Inherent in APAC's claim is the idea that the Settlement is somehow not favorable to COUs and to customers of COUs such as APAC. That is not the case.

As already described in Chapter 3, COUs will experience overall lower rates under the Settlement. The savings that the COUs will see in rates begin *this rate period* and are expected to grow over time.

But beyond the near-term and long-term REP savings, the Settlement resolves the uncertainty around BPA's development, calculation, and implementation of the Lookback construct. As noted in the introduction to this section, BPA has distributed approximately \$587 million in refunds under its Lookback case since FY 2009. *See* sections 6.1–6.3. Right now, not a single recipient of these refunds knows whether it may retain these funds without fear of disgorgement at some future time. Under the Settlement (if it is upheld as to all parties) the IOUs will forgo their challenges to any past refund payments BPA has made through FY 2011. That means that all \$587 million of refunds that have been distributed by BPA will be retained without dispute. BPA believes resolving these past issues substantially benefits all ratepayers of BPA. (BPA notes here that APAC is *not* a ratepayer of BPA; to the extent APAC believes it is entitled to any refunds, such refunds must be obtained from the local utilities that serve APAC's members, *not* BPA.)

Moreover, the Settlement not only permits the retention of past refunds, but provides even more refunds prospectively. The fixed nature of the Refund Amounts provides a substantial amount of certainty to the COUs. Unlike BPA's previous approach to returning Lookback Amounts to the COUs, the Refund Amounts would not be subject to adjustment by the Administrator. Gendron *et al.*, REP-12-E-BPA-04, at 11, 32-33. The Refund Amounts would be refunded from the IOUs as a class, and would not be dependent upon a specific IOU becoming eligible for REP benefits. *Id.* The Refund Amounts would be returned within a defined period: eight years. BPA could not provide a similar guarantee of repayment for the Lookback Amounts due to variations in the REP benefits of individual IOUs. Gendron *et al.*, REP-12-E-BPA-04, at 32-33. Combining the funds that BPA has already paid the COUs (\$587 million) with the new fixed schedule of Refund Amounts under the Settlement (\$612 million) results in a total refund payment by BPA to the COUs of approximately \$1.2 billion. *Id.* BPA believes that returning \$1.2 billion in refunds to customers without further dispute (if the Settlement is upheld), meets Staff's third primary criterion that requires that such Settlement "resolve, in a fair and equitable manner, all of the

outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period.”

APAC also claims that the Settlement fails to satisfy secondary criterion (1). APAC Br. Ex., REP-12-R-AP-01, at 4. APAC argues that it recognizes that the Settlement contains certain adjustments to the distribution among the IOUs of the Scheduled Amounts and among the COUs of the Refund Amounts. *Id.* To the extent these adjustments reflect unilateral considerations for those two groups, APAC does not take exception to them. *Id.* However, APAC states that it does object if these adjustments are relied on to prove some equity in the resolution of issues by the Settlement and the reasonableness of that resolution to non-settling parties. *Id.*

The first secondary criterion Staff is to evaluate is as follows:

(1) the Settlement would recognize that not all COUs were equally harmed by the costs of the 2000 REP Settlements and that IOUs’ respective residential consumers were differentially affected by BPA’s setting off REP benefits for Lookback Amounts...

Evaluation Study, REP-12-FS-BPA-01, section 11.2.

As noted above in the introduction to this Chapter 6 and Issues 6.5.2 through 6.5.5, the Settlement retains, for the most part, the Lookback return construct BPA first created in the WP-07 Supplemental rate proceeding. In simple terms, BPA’s Lookback return construct provides that the utilities that were most injured by the 2000 REP Settlements receive the greatest share of any refunds. Fifty percent of the Refund Amounts will be returned to the COUs based on each customer’s purchases of PF-02 power during the FY 2002–2006 period. *See* Gendron *et al.*, REP-12-E-BPA-04, at 13. The remaining 50 percent will be returned based on each COU’s Tier 1 Customer TOCA Share, which is the COU’s TOCA divided by the sum of all TOCAs. *Id.* In this way, the Settlement retains the features of BPA’s previous Lookback return construct that ensured those most harmed by the unlawful PF-02 rates received the largest portion of refunds. The Settlement, thus, has satisfied secondary criterion (1) because it properly recognizes that “not all COUs were equally harmed by the costs of the 2000 REP Settlements.” Evaluation Study, REP-12-FS-BPA-01, section 11.2.

APAC does not object to the Settlement’s distribution of Refund Amounts or, as far as BPA can tell, the calculation of the amounts to be returned to the COUs over the next eight years. APAC Br. Ex., REP-12-R-AP-01, at 4. Rather, APAC objects to the use of the Settlement to the extent it will be relied on to prove some equity in the resolution of issues by the Settlement and the reasonableness of that resolution to non-settling parties. *Id.* It is not entirely clear to BPA what APAC is driving at with its objection. In terms of whether the Settlement provides equity to non-settling parties, BPA believes the non-settling parties are being treated equitably under the Settlement because they will benefit from the return of the Refund Amounts and resolution of the past refund payments. As noted above, the Settlement permits *all* COUs to retain their portions of the \$587 million in refund payments BPA has made to COUs (whether or not they signed the Settlement) without fear of further adjustment, provided BPA’s decision to adopt the Settlement and apply it to all parties is upheld. Furthermore, *all* COUs will receive portions of the

additional \$612 million in *guaranteed* refund payments over the next eight years on a fixed schedule. APAC has long argued for BPA to return the Lookback Amounts on a fixed schedule, but BPA was unable to accommodate this request because of unknown fluctuations in REP benefits payable to the IOUs. *See* Evaluation Study Documentation, REP-12-E-BPA-01A, at 681-687 (APAC noting the uncertainty associated with BPA’s Lookback construct in its Opening Brief in the APAC litigation); *see also* WP-07 Supplemental ROD, WP-07-A-05, at 263-276. Now, under the Settlement, BPA can return a substantial amount of refunds to the COUs over a specified period of time, every dollar of which may be retained by the COUs without having to fear that their refunds will be subsequently reclaimed by BPA through some future court action (provided, of course, that BPA’s decision to adopt the Settlement is not challenged, or if challenged, is upheld). BPA has satisfied secondary criterion (1).

WPAG complains that the distribution of the Refund Amounts results in utilities with pre-Subscription power contracts receiving back only about one-half of the amount they paid through their power purchase under the PF rate. WPAG Br., REP-12-B-WG-01, at 35. In essence, WPAG claims this is a redistribution of the costs and benefits of the Settlement among preference customers. *Id.*

WPAG’s concerns with the distribution of the Refund Amounts under the Settlement are without merit. To evaluate whether the refund construct provided in the Settlement is reasonable or not, one must first examine what the Refund Amounts are purporting to resolve. Bliven *et al.*, REP-12-E-BPA-12, at 36. From BPA’s viewpoint, the Refund Amounts are a recognition by the parties that some amount of refunds should continue to be returned to the COUs that paid the PF-02 rates that were assessed the costs of the 2000 REP Settlements during FY 2002–2006. *Id.* Because of the close connection between Refund Amounts and Lookback Amounts, BPA believes it makes sense to apply a similar analysis to determine whether the Settlement’s treatment of Refund Amounts is reasonable. *Id.* Thus, whether a customer should or should not receive a share of Refund Amounts comes down to one simple question: Was that customer overcharged as a result of the 2000 REP Settlements? *Id.* If the answer is “no,” then BPA does not see why it would be “unfair” for that customer not to receive the same amount of refund as those that were overcharged. *Id.*

In terms of WPAG’s objections, WPAG has no basis to suggest that its members will be worse off under the distribution of Refund Amounts when compared to the Lookback construct. A number of WPAG’s members purchased power from BPA under agreements referred to as pre-Subscription contracts. Bliven *et al.*, REP-12-E-BPA-12, at 31-32, 40. Under these agreements, customers with pre-Subscription contracts paid negotiated rates established by BPA and the utility. *Id.* at 36-37. These agreements were based on rates BPA set in 1996, and as such, did not include any of the costs of the 2000 REP Settlements BPA included in the rates set in 2000. *Id.* at 37. Because these customers did not pay for the cost of the 2000 REP Settlements, these members of WPAG were ineligible to receive credits from BPA for Lookback Amounts. WP-07 Supplemental ROD, WP-07-A-05, at 279-282. Thus, since FY 2009, these customers have paid PF rates based on the aggregate costs of the REP, but received no Lookback Amount credits. Bliven *et al.*, REP-12-E-BPA-12, at 33-34. By paying the higher PF rate, these customers are, according to WPAG’s view of reflecting Refund Amounts in rates, funding the

credit on the bills of the COUs that paid the PF-02 rate. *Id.* In the pending APAC litigation, where BPA's Lookback construct has been appealed, no party has contested this aspect of BPA's decision from the WP-07 Supplemental case.

The situation proposed in the Settlement for WPAG's members is no different from BPA's current Lookback construct *except that it provides a better outcome* for WPAG's members that purchased power from BPA under pre-Subscription contracts in FY 2002–2006. Bliven *et al.*, REP-12-E-BPA-12, at 39. The flow of dollars that would result from the Settlement is only slightly different from that established in the WP-07 Supplemental proceeding. WP-07 Supplemental ROD, WP-07-A-05, at 253-295. Under the Settlement, all COUs would pay the PF Public rate that would include the costs of the REP Recovery Amounts determined by the Settlement, which include the Refund Amount. Bliven *et al.*, REP-12-E-BPA-12, at 39. The Settlement proposes that 50 percent of the Refund Amounts be distributed to COUs based on their TOCAs, and the remaining 50 percent be distributed based on the COUs' PF-02 revenue share. *Id.* So, just as occurs today, the COUs that purchased power from BPA under pre-Subscription contracts would pay the PF rate. *Id.* at 39-40. However, unlike today, under the Settlement, pre-Subscription customers would now receive a partially offsetting credit. *Id.* at 40.

In short, the settling COUs have chosen to spread their refunds to fellow COUs in an effort to resolve the claims in this case. The Settlement thus treats customers with pre-Subscription agreements, such as certain of WPAG's members, in a manner far superior to BPA's supplanted Lookback construct. Bliven *et al.*, REP-12-E-BPA-12, at 34. This is because pre-Subscription customers receive exactly *\$0 Lookback credit* on their power bills today and also prospectively under BPA's WP-07 Supplemental ROD decisions if the Settlement is not adopted. *Id.* BPA's adoption of the Settlement (assuming it is upheld) guarantees that pre-Subscription customers will receive an overall reduction in their PF-12 rate (because the IOUs will be taking \$24 million less in REP benefits) *plus* approximately *\$4 million in Refund Amounts* each year for eight years—or \$32 million better in total. *Id.* at 40. In BPA's view, the financial outcome of the proposed Settlement is clearly better for those preference customers that signed pre-Subscription contracts. *Id.* at 40. It may be that WPAG believes that the Settlement could have been improved to provide pre-Subscription customers with an even better deal. *Id.* at 40. While that may or may not be the case, BPA's view is that one should judge the Settlement based on what it *is*, rather than what it *could have been*. *Id.* As the above discussion makes clear, when compared to the status quo, the Settlement's treatment of COUs that had pre-Subscription contracts is unquestionably fair and reasonable.

WPAG states that it has two responses to BPA's puzzlement over WPAG's opposition to a settlement that lowers its members' rates above and beyond what BPA would provide under the no-settlement alternative. WPAG Br. Ex., REP-12-R-WG-01, at 48-49. First, WPAG contends that comparing the position of WPAG's members with or without the Settlement is not an apt comparison. *Id.* at 49. WPAG asserts that the Settlement is now a given unless it is invalidated on appeal. *Id.* The real issue, WPAG states, is how preference customers are treated under the Settlement's terms and what role BPA plays in such treatment. *Id.*

BPA disagrees with WPAG's assertion that comparing the position of WPAG's members with and without the Settlement is "not an apt" comparison now that the Administrator has determined that he may lawfully sign the Settlement. Indeed, the Administrator could not have determined that he could sign the Settlement in this case without comparing the Settlement's outcome with an outcome other than the Settlement; that is, a continuation of BPA's traditional implementation of the REP. The Settlement in this case is not being considered in a vacuum. There are established (though disputed) practices that BPA has vigorously defended in rate proceedings and in Court that would continue if the Settlement were not adopted. Under these established practices, certain WPAG members would be charged rates based on the full costs of the REP, but receive no offsetting Lookback Amount credit. *See Bliven et al.*, REP-12-E-BPA-12, at 34. Under the Settlement, *all* of WPAG's members will receive a credit. *See Bliven et al.*, REP-12-E-BPA-17, at 15. However one looks at these two situations, it remains that WPAG's members are better off under the Settlement than under BPA's alternative.

WPAG argues that all preference customers are being asked to forgo their pending claims against the IOUs, absolve the IOUs of any contingent liabilities, and accept the payment obligation for the REP benefits as laid out in the Settlement. WPAG Br. Ex., REP-12-R-WG-01, at 49. For some preference customers, WPAG contends, the claims being surrendered are both retrospective (claims for greater Lookback Amounts) and prospective (claims for lower REP benefit payments in the future). *Id.* In the case of utilities with pre-Subscription contracts, WPAG states that the Settlement requires them to forgo their claims for prospective relief against the IOUs (lower future REP costs), absolve the IOUs of contingent liabilities (deemer account balances), and pay their proportionate share of the IOU REP benefits. *Id.* While they are being asked to do all the things that other preference customers are doing under the Settlement, WPAG argues they will continue to pay a higher net PF Rate. *Id.* WPAG contends that the Settlement absolves the IOUs of liability for Lookback Amounts, but it does not do so for all preference customers. *Id.*

BPA disagrees with WPAG's characterizations of the Settlement and its treatment of WPAG's members. First, BPA disagrees that the Settlement forces WPAG's non-settling members to forgo anything. Rather, as a legal matter, BPA's decision to execute the Settlement (and therefore become a "Party"), and BPA's decision to replace its previous disputed decisions with the Settlement and this ROD, may have an effect on WPAG's pending claims. BPA has discussed these issues elsewhere in this ROD. *See* Chapter 8.

As to WPAG's claim that its members will be giving up their contentious and uncertain litigation for a "higher net PF rate," WPAG is factually incorrect. The PF rate will be *reduced* under the Settlement when compared to BPA's traditional approach to the REP. *See Bliven et al.*, REP-12-E-BPA-12, at 33 (IOU REP costs for FY 2012-2013 under the Settlement that are in the PF-12 rate are \$24 million lower than without the settlement; Evaluation Study, REP-12-FS-BPA-01, section 11.3). This reduction in the PF rate will be doubly felt by certain WPAG's members as they experience (1) lower overall REP costs in rates; and (2) a rate credit that will lower WPAG members' effective PF rate even more. *See Bliven et al.*, REP-12-E-BPA-12, at 40 ("... the financial outcome of the proposed Settlement is clearly better for those preference customers that signed pre-Subscription contracts—better by approximately \$32 million."). Not only will

WPAG's members have the benefit of lower rates prospectively, but to the extent they received a Lookback payment from BPA over the past three years, they will also be able to retain these refunds without dispute from the IOUs (provided the Settlement is upheld). This is a certainty that WPAG does not have today. However it is viewed, WPAG's members are substantially benefitted under the Settlement.

WPAG's second reason for opposing the treatment of Refund Amounts in this case is "one of principle." WPAG Br. Ex., REP-12-R-WG-01, at 49. WPAG contends that there were different rationales for retaining a targeted refund approach in the Settlement, including (1) such a provision was needed to continue refunds to large industrial customers of COUs at the retail level after any settlement terminated the IOU Lookback Payments; (2) refunds would assuage large industrial customers who appeared to believe that they had not been made whole by their local utilities; (3) refunds would spread the costs of the REP benefits under the Settlement more equitably to BPA's direct service industrial customers; and (4) refunds would make whole those preference utilities that paid the PF rate found unlawful in the *Golden NW* case, but that will not receive full reimbursement for those overcharges. *Id.* at 50. WPAG then states that under the Lookback Amounts the IOUs were paying the refunds, but under the Settlement that will not be the case. *Id.* As a matter of principle, WPAG states, the WPAG utilities believe that the Settlement should bring all liabilities regarding Lookback Amounts, for both IOUs and preference customers, to an end. *Id.*

Although WPAG styles these four rationales as "different," they all stem from a common theme that BPA first identified in the WP-07 Supplemental ROD: in constructing a remedy to respond to the Court's decisions in *PGE* and *Golden NW*, those customers that were most injured should receive the most back. *See* WP-07 Supplemental ROD, WP-07-A-05, at 279-281. Or, as aptly noted by JP02, the refunds associated with the Settlement need to get "into the right hands." Murphy and Kallstrom, REP-12-E-JP02-04, at 9-10. In developing such a remedy, it is unavoidable that some customers that were not injured by BPA's unlawful acts will not receive the same compensation as those that were injured. While WPAG may think as a matter of "principle" this is unfair, BPA thinks as a matter of "principle" reducing the rates of COUs that were insulated from the effects of the 2000 REP Settlements at the expense of COUs that were injured is equally unfair. The example of Grant County PUD discussed in Issue 6.5.2 is an apt example. *See* Issue 6.5.2. As the record in this case makes clear, not every customer of BPA was injured by the 2000 REP Settlements. *See* Bliven *et al.*, REP-12-E-BPA-12, at 32 ("The costs of the 2000 REP Settlement were primarily allocated to the PF-02 customer class under Northwest Power Act section 7(g). No costs of the 2000 REP Settlement, to our knowledge, were allocated to the FPS rates charged to customers under pre-Subscription contracts."). A few members of WPAG purchased power from BPA under pre-Subscription contracts. *See* Bliven *et al.*, REP-12-E-BPA-17, at 15. Nevertheless, the settling COUs have agreed to dilute their own refund by spreading it more broadly than BPA was willing to do in the WP-07 Supplemental ROD. This action directly benefits WPAG by providing certain of its members \$2.5 million in rate credits they were not receiving before. *Id.* As Staff noted:

WPAG's members will receive a direct and immediate benefit if the Settlement is adopted: Elmhurst Mutual Power and Light, Ohop Mutual Light and Parkland Light and Water, all pre-Subscription customers, will receive just short of

\$2.5 million in Refund Amount credits, notwithstanding the fact these customers incurred no overcharges as a result of the invalid 2000 REP settlement agreements. This is \$2.5 million more than they would receive without the Settlement.

*Id.* BPA cannot see how the Settlement harms WPAG’s members.

On this point it is interesting to note that 90 percent of the other customers who held pre-Subscription contracts agree that the Settlement is superior to the current alternative and have signed the Settlement. Overall, 30 BPA customers purchased power under pre-Subscription agreements and, as a consequence, were not receiving Lookback credits under BPA’s current Lookback construct. Of these customers, 27 have signed the Settlement, including one that is a member of WPAG. It is hard to understand why WPAG has taken up this battle of “principle” when 90 percent of the COUs who would be most affected by the Refund Amounts (including one current member of WPAG) have signed on to the Settlement.

Finally, WPAG’s argument on principle is not an argument against the current settlement construct (which retains the targeted refund approach), but rather an argument in favor of another settlement. While WPAG may believe this observation “denigrates” its argument, BPA does not know how else to respond to it. WPAG Br. Ex., REP-12-R-WG-01, at 51. WPAG is wishing away a significant provision of the Settlement (which is also a key component of BPA’s existing Lookback-construct), apparently believing instead that the Settlement should have been revised to “bring all liabilities regarding Lookback Amounts, for both IOUs and preference customers, to an end.” WPAG Br. Ex., REP-12-R-WG-01, at 50. While it would have made BPA’s implementation of the Settlement much easier if this were the case, the settling parties retained aspects of BPA’s Lookback construct in the final Settlement. Their reasons for retaining the targeted refund approach were largely the same as BPA’s rationale for creating this approach in the WP-07 Supplemental ROD: some customers were injured, while others were not. *See* Murphy and Kallstrom, REP-12-E-JP02-04, at 9-10. In constructing a settlement for those injured customers, the settling COUs believe, and BPA agrees, that retention of a targeted refund construct is appropriate to ensure that the COUs injured by the 2000 REP Settlements are brought a measure of relief for the past harm they experienced.

### **Decision**

*The Settlement properly resolves, in a fair and equitable manner, outstanding issues with BPA’s development and implementation of the Lookback for the FY 2002–2011 period, and thereby satisfies primary criterion (3) and secondary criterion (1).*

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## 7.0 THE 2012 REP SETTLEMENT AGREEMENT'S COMPLIANCE WITH PGE AND GOLDEN NW

### 7.1 The Court's Decision in PGE

In *PGE*, the Court reviewed BPA's exercise of its settlement authority in executing the 2000 REP Settlement. 501 F.3d at 1032–1036. The Court first looked at the scope of BPA's settlement authority. *Id.* at 1025. The Court then found that BPA, though having broad settlement authority, had exercised that authority without regard to sections 5(c) and 7(b) of the Northwest Power Act when BPA adopted the 2000 REP settlement. The Court then noted that BPA's settlement authority is subject to the constraints of the Northwest Power Act. *Id.* at 1028. The Court noted that the REP is governed by section 5(c) of the Northwest Power Act, and without section 5(c) there can be no REP claims to settle. The Court concluded that “whenever BPA engages in a purchase and exchange sale of power—whether on a yearly basis, under a REP program, or pursuant to a settlement agreement—BPA acts pursuant to its § 5(c) authority, and is thus subject to the Congressionally imposed limitations on that authority as expressed in § 5(c) and § 7(b).” *Id.* at 1032. The Court stated that “we do not in any way rule on the legality of BPA's settlement authority when it settles out of contractual power obligations in a manner consistent with the requirements of the [Northwest Power Act]. We simply hold that BPA cannot bypass the requirements of §§ 5(c) and 7(b) *altogether* when it settles out of purchase and exchange sale obligations.” *Id.* (emphasis added).

The Court then reviewed the exercise of BPA's settlement authority in adopting the 2000 REP Settlement. *Id.* The Court noted that when BPA forecast IOU REP benefits in its WP-02 rate case, it forecast \$48 million per year for the rate period. This calculation was based on Northwest Power Act section 5(c) calculations, as capped by section 7(b)(2) of the Act. *Id.* at 1033. BPA also determined that only three IOUs were eligible for REP benefits, and that two of these IOUs were entitled to 98 percent of the benefits. *Id.* The Court then contrasted these facts with the 2000 REP Settlement. *Id.* The Court concluded that BPA “did not rely on ASCs.” *Id.* The Court noted that BPA no longer received cost and load data from utilities through ASC filings as previously required under the RPSAs, and that instead of developing data from which ASCs could be calculated, BPA rejected using current ASCs. *Id.* The Court noted that BPA also stated that if it simply used ASCs to allocate settlement benefits, only a few IOUs would be allocated a large majority of the total settlement amount. *Id.* The Court noted that BPA's estimate of the cost of the settlement was \$796 million for the five-year period instead of \$496 million under its WP-02 forecasts for the REP. *Id.* Instead of relying on ASCs, BPA factored in three variables: (1) a possible legal challenge to the 1984 ASC Methodology; (2) a possible challenge to the PF Exchange rate; and (3) future fluctuations in the energy market. *Id.* Each of these assumptions served to enlarge the group of IOUs eligible for the settlement. *Id.*

The Court noted that BPA also ignored ASCs entirely to decide how to allocate the settlement. *Id.* at 1034. BPA proposed to allocate the 1,800 aMW of the settlement and then asked the public utility commissions of Idaho, Montana, Oregon, and Washington to negotiate a proposal

for dividing power among the IOUs, which they did, but also asking BPA to increase the amount of power to 1,900 aMW. *Id.* The Court stated that the most significant assumption BPA made was to consider the effect of a challenge to the 1984 ASC Methodology and BPA's reversion to the 1981 ASC Methodology. *Id.* This made more IOUs eligible for REP benefits and significantly increased the cost of the benefits payable to IOUs already qualified for the REP. *Id.* The Court stated that BPA's assumption that it would revert to the 1981 ASC Methodology was unfounded because there was no existing legal challenge; nor had BPA proposed changing its methodology. *Id.* The Court stated that until BPA adopts new regulations, it is bound by its regulations. *Id.* The Court concluded that the 2000 REP Settlement did not reflect BPA's current REP as defined by BPA's own regulations. *Id.* at 1035.

The Court also stated that BPA classified the costs of the settlement as settlement costs, which permitted BPA to treat the settlement costs as ordinary expenses in BPA's rates. *Id.* The Court stated that this violated section 7(b)(2) of the Northwest Power Act, which includes a provision requiring BPA to assume that "no purchases or sales ... were made [under the REP program], and that costs resulting from the rate test "shall be recovered through supplemental rate charges for all other power sold by the Administrator to all customers." *Id.*

*PGE*, however, reaffirmed BPA's broad settlement authority. The Court stated that:

The ability to settle claims without resort to litigation or full-throated regulatory administrative proceedings is certainly an important aspect for making BPA an efficient agency and fulfilling the Administrator's charge to conduct BPA as a well-run business. The ability to compromise claims, by its nature, requires flexibility and discretion. Regulatory claims are rarely capable of a sum-certain determination and an either/or assessment of the likelihood of success on the merits. It is thus implicit in the grant of settlement power that BPA have the flexibility to take into account a variety of considerations, including its litigation costs, differing damage assessments, and the risk of loss on the merits.

*PGE*, 501 F.3d at 1030. The Court stated that "[w]e have recognized within this opinion that BPA has broad authority to settle claims under the [Northwest Power Act]. We repeat: flexibility inheres in compromises under that authority." *Id.* at 1037. Extremely significant is the Court's recognition that BPA can settle REP disputes using its statutory settlement authority. The Court stated "[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b)." *Id.* at 1030.

## **7.2 The Court's Decision in Golden NW**

In *Golden NW*, the Court reviewed BPA's WP-02 power rates. 501 F.3d 1037. BPA's power rates were, before the 2000 REP Settlements, developed using the section 7(b)(2) rate test. The *Golden NW* Court, however, like the *PGE* Court, did not review BPA's statutory rate directives that affect ratemaking prior to accounting for section 7(b)(2). Before conducting the rate test, the Northwest Power Act requires BPA to develop a preliminary rate for preference customers, the PF Public rate. BPA does this by following the ratemaking directives of section 7(b)(1), which

expressly require BPA to allocate REP costs to the preference customers' rates. Section 7(b)(1) states that:

The Administrator shall establish a rate or rates of general application for electric power sold to meet the general requirements of public body, cooperative, and Federal agency customers within the Pacific Northwest. ... Such rate or rates shall recover the costs of that portion of the Federal base system resources needed to supply such loads until such sales exceed the Federal base system resources. *Thereafter, such rate or rates shall recover the cost of additional electric power as needed to supply such loads, first from the electric power acquired by the Administrator under section 5(c) [the REP] and then from other resources.*

16 U.S.C. § 839e(b)(1) (emphasis added). Because the FBS resources are insufficient to meet 7(b)(1) customer loads, BPA necessarily uses as much REP power to meet such loads as required by section 7(b)(1). This means REP costs are directly allocated to the preference customers' rates. BPA then, preceding the Settlement, conducted the 7(b)(2) rate test. The rate test compares the PF Public rate (the Program Case rate) less specified section 7(g) costs with a rate developed using the five assumptions listed in section 7(b)(2) (the 7(b)(2) Case rate). If the adjusted Program Case rate exceeds the 7(b)(2) Case rate, the rate test triggers, the PF Public rate is lowered to the 7(b)(2) Case rate plus specified section 7(g) costs, and the difference in costs is allocated to all other power rates. If the rate test does not trigger, the PF Public rate remains unadjusted and is directly assigned REP costs as required by section 7(b)(1). Thus, the statute is crystal clear. REP costs can be allocated to the preference customers' PF Public rates. Even when the rate test triggers, REP costs continue to be allocated to the preference customers' rates to some extent (unless the trigger amount is so large that REP benefits are completely eliminated). This is because REP costs have been allocated to the preference customers' rates before the rate test, and the rate test trigger amount is based on five assumptions that provide an amount to be allocated away from the preference customers' rates. It is important to note that allocating the trigger amount away from the preference customers' rates does not completely eliminate the REP costs that were previously allocated to those rates.

*Golden NW* involved the allocation of 2000 REP Settlement costs and not REP costs from the normal implementation of the REP. The Court noted that when BPA developed its WP-02 rates, it treated the 2000 REP Settlement costs as “an ordinary cost of doing business” under section 7(g) of the Northwest Power Act that could be recovered from all customers. *Golden NW* at 1048. The Court held this treatment was improper. The Court concluded that “[b]y burdening its preference customers with part of the cost of the REP settlement, BPA ‘ignored its obligations’ under section 7(b)(2) and 7(b)(3).” *Id.* Specifically, the Court stated that “[t]he [Northwest Power Act] requires that the IOUs’ exchange benefits not come at the expense of BPA’s preference customers. Under section 7(b)(2), preference customer rates must be calculated as if BPA made ‘no purchases or sales’ under the REP. 16 U.S.C. § 839e(b)(2).” *Id.* at 1047, 1048. The Court is correct that IOUs’ exchange benefits do not come “at the expense” of BPA’s preference customers because section 7(b)(2) protects preference customers from *excessive* REP and other costs, even though some REP costs remain allocated to the preference customers’ rates under section 7(b)(1). When the Court states that preference customer rates must be calculated as if BPA made “no purchases or sales” under the REP, it cites

section 7(b)(2) of the Northwest Power Act. 16 U.S.C. § 839e(b)(2). *Golden NW*, 501 F.3d at 1047, 1048. Reviewing section 7(b)(2), it is clear that the assumption of no REP in the 7(b)(2) Case of the rate test is one of *five* different assumptions that are made in conducting the test. Obviously, if the section 7(b)(2) rate test triggered, the trigger is the result of all five assumptions and not simply the elimination of REP costs. The fact that no REP costs are included in the 7(b)(2) Case of the 7(b)(2) rate test does not mean that preference customers pay no REP costs in their rates.

### **7.3 Differences Between the 2000 REP Settlement and the 2012 REP Settlement**

As fully described previously in section 1.4.2, BPA and its investor-owned utility customers entered into a REP Settlement in 2000. This previous settlement differs from the proposed 2012 REP Settlement in many significant ways. Bliven *et al.*, REP-12-E-BPA-12, at 48, and Attachment 14. Staff summarizes a few of these differences that are pertinent to ratemaking:

- (1) The 2000 REP Settlement was developed to prevent further decline in REP benefits; the 2012 REP Settlement is designed to constrict further growth of REP benefits and end litigation and uncertainty;
- (2) Payments made under the 2000 REP Settlement were not tested for compliance with the 7(b)(2) rate test, and were based on hypothetical challenges to the ASC Methodology and 7(b)(2) rate test; REP benefits under the 2012 REP Settlement are tested for compliance with the section 7(b)(2) rate test;
- (3) The 2000 REP Settlement did not provide REP benefits to the IOUs based on ASCs—all IOUs were guaranteed some REP benefits; the 2012 REP Settlement will pay IOUs based on their ASCs, which will continue to be determined pursuant to the ASC Methodology every two years; not all IOUs are guaranteed REP payments;
- (4) The 2000 REP Settlement had no cap on REP benefits and had immediate adverse rate impacts on COUs because REP benefits under settlement were higher than BPA’s forecast under traditional REP benefits in WP-02 rates; 2012 Settlement fixes IOU REP benefits, and provides \$24 million in immediate rate savings to COUs below BPA’s no-Settlement REP case (net of Lookback refund bill credits); analysis shows that this savings grows over time; and
- (5) Costs of 2000 REP Settlement were categorized as general “settlement costs” and allocated pursuant to section 7(g); costs of 2012 REP Settlement are categorized as “exchange resource costs” and allocated pursuant to 7(b) and excluded from the 7(b)(2) Case of the rate test.

*Id.* at 48.

The first distinction Staff identifies between the 2000 and 2012 REP Settlements is one of context. *Id.* at 49. The 2000 REP Settlement was developed at a time when REP benefits, on the

whole, were declining. *Id.* Under the 1984 ASC Methodology, REP benefits substantially declined from a high of over \$400 million in the early 1980s to \$64 million by 1998. *Id.* at Attachment 15. Congress even stepped in at one point during the WP-96 rate proceeding and passed legislation directing BPA to pay the IOUs a certain amount in REP benefits for their residential and small farm consumers in FY 1997. *Id.* at 49. Coupled with declining REP benefits was the looming expiration of the 1981 power sales agreements. *Id.* These events led to the Comprehensive Review of the Northwest Energy System in 1998, which in turn led to BPA's adoption of the Power Subscription Strategy. *Id.*; see Evaluation Study, REP-12-FS-BPA-01, section 2.2. One of the key features of the Subscription Strategy was BPA's stated intent to "to spread the benefits of the FCRPS as broadly as possible, with special attention given to the residential and rural customers of the region." Bliven *et al.*, REP-12-E-BPA-12, at 49; see Residential Program Settlement ROD (October 4, 2000) (2000 REP ROD) at 3. It was against this backdrop of declining REP benefits and a stated BPA policy of "sharing" the FCRPS with regional consumers that BPA's 2000 REP Settlement was born. *Id.*

BPA is presented with a much different context for the 2012 REP Settlement. Bliven *et al.*, REP-12-E-BPA-12, at 49. Instead of steadily declining REP benefits, REP benefits have been increasing for the past several years and are expected to continue to increase over time. *Id.* Already we are beginning to see what the new future of REP costs may look like to BPA and its ratepayers. *Id.*; see Evaluation Study, REP-12-FS-BPA-01, Figure 1. In the WP-10 rate case, REP benefits for the IOUs averaged around \$265 million per year. Bliven *et al.*, REP-12-E-BPA-12, at 49; see Power Rate Study Documentation, BP-12-FS-BPA-01A, Table 2.4.14. In the BP-12 and REP-12 proceedings, we are seeing IOU REP benefits increasing to about \$271 million per year under the no-settlement alternative. See the updated Non-Settlement Section 7(b)(2) Rate Test results in the Evaluation Study, BP-12-FS-BPA-01, Table 10.6. BPA's projections in the long-term 7(b)(2) models demonstrate that this trend is likely to continue into the future, with REP benefits reaching as high as \$752 million in FY 2028 under BPA's view of 7(b)(2) implementation, compared to the \$286 million under the Settlement. See Evaluation Study, REP-12-FS-BPA-01, Table 10.3.2.

In addition to increasing costs of REP benefits, there is great uncertainty in the region due to the almost certain continuation of contentious and complex litigation over the REP. Bliven *et al.*, REP-12-E-BPA-12, at 50. The current challenges to BPA's implementation of the REP call into question the validity of every PF and PF Exchange rate BPA has established and charged its customers since FY 2002. *Id.* To put this in perspective, 10 years have passed since BPA first implemented the WP-02 rates, and yet we still do not know whether those rates were set properly. *Id.* Thus, the need for a settlement of the REP disputes is much greater now than at any other time in the REP's 30-year history. *Id.*

A second distinction is the role that the section 7(b)(2) rate test played in BPA's evaluation of the 2000 REP Settlement. *Id.* To understand this distinction, it is helpful to briefly describe the method BPA previously used to evaluate the 2000 REP Settlement. *Id.* BPA did not actually run the 7(b)(2) rate test to determine whether the REP benefits provided under the 2000 REP Settlement comported with the limitations set forth in the Northwest Power Act. *Id.* Instead, BPA used the results of the 7(b)(2) rate test developed in the WP-02 rate proceeding to offer a

traditional REP as an alternative to the 2000 REP Settlement. *Id.* The traditional REP would have offered about \$48 million of REP benefits to three IOUs, given the record as it had then been developed. *Id.*; see 2000 REP ROD at 78. Conversely, the 7(b)(2) rate test did not test the payments made under the 2000 REP Settlement. Bliven *et al.*, REP-12-E-BPA-12, at 50. Instead, the PF Exchange rate used to make this determination was originally calculated in BPA's 1996 rate case (WP-96) and carried forward into the 2002 (WP-02) rate period. *Id.* The 2000 REP Settlement offered about \$140 million to all six IOUs, an amount that was subsequently increased to more than \$300 million. *Id.* at 50-51. BPA not only did not perform the 7(b)(2) rate test, but it relied on old ASC filings that were escalated forward in the WP-02 rate case to determine "eligibility" for the IOUs. *Id.* at 51. Some of these ASCs were from filings made in the early 1980s. *Id.* Using these historical ASCs, with certain additional cost adjustments, BPA determined that all of the IOUs would be eligible to receive REP settlement benefits. *Id.*

Once the eligibility of the IOUs for the 2000 REP Settlement was established, BPA performed a very general analysis to determine whether the "amount" of REP benefits provided under the 2000 REP Settlement was reasonable. *Id.* This analysis depended on successful challenges by the IOUs to BPA's calculation of the PF Exchange rate and hypothetical challenges to the then-existing ASC Methodology. *Id.* BPA assumed that if these challenges were sustained, it would mean a lower PF Exchange rate and a return to the ASC Methodology developed in 1981, which together would have resulted in overall higher ASCs and larger REP benefits. *Id.*; see 2000 REP ROD at 40, 50.

For the REP-12 Settlement, Staff performs the 7(b)(2) rate test for each year (plus the ensuing four years) of the Agreement, and bases these runs on ASCs developed using the existing ASC Methodology. Bliven *et al.*, REP-12-E-BPA-12, at 51. In performing this analysis, Staff tests the total amount of REP benefits under the Settlement to determine whether recovering this amount of REP benefits in rates comports with the protections afforded by the section 7(b)(2) rate test. *Id.* Staff's analysis, in this regard, goes far beyond simply determining whether a particular IOU would be "eligible" for REP benefits under the Settlement; it is a test of whether the REP benefits provided in the Settlement are permissible under the law. *Id.*

Staff's evaluation of the 7(b)(2) issues in the REP-12 case is also far more sophisticated than BPA's approach in 2000. *Id.* In the REP-12 case, Staff uses a PF Exchange rate that is developed using concurrent BP-12 rate case data and an up-to-date run of the 7(b)(2) rate test based on inputs developed for the REP-12 proceeding. *Id.* at 51-52. Staff also uses the IOUs' actual ASCs for FY 2012–2013 (based on the Final ASC Reports dated July 26, 2011), which are determined pursuant to the 2008 ASC Methodology. Evaluation Study, REP-12-FS-BPA-01, Chapter 7. These ASCs are projected for the 17 years of the Settlement using the same ASC forecasting models used in the ASC review process to calculate ASCs under the 2008 ASC Methodology. *Id.*, section 7.5.

Finally, Staff's scenario analysis does not rely on hypothetical challenges to BPA's 7(b)(2) determinations. Bliven *et al.*, REP-12-E-BPA-12, at 52. Instead, BPA is facing multiple pieces of litigation that challenge essential aspects of the REP. *Id.* To model the potential outcomes

that could result with adjudicating the litigation, Staff runs multiple scenarios using differing interpretations of section 7(b)(2) to test whether the Settlement’s REP benefits are reasonable under not only BPA’s interpretation of the relevant statutory provisions but also under other parties’ interpretations. *Id.* Again, Staff’s analysis supports a finding that the Settlement, in almost all instances, provides superior rate protection to the COUs, overall lower REP benefits to the IOUs, and lower IP rates for the DSIs. *Id.*

A third distinction is the ongoing role that ASCs play under the two settlements. *Id.* In the 2000 REP Settlement, ASCs played essentially no role in determining whether a utility received REP benefits or how much it received. *Id.*, citing 2000 REP ROD at 36 (“the issue of IOUs’ eligibility to receive REP benefits cannot be based on ASC forecasts alone.”). At the time, BPA took the position that ASCs were not necessary for determining a utility’s right to participate in a settlement of the REP, *id.*, and instead, BPA could look to a number of other considerations such as “the amount of residential and small farm load eligible for the REP, the historical provision of REP benefits, the REP benefits received in the last five-year period ending June 30, 2001, rate impacts on qualifying customers, and the individual needs and objectives of each state.” *Id.* at 52-53, citing 2000 REP ROD at 81.

Here, however, the REP-12 Settlement retains the requirement that the IOUs file ASCs with BPA pursuant to the 2008 ASC Methodology every rate period before receiving REP benefits. *Id.* at 53, citing REPSIA, REP-12-A-02A, Exhibit A, § 4. Moreover, no one IOU is guaranteed any REP benefits under the Settlement. *Id.* IOUs will have to “compete” with BPA’s rates to receive REP benefits, and only IOUs that have ASCs that exceed BPA’s PF Exchange rate will receive any payments under the Settlement. *Id.*

A fourth distinction relates to the different structure of the two settlements. *Id.* The 2000 REP Settlement had few real cost-limiting features. *Id.* The 2000 REP Settlement included certain options that BPA could exercise to limit its exposure to market costs, but these options still required BPA to provide the IOUs, in one form or another, 1,900 aMW of equivalent Federal power for the first five years and then 2,200 aMW of equivalent Federal power for the remaining five years. *Id.*, citing 2000 REP ROD at 13. The results of this approach provided the IOUs with more in near-term REP benefits under the 2000 REP Settlement (*i.e.*, \$140 million) than BPA was projecting under the traditional implementation of the REP in the WP-02 rates (*i.e.*, \$48 million). *Id.*, citing 2000 REP ROD at 78.

Under the 2012 REP Settlement, however, there are significant cost savings, both in the near-term rates and in the long-term projections. *Id.* First, in the near term, the Settlement would include in rates an amount of REP benefits that is \$24 million *below* BPA’s proposal for IOU REP benefits under the no-settlement alternative. Evaluation Study, REP-12-FS-01, section 11.3. Thus, under the REP-12 Settlement, BPA’s ratepayers will see immediate REP-related cost savings. Bliven *et al.*, REP-12-E-BPA-12, at 53-54.

Second, in the long term, the REP-12 Settlement will provide greater stability to BPA’s ratepayers because it fixes the IOUs’ REP benefits to the amounts in the Agreement. *Id.* Thus, no matter how high ASCs rise in relation to BPA’s PF Exchange rate, preference customers and

other BPA ratepayers will know with certainty that their rates will not pick up a cent more in REP benefits than what is called for in the Agreement. *Id.*

A fifth distinction is in the manner in which the “costs” of the two settlements are allocated. *Id.* With the 2000 REP Settlement, BPA categorized the costs of the agreement as general “settlement costs” and allocated these costs to all rates pursuant to section 7(g). *Id.*, citing WP-02 ROD, WP-02-A-02, at 12-4.

In the REP-12 case, however, the costs of the 2012 REP Settlement are being treated for ratemaking purposes in the same manner as traditional REP costs. *Id.* The costs of the section 5(c) purchases of exchange power from eligible IOUs are included in the revenue requirement and assigned to the exchange resource cost pool. *Id.* The section 5(c) sales of exchange power to eligible IOUs are included as loads in the 7(b) load pool, and costs are allocated to these loads pursuant to sections 7(b)(1) and 7(g). *Id.* Thus, the costs and revenues of the 2012 Settlement are allocated among BPA’s rate pools in accordance with section 7(b) of the Act. *Id.*

#### **7.4 The 2012 REP Settlement Complies with PGE and Golden NW and Corrects the Identified Deficiencies**

##### **Issue 7.4.1**

*Whether the 2012 REP Settlement Agreement is consistent with Portland General Elec. Co. v. Bonneville Power Admin., 501 F.3d 1009 (9th Cir. 2007) (PGE) and Golden NW Aluminum, Inc. v. Bonneville Power Admin., 501 F.3d 1037 (9th Cir. 2007) (Golden NW).*

##### **Parties’ Positions**

Alcoa, APAC, and WPAG argue that the 2012 REP Settlement is inconsistent with *PGE* and *Golden NW*. Alcoa Br., REP-12-B-AL-02, at 8-15; APAC Br., REP-12-B-AP-01, at 14-16; WPAG Br., REP-12-B-WG-01, at 20.

JP02 argues that the 2012 REP Settlement is consistent with *PGE* and *Golden NW*. JP02 Br., REP-12-B-JP02-01, at 8-9.

##### **BPA Staff’s Position**

In Staff’s understanding, the 2012 REP Settlement is consistent with *PGE* and *Golden NW*. Bliven *et al.*, REP-12-E-BPA-12, at 47.

##### **Evaluation of Positions**

The 2012 REP Settlement has corrected each deficiency the Court identified with the 2000 REP Settlement in *PGE* and *Golden NW*. The following discussion will take each deficiency found with the 2000 REP Settlement and demonstrate, based on the record, that the 2012 REP Settlement contains no such deficiency.

The first area the *PGE* Court reviewed was the amount of REP benefits forecast under BPA's WP-02 rates and the REP benefits provided by the 2000 REP Settlement. The Court noted that the WP-02 rate case forecast \$48 million of REP costs per year for the first five-year period (\$496 million total), using ASCs and the 7(b)(2) rate test. 501 F.3d at 1033. In contrast, the cost of the 2000 REP Settlement was \$159 million per year for the first five-year period (\$796 million total), which prompted the Court's review of BPA's ASC and 7(b)(2) assumptions. *Id.*

The enormous disparity between the REP costs forecast in BPA's rate case and the forecast REP settlement costs does not exist in the 2012 REP Settlement. In BPA's REP-12 proceeding, BPA's forecast of IOU REP costs without the Settlement is \$271 million for FY 2012. See the updated Non-Settlement Section 7(b)(2) Rate Test Study results in the Evaluation Study, BP-12-FS-BPA-01, Table 10.6. REP costs for FY 2012 in the 2012 REP Settlement are \$258.6 million. REP Settlement Agreement, REP-12-A-02A, Tables 3.1 and 3.2. Significantly, without the REP Settlement, the amount of REP costs forecast in BPA's FY 2012 rates is *greater* than the amount of REP costs established in the 2012 REP Settlement. In other words, the IOUs are settling the REP disputes for *less* than they would receive under BPA's normal implementation of the REP in the absence of the Settlement. This is true throughout the settlement period. Indeed, as the settlement period progresses, the IOUs receive increasingly less REP benefits under the Settlement when compared to the projected benefits under the traditional REP. Evaluation Study, REP-12-FS-BPA-01, Table 10.3.1 and Table 10.3.2. This is a striking and critical contrast to the 2000 REP Settlement.

The *PGE* Court then reviewed BPA's use of ASCs in determining REP costs in the 2000 REP Settlement. 501 F.3d at 1033. The Court noted that BPA did not use cost and load data from utilities through ASC filings for its ASC assumptions. *Id.* Also, during the WP-02 rate case, BPA had forecast that only three IOUs were eligible for REP benefits, and that two of these IOUs were entitled to 98 percent of the benefits. *Id.* The Court then contrasted these facts with the 2000 REP Settlement, where BPA "did not rely on ASCs" but instead factored in three variables: (1) a possible legal challenge to the 1984 ASC Methodology; (2) a possible challenge to the PF Exchange rate; and (3) future fluctuations in the energy market. *Id.* Each of these assumptions served to enlarge the group of IOUs eligible for the settlement. *Id.* In stark contrast to this approach, BPA's review of the 2012 REP Settlement relies on BPA's FY 2012–2013 ASCs and outyear ASC forecasts for each IOU in order to establish the Reference Case. IOUs will not receive Settlement benefits if their ASCs are lower than BPA's PF Exchange rate. In addition, IOUs will continue to make contemporaneous ASC filings with BPA throughout the 17 years of the Settlement, and BPA will establish contemporaneous PF Exchange rates in order to ensure proper intra-class allocation of REP benefits for each rate period.

Unlike the 2000 REP Settlement, which was developed during a period when BPA was not implementing the REP, the 2012 REP Settlement relies on cost and load data obtained from utilities through ASC filings under BPA's existing 2008 ASC Methodology. Again, in contraposition to the 2000 REP Settlement, the 2012 REP Settlement provides that settlement benefits are provided only to utilities that are eligible to receive benefits under the REP as established in BPA's REP-12 and BP-12 proceedings and that eligibility to receive REP benefits

will be redetermined every two years during the settlement term. The 2012 REP Settlement thus determines IOU REP benefits for eligible IOUs based on ASCs resulting from legitimate forecast costs, loads, and the 2008 ASC Methodology and associated filings, and the PF Exchange rate that is unaffected by the terms of the Settlement.

The *PGE* Court noted that BPA also ignored ASCs entirely in deciding how to allocate the benefits of the 2000 REP Settlement to the IOUs. 501 F.3d at 1034. BPA proposed to allocate the 1,900 aMW of the settlement and then asked the public utility commissions of Idaho, Montana, Oregon, and Washington to negotiate a proposal for dividing power among the IOUs. *Id.* In contradistinction, the 2012 REP Settlement does not defer the allocation of settlement benefits to state commissions or other entities. The 2012 REP Settlement allocations are based on the PF Exchange rates and the IOUs' respective ASCs as officially determined by BPA under the 2008 ASC Methodology.

The *PGE* Court stated that the most significant assumption BPA made when analyzing the 2000 REP Settlement was to consider the effect of a challenge to the 1984 ASC Methodology and BPA's assumed reversion to the 1981 ASC Methodology, which was unfounded because there was no existing legal challenge and BPA had not proposed changing its methodology. 501 F.3d at 1035. The Court stated that until BPA adopts new regulations, it is bound by its regulations. *Id.* The Court concluded that the 2000 REP Settlement did not reflect BPA's current REP as defined by BPA's own regulations. *Id.* at 1035-1036. In differentiation to the 2000 REP Settlement, as noted above, the 2012 REP Settlement relies on BPA's current 2008 ASC Methodology, not a previous methodology. This Methodology was adopted by BPA in July 2008 and approved by FERC in September 2009, and no challenges to the Methodology were filed with the Court. The analysis of the Settlement assumes no changes to the current Methodology. The 2012 REP Settlement therefore complies with BPA's existing regulations for implementing the current REP.

The *PGE* Court also stated that BPA classified the costs of the settlement as general operating costs, which permitted BPA to treat the settlement costs as ordinary expenses in BPA's rates. 501 F.3d at 1036. The Court stated that this violated section 7(b)(2) of the Northwest Power Act. *Id.*; see *Golden NW* at 1047-1048. Under the proposed Settlement, BPA has not treated the 2012 REP Settlement costs as "settlement costs" in order to allocate them in a particular manner in BPA's rates. Instead, the 2012 REP Settlement costs are treated as REP costs for BPA's ratemaking purposes. In fact, the Settlement requires very modest changes in the allocation of rate protection amounts to accomplish the outcome desired by the settling parties; except for the 7(b)(2) rate test not being performed to calculate rates, BPA's other ratesetting methodologies are virtually unchanged by the Settlement. In summary, the 2012 REP Settlement has directly addressed and corrected all of the deficiencies the Court identified in the 2000 REP Settlement.

In addition to these five major differences between the settlements, Staff identifies 18 more differences. Bliven *et al.*, REP-12-E-BPA-12, Attachment 14, at 14-1.

Alcoa and APAC argue that the Ninth Circuit has rejected *similar* efforts by BPA to settle its REP obligations, citing *PGE* and *Golden NW*. Alcoa Br., REP-12-B-AL-02, at 14; APAC Br.,

REP-12-B-AP-01, at 4. As explained in detail previously, the 2012 REP Settlement Agreement is not *similar* in any substantive fashion to the 2000 REP Settlement Agreements and does not violate the critical provisions reviewed by the Court in those cases.

Alcoa and APAC note that in *PGE*, the Ninth Circuit held that in exercising its authority to settle disputes, BPA must meet the statutory mandates of sections 5(c) and 7(b) of the Northwest Power Act. Alcoa Br., REP-12-B-AL-02, at 15; APAC Br., REP-12-B-AP-01, at 2-3. The *PGE* Court stated:

In our view, however, settlement of BPA’s REP obligations must be grounded in the REP program authorized by § 5(c) that creates the occasion for the settlement in the first place. A settlement agreement cannot be a means of bypassing Congressionally mandated requirements.

501 F.3d 1032. Similarly, the Court stated:

[W]henver BPA engages in a purchase and exchange of power—whether on a yearly basis, under a REP program, or pursuant to a settlement agreement—BPA acts pursuant to its § 5(c) authority, and is thus subject to the Congressionally imposed limitations on that authority as expressed in § 5(c) and § 7(b).

*Id.* BPA and the opposing parties agree that a REP settlement cannot bypass statutory requirements and must be “grounded in the REP” authorized by section 5(c). Although agreeing on the law, BPA and the opposing parties disagree on whether the 2012 REP Settlement satisfies these standards.

The opposing parties argue that the 2012 REP Settlement is inconsistent with sections 5(c) and 7(b) of the Northwest Power Act, and BPA must essentially incorporate the implementation of sections 5(c) and 7(b) in any REP settlement. The fatal flaw of this argument, however, is that it would result in contracts only *implementing* the REP, not contracts *settling REP disputes*. A brief summary of the REP explains this flaw in the parties’ argument.

As consistently recognized in previous REP settlements and in this REP-12 proceeding, there are numerous reasons it makes sense to settle REP disputes. REP settlements resolve contentious REP and ratemaking issues, provide stability to COUs by stabilizing the REP costs included in the COUs’ rates, and provide stability to exchanging COUs’ and IOUs’ REP benefits and retail rates. In implementing the REP under section 5(c), BPA establishes exchanging utilities’ ASCs using BPA’s 2008 ASC Methodology. Although statutorily there is no specific period that an ASC must be established for (or “in effect”), BPA establishes ASCs for a two-year period pursuant to BPA’s 2008 ASC Methodology. Similarly, although statutorily there is no specific period BPA’s rates must be established for (or “in effect”), BPA establishes power rates every two years, including the implementation of section 7(b)(2) in developing such rates. By establishing ASCs and rates concurrently, the costs reflected in rates represent the best estimates available.

Although ASCs and BPA’s power rates have historically been established every two or five years, there is no requirement that section 7(b)(2) be constrained to a rate period. This has been

thoroughly addressed elsewhere in this ROD. BPA has separately and thoroughly addressed the parties' specific arguments regarding (1) whether the 2012 REP Settlement complies with section 5(c) of the Northwest Power Act and (2) whether the 2012 REP Settlement complies with section 7(b) of the Northwest Power Act.

APAC argues that in *PGE* the factors the Court considered in finding that the 2000 Settlement was contrary to law were the facts that ASCs were not used to determine REP benefit levels and that BPA determined benefit levels based on "a critical set of assumptions" about the outcome of litigation that were unreasonable. APAC Br., REP 12-B-AP-01, at 3. APAC argues that in this case the settlement sets REP benefits independent of the differential between ASCs and BPA's rates and uses assumptions about the outcome of litigation that are unreasonable. *Id.* A review of the facts in *PGE* and the facts regarding the 2012 REP Settlement Agreements demonstrates that APAC's reliance on *PGE* is misplaced.

First, for the 2000 REP Settlement reviewed in *PGE*, BPA had conducted a forecast of REP benefits for the five-year rate period without using utility-filed ASCs and "estimated that the REP benefit would cost \$240.6 million for the 2002–2006 rate period," a "striking difference" from the \$736 million provided by the 2000 REP Settlement for the same period. 501 F.3d at 1033. In stark contrast, the REP benefits forecast for the IOUs in the absence of the Settlement are \$271 million per year for FY 2012–2013, and the 2012 REP Settlement benefits are \$258.6 million for the same rate period. See the updated non-settlement section 7(b)(2) rate test results in the Evaluation Study, BP-12-FS-BPA-01, Table 10.6. Thus, ASCs are not being used to inflate the 2012 REP Settlement amount. More specifically, the Court stated in *PGE* that the 2000 REP Settlement "did not rely on ASCs." 501 F.3d at 1035. In the 2000 REP Settlement, BPA "did not have usable data to calculate ASCs for purposes of offering a settlement." *Id.* In contrast, the parties developing the 2012 REP Settlement did so in the context of ASCs established in formal ASC reports and developed for each IOU in review processes established in BPA's 2008 ASC Methodology. These ASCs were available to the parties developing the 2012 REP Settlement from the ASC reports relied on in BPA's WP-10 rate proceeding. Furthermore, the settling parties set forth a structure that relies on contemporaneous ASCs and PF Exchange rates rather than simply choosing amounts of money to be distributed at will. In addition, BPA evaluates the 2012 REP Settlement based on ASCs and outyear ASC forecasts using the utilities' most current ASCs as reflected in the Final ASC reports dated July 26, 2011. Evaluation Study, REP-12-FS-BPA-01, Chapter 7. Therefore, unlike the 2000 REP Settlement reviewed in *PGE*, forecasts of ASCs are relied upon in verifying the appropriateness of the benefit levels in the REP-12 proceeding.

APAC argues that because the proposed 2012 REP Settlement is a replacement for the determinations made by BPA in the WP-07 Supplemental rate case, it must comply with the mandates of the Ninth Circuit in the *PGE* and *Golden NW* cases. APAC Br., REP-12-B-AP-01, at 4. APAC argues that the Settlement Agreement purports to impose terms that exceed the Court's mandate. *Id.* APAC claims that the *PGE* Court rejected BPA's collection of the costs of the illegal 2000 REP Settlement from preference customers. *Id.* APAC claims that the proper scope of BPA's response was limited to refunding those improper collections, but in the WP-07 Supplemental ROD and implicitly in the 2012 REP Settlement, BPA adopts rate adjustments to

its rates that fail to refund all of the improper over-collections and that reflect revisions to its ratemaking methodology exceeding the scope of the remand. *Id.* These issues were addressed in the WP-07 Supplemental ROD and are hereby incorporated by reference. See WP-07 Supplemental ROD, *e.g.*, 15-57. The 2012 REP Settlement responds fully to the Court’s mandate.

APAC argues that the proposed 2012 REP Settlement is not supported by many preference customers or their consumers. APAC Br., REP-12-B-AP-01, at 4. APAC’s remarkable assertion turns the facts on their head. One of the most significant characteristics of the 2012 REP Settlement is the massive and unprecedented support of the 2012 REP Settlement by preference customers. BPA has 128 preference customers (excluding Federal agencies) to which the Settlement was submitted for signing. Of these, 106 support the 2012 REP Settlement. The 2012 REP Settlement is therefore supported by *83 percent* of BPA’s preference customers. Viewed another way, preference customer load comprises the largest amount of the total loads served by BPA, and 88 percent of the load of BPA’s preference customers supports the 2012 REP Settlement. In contrast to this extensive support, the 2000 REP Settlement was challenged by nearly all of BPA’s preference customers. There were *no* preference customers that supported the 2000 REP Settlement.

APAC also argues that retail consumers of public utilities, as those who pay the rates billed by BPA to publics, are the real parties in interest and have been and will be injured by BPA’s continued error. APAC Br., REP-12-B-AP-01, at 4-5. APAC fails to note that retail consumers of public utilities, such as APAC’s industrial members, do not have power sales contracts with BPA and do not pay BPA’s wholesale power rates. Thus, contrary to APAC’s statement, only BPA’s public utility customers “pay the rates billed by BPA to publics,” not the consumers of those utilities such as APAC’s members. Retail consumers of public utilities pay the public utilities’ retail electric rates, which vary greatly from BPA’s power rates. Thus, the “real parties in interest” are BPA’s customers, not parties such as APAC that have only an indirect and contingent interest.

In contrast to APAC’s arguments regarding the *PGE* decision, JP02 argues that Staff’s careful attention to the statutory requirements of sections 5(c) and 7(b)(2) in the record of the REP-12 proceeding clearly distinguishes the present circumstances from those in the *PGE* case. JP02 Br., REP-12-B-JP02-01, at 8. There, according to the Court, BPA “took the position that the [settlement] agreement was governed by § 2(f) only, and it expressly denied that the settlement agreement would be subject to §§ 5(c) and 7(b).” *Id.*, *citing PGE*, 501 F.3d at 1027. Here, Staff and the settling Parties recognize that “the Settlement must have a clear and direct connection to the protections and requirements set forth in the Northwest Power Act.” JP02 Br., REP-12-B-JP02-01, at 8-9, *citing* Evaluation Study, REP-12-E-BPA-01, at 179; *see also* Carrasco *et al.*, REP-12-E-JP02-01, at 3. Based on the Staff’s detailed analysis, JP02 states that BPA can and should find that the rate protection and REP benefits under the 2012 REP Settlement fall within a range that does not contravene any clear requirements of sections 5(c) and 7(b). JP02 Br., REP-12-B-JP02-01, at 9. Thus, BPA will not be relying upon its settlement authority to transgress statutory requirements and “ignore[] the exchange program that Congress created in the [Northwest Power Act] and that BPA has implemented through its regulations.”

*Id.*, citing *PGE*, 501 F.3d at 1036. Rather, BPA will be adopting a program that can fairly be characterized as within the governing legal framework, while eschewing the adoption of definitive rulings on the specific and highly contested issues that most of its customers wish to settle for the next 17 years without precedent. JP02 Br., REP-12-B-JP02-01, at 9.

**Decision**

*The 2012 REP Settlement is consistent with the Court's decisions in PGE and Golden NW.*

## 8.0 EFFECT OF REP-12 SETTLEMENT ON PRIOR BPA DECISIONS

### 8.1 Introduction

As noted in section 1.3, in response to the Court's decisions in *PGE* and *Golden NW*, BPA commenced the WP-07 Supplemental Rate Hearing to consider whether and to what extent COUs were injured as a result of the 2000 REP settlement. BPA's final decisions regarding the refunds owed to COUs (the Lookback) and BPA's prospective implementation of the REP were presented in the WP-07 Supplemental ROD. In addition, BPA established new RPSAs to implement the REP for FY 2009. BPA's decisions regarding the final RPSAs were presented in the 2008 RPSA ROD. Following these decisions, BPA commenced another rate proceeding, the WP-10 rate proceeding, to establish rates for FY 2010–2011. In the WP-10 ROD, BPA issued final decisions regarding the implementation of the Lookback and the prospective implementation of the REP for FY 2010–2011. These decisions largely followed the decisions BPA reached in the WP-07 Supplemental ROD.

BPA's decisions have been challenged in Court. There are now 56 petitions pending before the Court challenging virtually every aspect of BPA's Lookback construct and implementation of the REP. The BPA final decisions being challenged, and the cases associated with those decisions, are as follows:

- (1) WP-07 Supplemental ROD, issued September 22, 2008. Parties' challenges to BPA's Lookback construct have been consolidated in the *APAC* case. Parties' challenges to BPA's WP-07 rates have been consolidated in the *Avista* cases.
- (2) 2008 RPSA and 2008 RPSA ROD, issued September 04, 2008. Parties' challenges to the 2008 RPSAs have been consolidated in the *IPUC* case.
- (3) WP-10 ROD, issued July 21, 2009. Parties' challenges to BPA's implementation of the Lookback for FY 2010–2011 have been consolidated in the *PGE II* case. Parties' challenges to the WP-10 rates have been consolidated in the *PacifiCorp* cases.

The Settlement would resolve challenges over BPA's implementation of the REP in return for a stream of REP benefits to the IOUs for a term of 17 years. *Id.* at 78701-78702. The COUs' obligation to pay REP benefits in rates would be limited to the COUs' share of the stream of REP benefits as set forth in the agreement. *Id.* The distribution of these REP payments to the IOUs would depend on each IOU's respective ASC and exchange load. *Id.* The IOUs would continue to file ASCs with BPA. *Id.* The notice in the Federal Register commencing the REP-12 proceeding stated that the Settlement, if adopted, would replace BPA's previous decisions responding to the Court's decisions in *PGE* and *Golden NW*:

If the Administrator determines that the settlement is consistent with applicable law, and is broadly supported by BPA's customers and other interested parties, he will sign the proposed 2012 REP Settlement and set BPA's FY 2012–2013 rates in accordance with the terms of the 2012 REP Settlement. In such case, *the 2012*

*REP settlement would replace BPA's current construct of withholding REP benefits due the IOUs and paying Lookback refund credits to eligible COUs as described in the WP-07 Supplemental ROD.*

*Id.* (emphasis added).

When BPA published its Initial Proposal in the REP-12 proceeding, Staff's testimony affirms that the Settlement would completely replace BPA's prior decisions:

The Settlement is proposed as a complete replacement of all decisions BPA made in the WP-07 Supplemental and WP-10 rate proceedings in response to *PGE* and *Golden NW*. If the Administrator executes the Settlement, such execution would withdraw his prior decisions regarding the FY 2002–2008 period and replace them with the resolution contained in the Settlement.

Gendron *et al.*, REP-12-E-BPA-04, at 3-4.

## **8.2 The Settlement's Effect on BPA's Prior Decisions in Response to Remand**

### **Issue 8.2.1**

*Whether the Settlement's replacement of BPA's previous decisions responding to the Court's PGE and Golden NW decisions renders the replaced decisions moot.*

### **Parties' Positions**

APAC claims that adopting a new REP-12 Settlement ROD does not moot APAC's appeal because, generally, actions for refunds of allegedly unlawful charges and for other affirmative relief present a live controversy regardless of intervening agency action. APAC Br., REP-12-B-AP-01, at 16; APAC Br. Ex., REP-12-R-AP-01, at 13-14.

### **BPA Staff's Position**

The Settlement, if adopted, would be a complete replacement of all decisions BPA made in the WP-07 Supplemental and WP-10 rate proceedings in response to *PGE* and *Golden NW*. Gendron *et al.*, REP-12-E-BPA-04, at 3-4. If the Administrator executes the Settlement, such execution would withdraw his prior decisions regarding the FY 2002–2008 period and replace them with the resolution contained in the Settlement. *Id.*

### **Evaluation of Positions**

APAC claims that adopting a new REP-12 Settlement ROD does not moot APAC's appeal because, generally, actions for refunds of allegedly unlawful charges and for other affirmative relief present a live controversy regardless of intervening agency action. APAC Br., REP-12-B-AP-01, at 16, *citing Atlantic Richfield Co. v. Bonneville Power Admin.*, 818 F.2d 701, 705 (9th Cir. 1987) (*ARCO*); APAC Br. Ex., REP-12-R-AP-01, at 14. *ARCO* does not support APAC's argument. In *ARCO*, BPA's DSI customers challenged BPA's inclusion of a customer charge in BPA's WP-83 rates, which were effective for a prospective two-year rate period.

Under the Northwest Power Act, FERC reviews and approves BPA's rates. 16 U.S.C. § 839e(a)(2). FERC first grants interim approval and then solicits public comment on whether it should grant final approval. *See* 16 U.S.C. § 839e(i)(6). Judicial challenges to BPA's rates, however, can occur only after FERC has granted *final* confirmation and approval to BPA's rates. 16 U.S.C. § 839f(e)(4)(D); *ARCO*, 818 F.2d at 704-705. In *ARCO*, the DSIs filed premature petitions challenging the customer charge after FERC had granted interim approval on October 26, 1983. 818 F.2d at 704. The DSIs filed additional timely petitions challenging the customer charge after FERC granted final confirmation and approval on July 2, 1985. *Id.* In *ARCO*, where the Court had consolidated the two sets of petitions, the Court held that it lacked jurisdiction to review the premature petitions that were filed after FERC granted interim approval of BPA's rates. 818 F.2d at 705.

During the litigation, however, BPA established new power rates in 1985 for a new prospective two-year period. In the new 1985 rates, BPA discontinued the customer charge. In *ARCO*, the Court held that even though BPA discontinued the customer charge in its 1985 rates, this did not render moot the DSIs' challenge to the 1983 rates because it was a separate rate period for which the DSIs could seek a refund. This is simply not the case in the current circumstances. In the REP-12 proceeding, BPA is adopting a settlement that *replaces* and remedies BPA's previous decisions regarding the 2000 REP Settlement Agreements and BPA's inclusion of the costs of such Agreements in its WP-02 power rates in response to the Court's remand order in *PGE and Golden NW*. In *ARCO*, BPA did not replace its 1983 rates for the two-year rate period for which they were established. The 1983 rates were established, applied to power sales during the two-year rate period without change, and approved by FERC. The Settlement, in contrast, contemplates that the application of the Settlement going forward corrects any alleged harm incurred subsequent to BPA's findings in the WP-07 Supplemental ROD. Settlement, REP-12-A-02A, § 7. Thus, in the instant proceeding, where a subsequent agency decision *replaces* and remedies a former agency action for its effective period, challenges to the former action are moot. *ARCO* is consistent with this approach.

APAC argues that although BPA and the settling parties believe the adoption of the Settlement would resolve or moot challenges to rate determinations made by the Administrator in the WP-07 Supplemental and WP-10 rate cases, failure by some parties to accept the Settlement means these challenges can only be finally determined by the Ninth Circuit. APAC Br., REP-12-B-AP-01, at 16; APAC Br. Ex., REP-12-R-AP-01, at 13-14. APAC claims that a partial settlement that does not resolve all claims between all adverse parties does not moot a pending appeal of those claims that remain live, *citing Federal Deposit Ins. Corp. v. Jennings*, 816 F.2d 1488, 1491 (10th Cir. 1987) (*Jennings*); *see also Biopolymer Engineering, Inc. v. Immunocorp.*, 397 Fed. Appx. 662 (Fed. Cir. 2010), WL 437733. *Id.* APAC's argument is incorrect. The cited cases do not show that parties' previously raised challenges to BPA's ratemaking determinations would continue despite a settlement. As in *ARCO*, the cited cases do not involve a subsequent agency action that completely replaced a previous agency action. Instead, they involve settlements that were not comprehensive, and thus issues that were not covered by the settlement were able to continue in litigation. In *Jennings*, the FDIC sued former officers and directors of an insolvent bank for breach of fiduciary duty and joined a public accounting firm that had audited the bank's financial statements. The court held that because a settlement *had not*

*resolved* the bank holding company’s non-derivative claims against the accounting firm regarding loan participation interests, the case was not moot. Similarly, in *Biopolymer*, a patent holder’s appeal was not moot where a settlement agreement between the parties *did not resolve all the claims* with respect to all the products that patent holder accused of infringing its patent. The Settlement, however, replaces all of BPA’s decisions in the WP-07 Supplemental and WP-10 proceedings that responded to the Court’s remand in *PGE* and *Golden NW*. These include challenges to BPA’s rate determinations such as the 7(b)(2) issues. (As noted below, however, while the Settlement comprehensively replaces BPA’s previous decisions in response to the Court’s remand in *PGE* and *Golden NW*, there may be non-remand-related issues that would not be rendered moot by the Settlement.)

Contrary to APAC’s argument, case law supports the proposition that when an agency adopts a decision that replaces a former decision, the challenges to the issues raised in the former decision are moot. *Nat’l Min. Ass’n v. U.S. Dept. of Interior*, 251 F.3d 1007, 1010-1012 (D.C. Cir. 2001) (vagueness challenge to the definition of “owned and controlled” in Department of Interior’s regulations interpreting the Surface Mining Reclamation and Control Act was moot following promulgation of new rules containing new definitions); *Schering Corp. v. Shalala*, 995 F.2d 1103, 1105 (D.C. Cir. 1993) (appeal of challenge to Food and Drug Administration’s test for bioequivalence of generic drugs was rendered moot by FDA’s intervening promulgation of regulation defining “bioequivalence” differently than under the prior test); *W. Radio Services Co., Inc. v. Glickman*, 113 F.3d 966, 974 (9th Cir. 1997) (claim based on letter from Forest Service official, which discontinued multi-user special use permits, was rendered moot by superseding published fees schedule authorizing multi-user permits) (citing to *Schering*); *American Rivers v. National Marine Fisheries Service*, 126 F.3d 1118, 1122-1124 (9th Cir. 1997) (“[T]he biological opinion in the present case has been superseded by the 1995 Biological Opinion. Therefore, any challenge to the 1994–1998 Biological Opinion is moot.”); *Wyoming v. U.S. Dept. of Agr.*, 414 F.3d 1207, 1211-1214 (10th Cir. 2005) (Forest Service’s adoption of a new rule mid-litigation mooted appeal of challenge to the rule it replaced).

As noted previously, adoption of the Settlement would replace BPA’s decisions (primarily in the WP-07 Supplemental proceeding, *see generally* WP-07 Supplemental ROD, WP-07-A-05), comprising its response to the Court’s remand order in *PGE* and *Golden NW*, which would render moot most of the issues currently pending before the Ninth Circuit. BPA acknowledges that there are some issues in the pending litigation that do not involve the issues governed by the Settlement and recognizes that such issues are not rendered moot by the Settlement. For example, PNGC’s arguments regarding costs of DSI service in preference customer rates in *Avista Corp. v. Bonneville Power Admin.*, Nos. 09-73160 *et al.*, are not governed by the Settlement and therefore may be resolved by the Ninth Circuit (unless there is some non-remand related issue that would keep the Court from reviewing such issues). These claims are akin to the bank holding company’s non-derivative claims against the accounting firm regarding loan participation interests in *Jennings* and the non-settlement products in *Biopolymer*. The remand-related issues in the WP-07 Supplemental and WP-10 proceedings (including relevant ratemaking issues), however, are moot and should not be reviewed by the Court. The following discussion identifies the issues that are rendered moot by the Settlement and those issues that remain for resolution by the Court.

*APAC* involves petitions for review that were filed after the conclusion of BPA’s WP-07 Supplemental proceeding but prior to final confirmation and approval of BPA’s WP-07 power rates by FERC. The petitions claim that they do not challenge BPA’s WP-07 rates, but rather challenge the general Lookback approach BPA adopted in response to *PGE*. This approach, in simple terms, calculated the difference between the benefits the IOUs received under the 2000 REP Settlement and the benefits the IOUs would have received under the traditional REP for the years the 2000 REP Settlement was in effect. *See* WP-07 Supplemental ROD, WP-07-A-05, Chapters 8 and 9. In calculating this difference, BPA made assumptions regarding the validity of the IOUs’ Load Reduction Agreements (LRAs) and an invalidity clause in the 2000 REP Settlement Agreements. *Id.* at 165-190. This difference was then refunded to preference customers through monetary payments and rate credits. *Id.* at 279-295. The difference was recovered from the IOUs through prospective reductions in the IOUs’ REP benefits. *Id.* at 256-260. Because the Settlement would *completely* replace the Lookback approach as BPA’s means of responding to *PGE*, all of the issues raised in *APAC* would be rendered moot.

*Idaho Public Utilities Commission, et al. v. Bonneville Power Admin., Nos. 08-74927 et al. (IPUC)* involves petitions for review challenging (i) BPA’s “Short-Term Bridge Residential Purchase and Sale Agreement for the Period Fiscal Years 2009–2011 and Regional Dialogue Long-Term Residential Purchase and Sale Agreement for the Period Fiscal Years 2012–2028, Administrator’s Final Record of Decision,” and (ii) BPA’s final RPSA Templates, which were offered on September 12, 2008, to customers eligible for the Residential Exchange Program. In briefing this case, the IOUs raised the issue of the efficacy of an invalidity clause provision in the 2000 REP Settlement Agreements. Evaluation Study Documentation, REP-12-E-BPA-01A, at 1971-1992. BPA believes this issue should properly be addressed in *APAC*. In any event, because the Settlement would implement the REPSIA in place of the RPSAs challenged in *IPUC*, all of the issues challenging the RPSAs would be rendered moot. Similarly, because the invalidity clause issue is related to the Lookback approach and, as noted above, the Settlement would completely replace the Lookback approach as BPA’s means of responding to *PGE*, the invalidity clause issue would be rendered moot.

*Avista Corp., et al. v. Bonneville Power Admin., Nos. 09-73160 et al. (Avista)* involves petitions for review challenging BPA’s WP-07 wholesale power rates, which were granted final FERC approval on July 16, 2009. A number of parties filed petitions for review under section 9(e) of the Northwest Power Act seeking review of BPA’s WP-07 rates, BPA’s 2008 Section 7(b)(2) Legal Interpretation, and BPA’s Section 7(b)(2) Implementation Methodology. These petitions involve WP-07 ratemaking issues separate from the Lookback issues in *APAC*. The parties have not yet briefed the issues in *Avista*, so it is not possible to identify all issues that will be addressed. The Settlement resolves the means of implementing section 7(b)(2) for the 27-year settlement term; therefore, all 7(b)(2)-related issues in *Avista* would be rendered moot. Because the Settlement would *completely* replace the Lookback approach as BPA’s means of responding to *PGE*, all of the issues raised in *Avista* would be rendered moot. However, there may be other ratemaking issues that will be raised in *Avista* that do not relate to the 7(b)(2) rate test or other REP-related decisions. Such issues would not be moot and would be addressed by the Court in its review.

*Portland General Electric Co., et al. v. Bonneville Power Admin.*, Nos. 09-73288 *et al.* involves petitions for review challenging Lookback decisions in BPA’s 2010 wholesale power and transmission rates. The 2010 rate case incorporated certain decisions from BPA’s WP-07, WP-07 Supplemental, and WP-10 rate proceedings, which are under review in APAC. Five IOUs filed petitions for review of such decisions to the extent they are non-ratemaking issues that might be subject to the Ninth Circuit’s jurisdiction prior to FERC granting final approval to BPA’s WP-10 wholesale power rates. Because the Settlement would completely replace the Lookback approach as BPA’s means of responding to *PGE* and *Golden NW*, all of the Lookback-related issues raised in *PGE* would be rendered moot.

*PacifiCorp, et al. v. Bonneville Power Admin.*, Nos. 10-73348 *et al.* involves petitions for review challenging BPA’s 2010 wholesale power and transmission rates, which incorporated certain decisions from BPA’s WP-07, WP-07 Supplemental, and WP-10 rate proceedings, which are under review in APAC. Because the Settlement would completely replace the Lookback approach as BPA’s means of responding to *PGE*, all of the Lookback-related issues raised in *PacifiCorp* would be rendered moot. The Settlement also resolves the means of implementing section 7(b)(2) for the 27-year settlement term. Therefore, all 7(b)(2)-related issues in *PacifiCorp* would be rendered moot. However, there may be other ratemaking issues that will be raised in *PacifiCorp* that do not relate to the 7(b)(2) rate test or REP-related decisions. Such issues would not be moot and would be addressed by the Court in its review.

In summary, the Settlement Agreement completely replaces the Lookback approach BPA adopted in the WP-07 Supplemental rate case in response to *PGE* and *Golden NW*. In addition, the Settlement resolves the manner in which BPA will implement section 7(b)(2) for the 27-year term of the settlement. BPA’s previous decisions responding to the Court’s decisions in *PGE* and *Golden NW*, including the Lookback and 7(b)(2), are therefore rendered moot by the Settlement. Ratemaking issues not related to these decisions would not be rendered moot and would be addressed by the Court in the relevant pending litigation.

APAC argues that the contract created by the Settlement can only be enforced on the parties to that contract. APAC Br. Ex., REP-12-R-AP-01, at 14. APAC claims that once BPA imposes the settlement terms on other, non-settling parties, it becomes a rate determination, and must comply with all of BPA’s ratemaking obligations. *Id.* First, the signers of the Settlement are bound by the terms of the Settlement. Non-signers are bound only in the sense that they will pay in rates the REP benefits provided under the Settlement, but only after BPA has independently found that the Settlement satisfies the requirements and protections set forth in the Northwest Power Act. This is not the same thing, though, as treating non-signers as if they have executed the Settlement. For example, pursuant to section 7.10 of the Settlement, signers may not “directly or indirectly challenge, either in whole or in part, the legality of this Settlement Agreement or any REP Settlement Implementation Agreement.” Non-signers are not so limited. Second, the Settlement establishes, *inter alia*, REP benefits for the IOUs and REP costs for BPA’s customers. Although the Settlement does not establish any rates, BPA has recognized that the Settlement must be consistent with sections 5(c) and 7(b) of the Northwest Power Act. The Settlement’s compliance with these provisions is addressed in separate sections of this ROD.

## **Decision**

*The Settlement replaces BPA's previous decisions responding to the Court's decisions in PGE and Golden NW and renders challenges to such decisions moot.*

### **8.3 Clarification Language Requested by Parties**

#### **Issue 8.3.1**

*Whether BPA should adopt language proposed by parties to the Settlement clarifying implementation of sections 3, 6, 7, and 10 of the Settlement in the event the Settlement is set aside in whole or in part by a court.*

#### **Parties' Positions**

JP02 and JP04 request that BPA include in this ROD language proposed by the parties to the Settlement and provided to BPA on March 22, 2011. In order to clarify the intent of portions of sections 3, 6, 7, and 10 of the Settlement Agreement, which address the possibility of an adverse court ruling, the parties request that BPA include the following language:

Consistent with the Settlement Agreement, if a court enters a final decision that sets aside, in whole or in part, BPA's determination to enter into the Settlement Agreement, BPA will reinstate and implement BPA's determinations in the WP-07 Supplemental, WP-10, and 2008 RPSA Records of Decision, to the extent not inconsistent with any such court decision and any final order that may have been entered in the Litigation.

JP02 Br., REP-12-B-JP02-01, at 4, n.3; JP04 Br., REP-12-B-JP04-02, at 10. JP04 states that if the Administrator decides to sign the Settlement Agreement, this ROD should be consistent with the provisions of the proposed Agreement. *Id.* at 9.

#### **BPA Staff's Position**

The language proposed by the settling parties clarifies the intent of Staff regarding the implementation of sections 3, 6, 7 and 10 of the Settlement. Bliven *et al.*, REP-12-E-BPA-17, at 25. The settling parties have agreed that the foregoing language captures their intent when they drafted the cited sections. *Id.* Because the intent matches Staff's understanding of the intent of the settling parties, Staff proposes that the Administrator adopt the language as his statement of intent should the conditions set forth in the language come to pass. *Id.*

#### **Evaluation of Positions**

While the parties to the Settlement intend it to be a complete replacement for the determinations made in WP-07 Supplemental and WP-10 on REP-related issues, they recognize the possibility that the Settlement Agreement may be set aside in whole or in part. JP02 Br., REP-12-B-JP02-01, at 4, n.3. JP02 states its understanding that if the Settlement Agreement is set aside in whole or in part by a court, BPA will first evaluate the court's decision, and then formally

reinstate and implement its prior determinations to the extent that BPA concludes that those prior determinations are not inconsistent with the court's decision. *Id.*

JP04 states that it is the intention of each entity in the Pacific Northwest Investor-Owned Utilities Group that, if BPA enters into the Settlement Agreement, any and all claims and defenses arising out of the BPA RODs (including without limitation the WP-07 Supplemental ROD, the 2008 RPSA ROD, and the WP-10 ROD) challenged in the Litigation (as that term is defined in the Settlement) will be available to each entity in the Pacific Northwest Investor-Owned Utilities Group under certain circumstances, including the following, for example:

- (i) to oppose any argument that BPA should set rates in any manner inconsistent with the proposed 2012 REP Settlement Agreement,
- (ii) to defend against any argument made in the Litigation, should the Litigation continue despite the proposed 2012 REP Settlement Agreement becoming effective, or
- (iii) in the event that proposed 2012 REP Settlement Agreement in its entirety (or the proposed 2012 REP Settlement Agreement in its entirety with the exception of sections 10, 11.1, and 11.2) becomes void *ab initio*.

JP04 Br., REP-12-B-JP04-02, at 9-10.

JP04 also states that the proposed language contains the understanding and the recommendation of the Pacific Northwest Investor-Owned Utilities Group and most of the PF Preference rate customers that have worked together to prepare the Settlement Agreement. *Id.* at 10-11.

JP02 and JP04 represent the overwhelming majority of the entities supporting the Settlement. These parties agree that the proposed language appropriately clarifies and represents their understanding and intent with regard to the circumstance where a court enters a final decision that sets aside the Settlement, in whole or in part. The intent matches BPA's understanding of the intent of the settling parties in this regard. For these reasons, BPA adopts the proposed clarification language.

### **Decision**

*Consistent with the Settlement, if a court enters a final decision that sets aside, in whole or in part, BPA's determination to enter into the Settlement Agreement, BPA will reinstate and implement BPA's determinations in the WP-07 Supplemental, WP-10, and 2008 RPSA Records of Decision, to the extent not inconsistent with any such court decision and any final order that may have been entered in the litigation.*

## 9.0 BPA SETTLEMENT AUTHORITY

### 9.1 Introduction—The Bonneville Project Act and the Northwest Power Act Provide BPA Broad Discretion to Enter into Contracts and Arrangements and to Compromise and Settle Disputes

In BPA’s organic legislation, Congress granted the BPA Administrator broad discretion not normally provided to government organizations to take such actions as the Administrator determined to be appropriate and necessary in the conduct of BPA’s business. These actions include the establishment of contracts and settlement agreements. Section 2(f) of the Bonneville Project Act provides as follows:

Subject only to the provisions of this Act, the Administrator is authorized to enter into such *contracts, agreements, and arrangements*, including the amendment, modification, adjustment, or cancellation thereof, and *the compromise or final settlement of any claim arising thereunder*, and to make such expenditures, *upon such terms and conditions and in such manner as he may deem necessary*.

16 U.S.C. § 832a(f) (emphasis added).

Section 2(f) is an extraordinarily broad statutory grant of authority to a Federal agency, which recognizes the unique nature of BPA as a business in the electric power industry. Congress enacted this revised version of section 2(f) in 1945 to “put the Bonneville [Power] Administration on a more businesslike basis.” *Hearings on H.R. 2690 and H.R. 2693 Before the House Comm. on Rivers and Harbors*, 79th Cong. 2 (1945) (statement of Rep. Jackson).<sup>21</sup> Because Congress amended section 2(f), Congress carefully considered the words used in the provision. Therefore, it is significant that Congress intended the BPA Administrator to enter into contracts and arrangements and compromise and settle claims arising thereunder “upon such terms and conditions and in such manner as he may deem necessary.” 16 U.S.C. § 832a(f).

The broad grant of authority in section 2(f) is based on the premise that BPA is a regional business agency, and the broad discretion would permit it to “function in a more businesslike manner.” *Hearings on H.R. 2690 and H.R. 2693 Before the House Committee on Rivers and Harbors*, 79th Cong. 2 (1945) (statement of Rep. Jackson). “The Bonneville Power Administration is not engaged in a governmental regulatory program. It operates a business enterprise. ... [The amendment] will facilitate its operations as a regional and business agency.” S. Rep. No. 79-469, 79th Cong., 1st Sess. 13 (1945).<sup>22</sup> The legislative history provides that

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<sup>21</sup> Some of the changes to section 2(f) of the 1937 Bonneville Project Act were (1) adding “only” at the beginning of the sentence; (2) adding the words “upon such terms and conditions and in such manner as he may deem necessary”; and (3) dropping the phrase “to carry out the purposes of this Act.”

<sup>22</sup> The Comptroller General has concluded that this provision provides the Administrator with broad discretion. Comp Gen. Dec. B-105397 (Sept. 21, 1951). In that decision, the Comptroller General ruled that the Administrator had the authority to finance a cloud seeding operation even though such an authority was not explicitly granted in the Bonneville Project Act. In a 1979 opinion, the Comptroller General similarly found that the Administrator, though lacking any explicit statutory authority, could finance electric conservation activities if he determined they

“[t]he Department of the Interior has wisely recognized that such a regional agency [as BPA] must be as free as possible to deal with problems which are essentially local matters,” and that the purpose of the bill was to allow BPA “to employ business principles and methods” in performing its functions. H.R. Rep. No. 79-777, at 3 (1945) *reprinted in* 1945 U.S. Code Cong. Serv. 874.<sup>23</sup>

More specifically, the expansive language of section 2(f) gives the Administrator broad authority to settle contract claims. Legislative history confirms this point:

[Section 2(f)] authorizes the Administrator to amend, modify, and cancel contracts. Strong contracts, containing provisions in favor of the United States sufficient to permit it to control situations when such control is necessary, should be required. At the same time Bonneville should have authority to relax the contracts when good business dictates that it do so. ... *The section also permits the Administrator to compromise claims arising out of contracts he has executed. The Administrator is a responsible officer of the Government and is the one who is most familiar with the claim and the facts out of which it arose. The discretion to compromise and settle it should be a part of Bonneville’s business operations.*

H.R. Rep. No. 79-777, at 3 (1945), *reprinted in* 1945 U.S. Code Cong. Serv. 874-75 (emphasis added).

Congress carried forward this broad authority into subsequent legislation. In the Department of Energy Reorganization Act, Congress intended that this authority remain unabridged as the functions and authorities of the Secretary of the Interior were transferred to the new Department of Energy. 42 U.S.C. § 7152(a). The Senate Report on the legislation states:

This legislative history reflects a congressional recognition of the significant role played by BPA in the Pacific Northwest, and an effort to enable this organization to operate in a businesslike fashion and to free it from the requirements and restrictions ordinarily applicable to the conduct of Government business. The transfer of the functions of BPA from the Department of Interior to the Department of Energy is not intended to diminish in any way the authority or flexibility which is requisite to the efficient management of a utility business.

S. Rep. No. 95-164, at 30 (1977), *reprinted in* 1977 U.S.C.C.A.N. 884.

In 1980, Congress again affirmed the BPA Administrator’s broad authority to contract and settle claims according to section 2(f) of the Bonneville Project Act. This express affirmation is contained in section 9(a) of the Northwest Power Act. 16 U.S.C. § 839f(a). Section 9(a) of that

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constituted reasonable means of achieving the responsibilities imposed on him by law. Comp. Gen. Dec. B-114858 (July 10, 1979).

<sup>23</sup> Other laws relating to BPA also demonstrate congressional intent that BPA be operated with the requisite autonomy to ensure its programs are implemented successfully. In the Federal Columbia River Transmission System Act of 1974, Congress recognized the businesslike nature of BPA’s responsibilities by giving BPA self-financing authority. Further, BPA’s budget and accounting procedures were made subject to the Government Corporation Control Act to give BPA the autonomy and flexibility of its day-to-day decisions and operations similar to a private corporation.

Act states “[s]ubject to the provisions of this chapter, the Administrator is authorized to contract in accordance with section 2(f) of the Bonneville Project Act of 1937 (16 U.S.C. § 832a(f)).” 16 U.S.C. § 839f(a). *See generally Tenaska v. U.S.*, 34 Fed. Cl. 434, 441-43 (1995) (discussing BPA’s section 2(f) authority). The legislative history of the Northwest Power Act confirms that section 9(a) “provides the Administrator the same general contracting authority for actions under the act as is provided under section 2(f) of the Bonneville Project Act.” S. Rep. No. 96-272, 96th Cong., 1st Sess. 33 (1979). In addressing section 9(a), Congressman Swift made the following statement during floor debate:

Section 9(a) extends Bonneville’s existing special contracting authorities (and related expenditure authorities) contained in section 2(f) of the Bonneville Project Act to include the new contract and expenditure responsibilities provided in this legislation. In 1945, Interior Secretary Ickes in supporting the inclusion of 2(f) ... recognized that Bonneville is not engaged in an “ordinary government ... regulating enterprise.” Rather, Bonneville, then and even more so now, operates and functions as an integral part of the region’s power system. *When Congress amended Section 2(f) into the Bonneville Project Act of 1945, it recognized the need for Bonneville to have the ability to employ business principles and methods not normally applicable to governmental agencies.* The Comptroller General in reviewing this unique authority and its application summarized the intent of Congress as “*enabling the (Bonneville Power) Administrator to conduct the business of Bonneville with a freedom similar to that which has been conferred on public corporations carrying on similar or comparable activities.*” The amendment to Section 9(a) applies this important legislative principle into Bonneville’s future contracts (and related expenditures) under this Act as well as the Bonneville Project Act, the Federal Columbia River Transmission Act and other related statutes, while continuing to effect the laws currently applicable to BPA contracting and expenditures....

126 Cong. Rec. 27,808, 27,821 (1980) (emphasis added). Overall, the legislative history of sections 2(f) and 9(a) provides no clear limitation on BPA’s authority to settle contracts and agreements, so long as the settlement does not contravene other statutory requirements applicable to BPA.

## **9.2 BPA’s Contracting and Settlement Authority Under the Bonneville Project Act and the Northwest Power Act Permit BPA to Settle REP Disputes as Provided in the Settlement**

### **Issue 9.2.1**

*Whether BPA’s contracting and settlement authority under the Bonneville Project Act and the Northwest Power Act permit BPA to settle REP disputes as provided in the Settlement.*

## **Parties' Positions**

WPAG argues that BPA's exercise of its settlement authority as reflected in the Settlement is inconsistent with sections 5(c) and 7(b) of the Northwest Power Act. WPAG Br., REP-12-B-WG-01, at 18-21.

APAC argues that BPA's settlement authority does not permit BPA to adopt the Settlement and it would be improper to impose the Settlement on all customers, whether they accepted it or not. APAC Br., REP-12-B-AP-01, at 1, 15-16. APAC argues that adopting a new REP-12 Settlement ROD should not moot APAC's appeal of issues resolved by the Settlement. *Id.*

JP02 states that BPA's settlement authority supports its adoption of the Settlement and recognizes that a settlement does not need the unanimous consent of all parties affected by it to be valid, binding, and enforceable, as long as the settlement does not violate any "clear statutory directive." JP02 Br., REP-12-B-JP02-01, at 5-13.

## **BPA Staff's Position**

Staff believes that the Bonneville Project Act and the Northwest Power Act provide the Administrator with the contracting and settlement authority necessary to adopt the Settlement.

## **Evaluation of Positions**

Before further discussion of BPA's settlement authority, it is important to reiterate that BPA's determinations regarding the Settlement are grounded first in sections 5(c) and 7(b) of the Northwest Power Act. These statutory provisions establish requirements upon which to judge the Settlement. Therefore, BPA is not simply adopting the Settlement as a matter of settlement, but instead is adopting the Settlement as a sound exercise of its statutory authority to administer the REP and make ratemaking decisions.

### **A. The Courts Have Consistently Recognized the BPA Administrator's Broad Discretion to Enter into Contracts and Settlement Agreements**

The Federal courts' previous decisions involving section 2(f) of the Bonneville Project Act and section 9(a) of the Northwest Power Act have recognized the BPA Administrator's broad discretion in entering into contracts and arrangements, in compromising and settling claims thereunder, and in making decisions that concern BPA's business interests. Six published cases address BPA's authority to settle claims pursuant to section 2(f) of the Bonneville Project Act and section 9(a) of the Northwest Power Act. All of these cases support the Administrator's broad contract and settlement authority, provided it is exercised consistent with law. Three cases are particularly relevant to the Settlement.<sup>24</sup>

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<sup>24</sup> Three additional cases briefly mention BPA's statutory contract authority. *Bell v. Bonneville Power Admin.*, 340 F.3d 945, 948-49 (9th Cir. 2003) (BPA's curtailment amendments to DSI power sale contracts were within BPA's authority because BPA "has explicit statutory direction to amend contracts 'upon such terms and conditions and in such manner as he may deem necessary'" according to section 9(a) of the Northwest Power Act and 2(f) of the Bonneville Project Act); *Coos-Curry Elec. Coop., Inc. v. Jura*, 821 F.2d 1341, 1345 (9th Cir. 1987) (BPA had statutory authority to grant mitigation relief under section 9(a) of the Northwest Power Act where BPA had created a

1. *Utility Reform Project v. Bonneville Power Administration*

The first case is *Utility Reform Project v. Bonneville Power Admin.*, 869 F.2d 437, 443 (9th Cir. 1989) (*Util. Reform Project*). In *Util. Reform Project*, certain BPA preference customers challenged a settlement agreement between BPA and its IOU customers. The settlement agreement resolved a dispute arising from BPA's recommendation that the construction of the WNP-3 nuclear plant be delayed and the plant "mothballed." *Id.* at 440. A halt to construction followed, and the IOUs brought an action in Federal district court challenging the suspension. *Id.* at 441. In that action, the IOUs claimed that certain "Net Billing Agreements," which required the Washington Public Power Supply System to sell its 70 percent share of WNP-3 to the participating preference utilities, which in turn assigned their shares of the output to BPA, prohibited the construction delay and required BPA to pay the costs of construction. *Id.* The settlement agreement provided that BPA, over a 30-year period, would transfer an amount of power to the IOUs equal to that which WNP-3 would have generated for the IOUs if it had been completed and pay BPA at rates based on the cost of operation and maintenance of four surrogate nuclear plants. *Id.* In return for the BPA power, the IOUs were obligated to make an equal amount of energy available to BPA annually. *Id.* If BPA accepts the energy, it pays for it at the IOUs' higher costs. *Id.* The agreements for this exchange of power also contained a fallback agreement that would take effect if the settlement agreement were held invalid. *Id.* The fallback agreement provided for BPA to make monetary payments to the IOUs so that they could purchase the power BPA would have provided them in the exchange. *Id.*

The Court concluded that the case was heavily colored by the fact that the Court was reviewing a *settlement*. *Id.* at 443. The Court noted that BPA was facing a claim with estimated damages of approximately \$2.5 billion. *Id.* The Court concluded that "[t]here was clearly an overriding public interest in settling the controversy." *Id.* In reviewing the petitioners' claim, the Court cited section 2(f) of the Bonneville Project Act, concluding that "[t]he unrestricted language of the statute gives the Administrator expansive authority to settle contract claims." *Id.* The Court concluded that the legislative history of the Act confirmed this authority. *Id.* (*citing* H.R. Rep. No. 79-777, at 3 (1945), *reprinted in* 1945 U.S. Code Cong. Serv. 874-875).

In summary, the Court held in *Util. Reform Project* that the WNP-3 settlement (i) was consistent with the section 2(f) of the Bonneville Project Act, (ii) was consistent with the preference and priority provisions of the Bonneville Project Act and the Northwest Power Act, (iii) did not constitute ratemaking, (iv) did not constitute the acquisition of a major resource, and (v) complied with National Environmental Policy Act requirements. In addition, the Court addressed the argument that the settlement did not "equitably distribute" benefits under the Northwest Power Act because it favored IOUs at the expense of BPA's preference customers and other ratepayers. *Util. Reform Project*, 869 F.2d at 448. The Court recognized that there was "considerable force" behind BPA's argument that the requirement of an equitable distribution "is so vague and discretionary a standard that there is no law to apply." *Id.* The Court did not reach that issue because it was not clear that the IOUs received "economically advantageous

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program to reimburse utilities for transformer costs); *Vulcan Power Co. v. Bonneville Power Admin.*, 89 F.3d 549, 550 (9th Cir. 1996) (section 2(f) of the Bonneville Project Act and section 9(a) of the Northwest Power Act give BPA broad discretion to establish contracts for the acquisition of resources).

quantity, price and delivery terms.” *Id.* The Court also noted that the settlement benefited all participants in the BPA power system by ending protracted and costly litigation. *Id.* Finally, the Court concluded that the argument that the costs of the settlement would be unfairly imposed on BPA’s customers was premature because the allocation of costs in BPA’s rates is subject to ratemaking proceedings and “[u]ntil the costs are allocated to rates, and the rates made final, petitioners’ argument is premature.” *Id.*

The WNP-3 settlement involved potential damages of \$2.5 billion dollars. The Court concluded that “[t]here was clearly an overriding public interest in settling the controversy.” *Id.* at 443. Similarly, the Settlement involves the benefits provided to the residential and small farm customers of the IOUs under the Northwest Power Act. IOUs’ claims before the Court related to the REP could provide REP benefits conservatively in excess of \$300 million per year, or \$4.5 billion over the 17 years of the Settlement. COUs’ claims for refunds before the Court could reach over \$4 billion. Wolverton, REP-12-E-AP-01, at 14. The litigation resolved by the Settlement affects millions of electricity consumers in the Pacific Northwest. The resolution of the pending litigation is therefore clearly in the public interest.

## 2. *Association of Public Agency Customers, Inc. v. Bonneville Power Administration*

The Court also reviewed the scope of BPA’s settlement authority under section 2(f) in *Association of Public Agency Customers, Inc. v. Bonneville Power Administration*, 126 F.3d 1158, 1163 (9th Cir. 1997) (*APAC*<sup>25</sup>). In *APAC*, the Court reviewed BPA’s adoption of a market-driven business plan, power sales contracts with the DSIs, and the extension of transmission agreements with the DSIs. *Id.* In affirming BPA’s interpretation of its authority to transmit non-Federal power, the Court cited section 2(f) of the Bonneville Project Act and concluded that this “section was enacted to allow BPA to function more like a business than a governmental regulatory agency,” *APAC*, 126 F.3d at 1170 (*citing* S. Rep. No. 79-469, 79th Cong., 1st Sess. 13 (1945)). The Court also concluded that subsequent legislation reaffirmed BPA’s broad authority to further its business mission. *Id.* (*citing* S. Rep. No. 95-164, 30 (1977), *reprinted in* 1977 U.S.C.C.A.N. 854, 883). In addition, the Court noted that section 9(a) of the Northwest Power Act, 16 U.S.C. § 839f(a), “reaffirmed the Administrator’s broad authority to contract in no uncertain terms.” *APAC*, 126 F.3d at 1170. The Court concluded that:

BPA’s new, more typically governmental responsibilities suggest the propriety of even greater deference to the Administrator’s decisions. He must continue to run BPA like a business on a sound financial basis, enabling it to repay its debt to the federal treasury in a timely fashion, while discharging costly new public duties assumed after the Northwest Power Act’s passage.

*Id.* at 1170-1171. These “costly new public duties” include the REP. 16 U.S.C. § 839c(c). The Supreme Court has described the REP as “obviously a money-losing program for BPA.” *Aluminum Company of America v. Central Lincoln People’s Utility District*, 467 U.S. 380, 104 S. Ct. 2472, 2484, 81 L. Ed.2d 301 (1984).

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<sup>25</sup> The party to this proceeding, the Association of Public Agency Customers (APAC), is a similar, but separate and distinct party from the group known as APAC in the 1997 litigation.

*APAC* is also relevant to the instant proceeding in its consideration of BPA’s interpretation of its organic statutes. In *APAC*, petitioners challenged BPA’s authority to transmit, or “wheel,” non-Federal power over BPA’s transmission lines. There was no express statutory authority to do so. The Court inquired whether Congress left a void for the Administrator to construe. *Id.* at 1171. The Court held that “the ‘gap’ Congress left for the Administrator is how best to further BPA’s business interests consistent with its public mission.” *Id.* The Court noted that “[t]he statutes governing BPA’s operations are permeated with references to the ‘sound business principles’ Congress desired the Administrator to use in discharging his duties.” *Id.* The Court concluded:

Thus, although Congress did not prescribe the parameters of the Administrator’s authority, it granted BPA an unusually expansive mandate to operate with a business philosophy. Accordingly, it seems wise to defer to the agency’s actions in furthering its business interests, especially when the agency is responding to unprecedented changes in the market resulting from deregulation.

That Congress never foresaw unbundled transmission service as a valuable commodity, and thus never considered whether BPA could sell transmission services to the DSIs separate from BPA power, does not change this conclusion. Congress gave the Administrator the authority to run BPA like a business. In that sense Congress addressed BPA’s authority to act in response to unforeseen eventualities, as businesses frequently must. In this context, BPA’s statutory construction of its organic statutes appears reasonable, requiring our deference to its judgment.

*Id.*

*APAC* is particularly instructive here, even though *APAC* did not involve a settlement. The Court found that Congress had granted wheeling authority to BPA by directing BPA to operate like a business and respond to unforeseen eventualities. In *APAC*, the Court concluded that:

the Administrator made a reasoned business decision. As with all such choices in an uncertain market, we cannot foretell if the strategy will succeed or not. Time may prove the Administrator’s plan unsound. However, it would be improper of us to substitute our business acumen, or lack of it, for the Administrator’s.

*Id.* at 1182. In the REP-12 proceeding, as in *APAC*, the Administrator must make a reasoned business decision—whether to adopt a settlement that would resolve extensive pending litigation and establish stability in the REP costs allocated to rates and the REP benefits provided to qualified utilities. The record in this proceeding strongly suggests that the Settlement would provide greater rate protection and lower REP costs than in the absence of the Settlement.

### 3. *Portland General Electric Co. v. Bonneville Power Admin.*

In *PGE*, 501 F.3d 1009 (9th Cir. 2007), the Court reviewed 2000 REP Settlements BPA executed with its IOU customers in 2000. The Court noted that it provides administrative agencies considerable leeway in the interpretation of the scope of their authority. *Id.* at 1025. The Court noted that because of the complexity of BPA’s statutory scheme and its “unusually expansive mandate to operate with a business-oriented philosophy,” the Court has been particularly

deferential to BPA. *Id.* The Court then acknowledged BPA’s broad settlement authority under section 2(f) of the Bonneville Project Act and section 9(a) of the Northwest Power Act. *Id.* at 1026. The Court concluded that BPA’s settlement authority is subject to the constraints of the Northwest Power Act—a conclusion BPA agreed with. The Court then concluded that the 2000 REP Settlements were contrary to law because they did “not resemble the REP program created in §§ 5(c) and 7(b) [of the Northwest Power Act] that it purports to be settling.” *Id.* at 1036. Although the particular 2000 REP Settlements reviewed in *PGE* did not satisfy sections 5(c) and 7(b), the Court reaffirmed BPA’s broad settlement authority. The Court stated:

The ability to settle claims without resort to litigation or full-throated regulatory proceedings is certainly an important aspect for making BPA an efficient agency and fulfilling the Administrator’s charge to conduct BPA as a well-run business. The ability to compromise claims, by its nature, requires flexibility and discretion. Regulatory claims are rarely capable of a sum-certain determination and an either/or assessment of the likelihood of success on the merits. It is thus implicit in the grant of settlement power that BPA have the flexibility to take into account a variety of considerations, including its litigation costs, differing damage assessments, and the risk of loss on the merits.

*Id.* at 1030. While concluding that a settlement must resemble the program it settles, the Court stated: “We have recognized within this opinion that BPA has broad authority to settle claims under the [Northwest Power Act]. We repeat: flexibility inheres in compromises under that authority.” *Id.* at 1037. Extremely significant is the Court’s recognition that BPA can settle REP disputes. The Court stated “[BPA] may enter into REP settlement contracts with IOUs, but only on terms that will protect the position of its preference customers, consistent with §§ 5(c) and 7(b).” *Id.* at 1030. The record in this proceeding affirms that the Settlement would protect preference customers consistent with Northwest Power Act sections 5(c) and 7(b). This conclusion is supported by the vast majority of BPA’s preference customers.

## **B. Settlement Authority Issues**

### *1. Authority to Adopt Contested Settlements*

APAC argues that it would be improper to impose the Settlement on all customers, whether they accepted it or not. APAC Br., REP-12-B-AP-01, at 15-16. Initially, it should be recognized that in the utility industry it is commonplace for non-unanimous or “contested” settlements to be adopted by agencies and reviewed by the courts. For example, FERC reviews the wholesale power rates of IOUs under the Federal Power Act. FERC’s authority to approve settlement agreements is found in section 554(c) of the APA and FERC’s own regulations, 18 C.F.R. § 385.602. *Mobil Oil Corp. v. Fed. Power Comm’n*, 417 U.S. 283, 314 (1974). The courts recognize that FERC may approve a settlement proposed by some parties, but objected to by others, and may bind all parties to the terms of the settlement. *United Mun. Distributors Group v. F.E.R.C.*, 732 F.2d 202, 209 n.11 (D.C. Cir. 1984). Courts review FERC’s decisions to approve contested settlements under the APA section 706’s “arbitrary and capricious” standard. *Exxon Co., U.S.A. v. F.E.R.C.*, 182 F.3d 30, 37 (D.C. Cir. 1999). Under that standard, the court will uphold the contested settlement if it determines that FERC made “an independent finding

supported by ‘substantial evidence on the record as a whole’ that the proposal will establish ‘just and reasonable’ rates for the area.’” *Mobil Oil*, 417 U.S. at 314.

Similarly, state public utility commissions routinely adopt contested settlements. *See, e.g.*, Wash. Admin. Code 480-07-730 Settlement; Wash. Admin. Code 480-07-740 Settlement consideration procedure; Wash. Admin. Code 480-07-750, Commission discretion to accept settlement, impose conditions, or reject a proposed settlement; OAR 860-001-0350 Settlements; Idaho Admin. Code r. 31.01.01.274 Consideration of Settlements. Furthermore, the adoption of contested settlements is commonplace in other regulatory environments. *See, e.g.*, Dept. of Labor, 29 C.F.R. § 2570.165; Federal Trade Comm’n, 16 C.F.R. § 1025.26.

BPA’s broad authority to enter into settlement agreements permits the adoption of contested settlements. *See, e.g.*, *APAC*, 126 F.3d at 1170. Courts will review BPA’s decision to enter into a settlement agreement using the APA’s “arbitrary and capricious” standard. Under APA review, the Court will uphold BPA’s contested settlements as long as BPA’s adoption of a contested settlement is supported by substantial evidence on the record as a whole and is consistent with sections 5(c) and 7(b) of the Northwest Power Act. Thus, it does not matter that some parties may fail to support a proposed settlement. The issue is whether the settlement is consistent with the law.

In the absence of the proposed Settlement, BPA performs a number of ratesetting steps to determine how costs are allocated to customer classes. *Gendron et al.*, REP-12-E-BPA-04, at 8. One of these steps is the rate test performed pursuant to section 7(b)(2) of the Northwest Power Act. *Id.* Up to the point of the rate test, the Settlement leaves the ratesetting process almost entirely unchanged. *Id.* At this point of the process, BPA’s rates for COUs and REP participants are essentially equal. *Id.* A preliminary amount of REP benefits for REP participants can be quantified at this point as an amount referred to in the Settlement as Unconstrained Benefits. *Id.*

Absent the Settlement, the rate test would be performed next. *Id.* The rate test quantifies the amount of rate protection afforded to COUs and lowers, if necessary, the total costs allocated to the rates for the COUs. *Id.* The costs allocated away from COUs are allocated to all other power sold by BPA, as specified in section 7(b)(3) of the Northwest Power Act. *Id.* The cost of rate protection raises the rates of the other customer classes, including the Priority Firm Power Exchange rate. *Id.* The increase in the PF Exchange rate caused by this reallocation of costs reduces the amount of REP benefits below the Unconstrained Benefits amount. *Id.* Some other customer classes bear some of the costs of rate protection; however, a majority, but not all, of the cost of the rate protection falls on the PF Exchange rate. *Id.*

The final result of the rate test, assuming the rate test triggers, is to reduce REP benefits. *Id.* No other cost included in BPA’s rates is changed as a result of the rate test. *Id.* Rate levels of each of BPA’s rates change as REP benefits are reduced by the rate test, but each change is a direct result of either receiving rate protection or bearing the cost of rate protection. *Id.* Thus, there is a direct correspondence between the amount of rate protection and the level of REP benefits. *Id.* One element defines the other. *Id.*

The foregoing principle is inherent in the Settlement. *Id.* at 9. Because the Settlement defines the level of REP benefits, it also defines the amount of rate protection. *Id.* The Settlement does not state the amount of rate protection because the level of Unconstrained Benefits is not known until the calculation of the Unconstrained Benefits is performed in each rate case. *Id.* Once the level of Unconstrained Benefits is calculated in a rate case, however, the direct correspondence between the amount of rate protection and REP benefits allows the amount of rate protection to be quantified based on the level of Unconstrained Benefits and the level of REP benefits. *Id.* Simply stated, in the absence of the Settlement, the relationship between the two known quantities (Unconstrained Benefits minus a large portion of the cost of rate protection) solves for REP benefits. *Id.* Under the Settlement, the relationship of the two known quantities (Unconstrained Benefits minus the REP benefits) solves for a large portion of the cost of rate protection. *Id.* In the absence of the Settlement, the remaining portion of the cost of rate protection is allocated to the Industrial Firm Power (IP) rate, New Resources (NR) rate, and surplus sales. *Id.* The costs allocated to the IP and NR rates form the 7(b)(3) Supplemental Rate Charge that is included in each rate. *Id.* The costs allocated to surplus sales reduce the secondary revenue credit included in all rates. *Id.* Under the Settlement, a remaining portion of the cost of rate protection is embodied in the REP Surcharge included in the IP and NR rates. *Id.* The Settlement instructs how to calculate the REP Surcharge and, thus, the remaining portion of the cost of rate protection allocated to the IP and NR rates. *Id.*

When Staff evaluates the Settlement, it develops a set of criteria used to “test” the settlement. Evaluation Study, REP-12-FS-BPA-01, section 11.2. These criteria include a requirement that the settlement would provide COUs with at least as much rate protection as the rate protection afforded under section 7(b)(2) of the Northwest Power Act. *Id.* In order to ensure that the Settlement provides COUs the rate protection of section 7(b)(2), Staff developed a model that uses BPA’s current Section 7(b)(2) Implementation Methodology and a base case, or best projection, of inputs used in ratemaking. *Id.* at 164. This “Reference Case” is built upon the updated 7(b)(2) rate test results—the results that would be used in the absence of the Settlement. *Id.*, section 10.3. Because the Settlement has 17 future years, Staff could not simply use one 7(b)(2) rate test for a single 17-year rate period. Instead, Staff uses the Long-Term Rate Model to produce 17 individual years of results consistent with the Section 7(b)(2) Rate Test Study. Evaluation Study, REP-12-FS-BPA-01, Chapter 11.

The technical analysis examines the ratemaking provisions of the Settlement by constructing a variety of scenarios resulting in potential future streams of REP benefits based on differing implementations of the section 7(b)(2) rate test or other major drivers of REP benefits. *Id.* Constructing these alternative results using the 7(b)(2) rate test allows evaluation of the Settlement through the comparison of the results specified in the Settlement with the results of the scenarios developed in Staff’s analysis. *Id.* The analysis is divided into two major groups of scenarios; those that examine the issues in litigation that are developed and discussed in section 7 of the Study, and those that examine the two major “natural” drivers of REP benefits: ASC levels and BPA rate levels. *Id.* In other words, Staff examines the ratemaking effects that the issues in litigation could have on REP benefits. *Id.* at 165. REP benefits are a good benchmark of comparison for analyzing the Settlement because of the interrelationship between rate protection and REP benefits. *Id.* Scenarios are developed to analytically assess the impact of each of the

issues in litigation discussed in section 7 of the Study. *Id.* A scenario is developed for each issue, followed by several scenarios that combine several issues to represent the aggregate position of the COU parties or the IOU parties. *Id.*

After conducting its extensive analysis, Staff evaluates the Settlement given its initial criteria, including 7(b)(2) cost protection. To “test” whether the proposed Settlement satisfies its criteria, Staff compares the projected rate protection amounts and REP benefits developed by the various litigation scenarios with the amounts provided under the Settlement. *Id.* at 168. Staff concludes that under almost all outcomes of the analysis, the Settlement provides superior rate protection compared to the 7(b)(2) rate test scenarios. *Id.* The analysis performs the rate test under a variety of potential future rate scenarios and litigation results and shows that except in the instance that COUs prevail on nearly every contested issue, the rate protection is greater and REP benefits smaller under the Settlement. *Id.* The conclusion is that under most possible future results of the rate test, rates for COUs would be higher than the rates under the Settlement, all other factors being the same in both futures. *Id.* Thus, BPA is not imposing rates on non-signing customers that would deny such customers their statutory 7(b)(2) protection. Also, contrary to WPAG’s claim, non-signing COUs do not forgo cost protection because of the willingness of other preference customers to sign the Settlement. Instead, non-signers receive 7(b)(2) cost protection in the manner just described. Thus, the Administrator, when developing rates that reflect the Settlement, does not repeal the statutory rate directives or avoid his obligation to set rates in accordance with those directives.

## 2. *BPA’s Settlement Authority Does Not Override Statutory Directives, and the Settlement Is Consistent with Such Directives*

WPAG states that for each rate period during the term of the REP Settlement, BPA is proposing to use the predetermined, negotiated REP benefits from the REP Settlement in place of the REP benefits that would be calculated under sections 5(c), 7(a)(1), 7(b)(2), and 7(b)(3) using the data and information relevant to that rate period. WPAG Br., REP-12-B-WG-01, at 18. WPAG argues that implicit in this proposal is the legal theory that BPA’s settlement authority permits it to suspend its obligation to comply in each rate proceeding with these statutory rate directives. *Id.* WPAG reiterates the Court’s findings in *PGE*, which provide that BPA must exercise its settlement authority in a manner consistent with sections 5(c) and 7(b) of the Northwest Power Act. *PGE*, 501 F.3d at 1029-1030. WPAG has misrepresented the issue. WPAG seeks to characterize the issue as one of BPA attempting to use its settlement authority to override sections 5(c), 7(a), and 7(b). BPA, however, is not doing so. BPA makes no claim that its settlement authority permits BPA to ignore sections 5(c) and 7(b) in the REP Settlement, and such a legal theory is absent from the REP Settlement.

Instead of ignoring sections 5(c) and 7(b), parties’ disagreements over the implementation of section 7(b)(2) formed the genesis of the Settlement. BPA had conducted three separate 7(b)(2) rate tests in its WP-07 Supplemental rate case (for FY 2002–2006, FY 2007–2008, and FY 2009) and an additional rate test in its WP-10 rate case upon which the parties relied in developing the REP Settlement to estimate a level of prospective rate protection provided to preference customers and a level of REP costs to be included in preference customers’ rates for the

Settlement term. Furthermore, BPA's analysis of the Settlement included 7(b)(2) rate tests for each of the 17 years of the Settlement plus the following four years for each respective year. These rate tests demonstrate that the REP Settlement provides greater rate protection under section 7(b)(2) than almost any scenario; only the litigation scenarios where the COUs prevail on multiple issues provide more rate protection. Instead of believing BPA's settlement authority overrides sections 5(c) and 7(b), BPA believes the REP Settlement is based on *compliance* with the provisions of section 5(c) and 7(b) in the context of a settlement.

WPAG argues that BPA's settlement authority is a facilitative power which must be grounded in and consonant with the substantive authority, such as sections 5(c) and 7(b), that gives rise to its use. WPAG Br., REP-12-B-WG-01, at 19, *citing PGE* at 1032. BPA agrees. WPAG argues that the REP Settlement raises the question of whether BPA may exercise its "facilitative settlement authority" to settle its REP benefit obligation to the IOUs under section 5(c) in a manner that absolves BPA of its obligations, under section 7(a)(1), 7(b)(2), and (3), to determine the REP "amounts to be charged" preference customers in each rate proceeding. WPAG Br., REP-12-B-WG-01, at 20. Once again, WPAG has misstated the issue. BPA is not using its "facilitative settlement authority" to absolve BPA of *any statutory obligations whatsoever*. Directly to the contrary, BPA does not rely on its facilitative settlement authority as the primary support for the REP Settlement, but instead the fact that BPA has directly addressed and complied with all relevant statutory requirements, including sections 5(c) and 7(b). To state the dispute more accurately, BPA believes it has properly exercised its *substantive* REP and ratemaking authority in compliance with the Northwest Power Act, and WPAG disagrees. This dispute must be resolved by reviewing the manner in which BPA complied with its substantive statutory directives, not by making false claims that BPA believes its settlement authority allows it to ignore substantive statutory requirements. *PGE* directly addresses this issue and BPA respects and has followed that decision in reviewing the Settlement. BPA directly addresses the manner in which the REP Settlement satisfies the statutory requirements of sections 5(c) and 7(b) in separate sections of this ROD. See Chapters 4 and 5.

In addition, opposing parties' arguments regarding compliance with sections 5(c) and 7(b) suggest that BPA can only implement section 7(b)(2), for example, for a single rate period. This single rate period issue has been addressed earlier. Also, this would preclude BPA's ability to have *any* REP settlements, contrary to the COUs' previous belief as evidenced by their entry into dozens of REP settlements in the 1980s and 1990s. As consistently recognized in previous REP settlements and in this REP-12 proceeding, there are numerous reasons why it makes sense to settle REP disputes. Among other things, REP settlements resolve contentious REP and ratemaking issues, provide stability to COUs by stabilizing the REP costs included in the COUs' rates, and provide stability to exchanging COUs' and IOUs' REP benefits and retail rates. Because ASCs and BPA's power rates have historically been established every two or five years, however, there is no need for a settlement for any two or five-year rate period because ASCs and rates have been fixed for such periods. Therefore, a settlement must last longer than a single rate period to have any significant value.

Furthermore, in order to have *any* REP settlement longer than, for example, five years, BPA must determine a manner in which to establish ASCs and reflect section 7(b)(2) in the

determination of the settlement benefits for the period following the first five years. BPA must ensure that the Settlement accomplishes this in a lawful manner. BPA separately addresses the parties' specific arguments regarding (1) whether the Settlement complies with section 5(c) of the Northwest Power Act and (2) whether the Settlement complies with section 7(b) of the Northwest Power Act, in other chapters of this ROD.

WPAG acknowledges that the Court has stated that BPA's settlement authority is both important and broad. WPAG Br. Ex., REP-12-R-WG-01, at 11, *citing PGE*, 501 F.3d at 1017-1018. WPAG notes that in the context of settling pending litigation, the Court has been deferential to BPA's judgment on whether a litigation settlement will be beneficial to BPA and its customers. *Id.* at 11-12, *citing Utility Reform Project v. Bonneville Power Admin.*, 869 F.2d 437, 442 (9th Cir. 1989). WPAG states that this is consistent with the general view that although BPA is a governmental agency, it is charged with conducting what amounts to a business that requires a greater flexibility and freedom of action than is normally accorded to a governmental agency. *Id.* at 12, *citing PGE*, 501 F.3d at 1030 n.17. WPAG also admits that the *PGE* decision expressly recognized that the Court "[did] not in any way rule on the legality of BPA's settlement authority when it settles out of contractual power obligations in a manner consistent with the requirements of the [Northwest Power Act]." WPAG Br. Ex., REP-12-R-WG-01, at 13, *citing* 501 F.3d 1032 n.20. WPAG argues, however, that the *PGE* court was "not reviewing a settlement which would result in the [7(b)(2) rate test] not being conducted in all rate cases during its term." WPAG Br. Ex., REP-12-R-WG-01, at 13. WPAG claims this is demonstrated by the fact that BPA continued to perform the rate test while the 2000 REP Settlement was in place. *Id.* WPAG argues that because of this difference, the *PGE* court's recognition of BPA's authority to settle REP obligations is not dispositive. *Id.* at 13-14. This argument, however, ignores the fact that *the 7(b)(2) rate test was irrelevant to setting BPA's rates in the rate proceedings conducted during the 2000 REP Settlements.*

Prior to the WP-02 rate case, BPA developed a Subscription Strategy to establish the manner in which BPA would serve its different customer classes. The Subscription Strategy provided the IOUs with a choice: (1) continue the traditional implementation of the REP, or (2) execute the 2000 REP Settlements. Although the 2000 REP Settlements provided greater benefits, they also involved greater risk. Therefore, when BPA conducted the WP-02 rate case for the first five years of the 2000 REP Settlements, BPA did not know whether the IOUs would select the traditional implementation of the REP or would select the settlement. In order to determine what rates would be if the IOUs chose traditional REP participation, BPA conducted a 7(b)(2) rate test. The costs of the 2000 REP Settlements, however, were higher than the traditional REP. Therefore, rates based on the 7(b)(2) rate test would have been inadequate to establish rates to recover BPA's total costs as required by law if the IOUs signed the 2000 REP Settlements. BPA then conducted a second ratemaking step (the Subscription Step), which rendered the 7(b)(2) rate test meaningless and simply included the costs of the proposed 2000 REP Settlements in rates pursuant to section 7(g) of the Northwest Power Act. (This allocation approach was rejected by the Court in *Golden NW*, 501 F.3d at 1048.) Thus, although BPA performed a 7(b)(2) rate test in its WP-02 rate case, the rate test was unnecessary to the establishment of rates for the five-year rate period. During the remaining term of the settlement BPA would continue to recover the settlement costs through section 7(g) regardless of the 7(b)(2) rate test. Therefore, WPAG's

suggestion that the *PGE* court “was not reviewing a settlement that would result in the 7(b)(2) rate test not being conducted in all rate cases during its term” is simply wrong.

BPA’s pre-2000 REP Settlements also do not support WPAG’s argument. WPAG notes that during the 1980s and 1990s, BPA executed over 33 REP settlements with both IOUs and preference customers. WPAG Br. Ex., REP-12-R-WG-01, at 7. In an attempt to distinguish these settlements from the Settlement, WPAG states that none of these settlements required BPA to forgo the performance of the 7(b)(2) rate test in every BPA rate proceeding conducted during their term, and BPA continued to perform the 7(b)(2) rate test during the terms of these settlements. *Id.* In fact, in the development of any REP settlement, the parties must establish the amount of REP benefits the exchanging utility will receive over the term of the settlement. In order to do so, the parties estimate (or forecast) the implementation of the 7(b)(2) rate test for the settlement term, which establishes a trigger amount and results in a PF Exchange rate. The parties must also forecast the utility’s ASC for the settlement term. From these two elements, plus the utility’s exchange load, the parties can estimate the utility’s prospective REP benefits. The parties also may agree to discount the forecast benefits to reflect risk.

Thus, both 7(b)(2) and ASC determinations were implicit in the 33 REP settlements with preference customers and IOUs, and those determinations were effective for the entire settlement term in each of the settlements. Because BPA developed each of the 33 settlements individually over a span of years, BPA’s rate proceedings did not directly address each settlement. Also, the REP benefits for each of the settlements were paid from BPA’s reserves, which did not show up in BPA’s ratemaking other than as a reduction in reserves. Thus, although BPA conducted rate tests during its rate proceedings, BPA did indeed forgo the performance of the 7(b)(2) rate test in each rate proceeding *in a manner in which the 7(b)(2) rate test would affect any of the 33 REP settlements*. Moreover, the rate tests BPA conducted in these rate proceedings were not the type of 7(b)(2) rate tests that WPAG suggests. Because the rate tests did not include the 33 settlements during their respective terms, the rate tests were not conducted in the same manner as in the absence of REP settlements.

Thus, the Settlement is the type of REP settlement contemplated by the *PGE* court. The Settlement accommodates implementation of section 7(b)(2) through the Reference Case and the 17 individual 7(b)(2) rate tests for each of the 17 future years of the Settlement, with each of these rate tests analyzed under numerous risk and litigation scenarios. This approach lawfully makes additional subsequent rate tests during the Settlement term unnecessary.

In summary, BPA’s settlement authority allows BPA to adopt contested settlements, provided that such settlements are consistent with law. BPA does not claim that its settlement authority allows BPA to adopt a settlement that is inconsistent with law, and the Settlement is consistent with BPA’s statutory directives.

## **Decision**

*BPA’s contracting and settlement authority under the Bonneville Project Act and the Northwest Power Act allows the Administrator to settle disputes regarding the implementation of the REP in the manner provided in the Settlement.*

## **9.3 Application of Settlement Ratemaking to Non-Settling Customers**

### **Issue 9.3.1**

*Whether BPA can apply rates reflecting the Settlement to non-settling customers.*

#### **Parties' Positions**

WPAG argues that Settlement rates cannot be imposed on customers who are not parties to the Settlement. WPAG Br., REP-12-B-WG-01, at 26; WPAG Br. Ex., REP-12-R-WG-01, at 36-42. WPAG argues that the Administrator does not have the authority to determine whether non-signing preference customers must forgo the REP cost protection provided by Congress under the Northwest Power Act, and instead receive the REP cost protection under the REP Settlement based on the willingness of other preference customers to sign that agreement. *Id.*

APAC states that it and many COUs have properly asserted challenges to rate determinations made by the Administrator in the WP-07 Supplemental and WP-10 rate cases. APAC Br., REP-12-B-AP-01, at 16. APAC objects to the decision to impose the Settlement on non-settling parties as a violation of the legal rights of those parties. APAC Br. Ex., REP-12-R-AP-01, at 4. APAC notes that it and some COUs have not accepted the settlement and have not waived their statutory protections. *Id.* at 13-14.

JP02 recognizes that a settlement does not need the unanimous consent of all parties affected by it to be valid, binding, and enforceable, as long as the settlement does not violate any “clear statutory directive.” JP02 Br., REP-12-B-JP02-01, at 4, *citing Utility Reform Project v. BPA*, 869 F.2d 437, 443 (9th Cir. 1989).

#### **BPA Staff's Position**

The application of a contested settlement to non-settling parties is a legal issue upon which Staff took no position. In the BP-12 proceeding, Staff proposed one set of rates that reflected the Settlement for all BPA customers.

#### **Evaluation of Positions**

WPAG argues that Settlement rates cannot be imposed on customers who are not parties to the Settlement. WPAG Br., REP-12-B-WG-01, at 26. WPAG states that the Settlement requires the Administrator to impose power rates established in accordance with its terms on preference customers who elect not to execute that agreement. *Id.*, *citing* Settlement, REP-12-E-BPA-11, §§ 3.3.4, 3.7(iii). WPAG states that Staff has recommended that the Administrator make such a finding based on its assessment that the Settlement offers preference customers REP cost protection that is superior to that provided by the 7(b)(2) rate test. *Id.* WPAG argues that the Administrator does not have the authority to determine whether non-signing preference customers must forgo the REP cost protection provided by Congress under the Northwest Power

Act, and instead receive the REP cost protection<sup>26</sup> under the REP Settlement based on the willingness of other preference customers to sign that agreement. *Id.*

Contrary to WPAG’s argument, first, the Settlement does not “impose” or prescribe any particular power rates to be established by BPA. Instead, the Settlement prescribes the rate protection and REP costs that will be included in BPA’s rate development. Rate development requires much more than the inclusion of one specified program cost, including a load and resource study; a revenue requirement study; a market price forecast; a risk analysis; a cost of service analysis; a rate design analysis; and numerous other elements.

Second, BPA does not argue that the Administrator’s settlement authority permits the Administrator to require non-signing parties to forgo 7(b)(2) cost protection under the Northwest Power Act. Instead, BPA can charge non-signing customers rates that *include* the 7(b)(2) cost protection, which is provided through using the Settlement’s established 7(b)(2) cost protection framework during BPA’s rate development. Non-signers continue to receive, and do not forgo, 7(b)(2) rate protection. The Settlement comports with and effectuates section 7(b)(2). This is because the Settlement sets forth a schedule of REP benefit payments that BPA would pay to the settling IOUs between FY 2012 and FY 2028. Gendron *et al.*, REP-12-E-BPA-04, at 7. In doing so, the Settlement quantifies the results of the rate protection that will be afforded to COUs for the FY 2012–2028 period. *Id.* In addition, the Settlement establishes a framework for incorporating the results of the rate protection and the REP benefits into BPA’s ratemaking. *Id.* Simply put, the amount of rate protection afforded to COUs defines the amount of REP benefits paid to REP participants and how much each customer class pays to provide the REP benefits. *Id.*

WPAG states that if the Administrator fails in this proceeding to make a determination that the rates of non-settling parties can and will be set in the same manner as settling parties for the entire Settlement term, the Settlement terminates and is void *ab initio*. WPAG Br. Ex., REP-12-R-WG-01, at 36. WPAG notes that BPA Staff has recommended that the Administrator make a finding that preference customers who have not signed the Settlement can and should have their REP cost protection (and REP payment obligation) based on the provisions of the Settlement. *Id.* at 37. WPAG claims this would be inappropriate. *Id.*

First, WPAG argues that the 7(b)(2) rate test requires BPA to compare the costs in rates it proposes to charge preference customers for a rate period with those same rates modified as required by section 7(b)(2). WPAG Br. Ex., REP-12-R-WG-01, at 37-38. This argument is already addressed in this ROD, where BPA established that the seventeen 7(b)(2) rate tests BPA performed for each respective year of the Settlement period are based on BPA’s best forecast of the costs for that year, including scenario analyses that examine possible variations in cost. *See* Chapters 3 and 5.

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<sup>26</sup> Notably, COUs do not receive “REP cost protection” but rather “7(b)(2) cost protection” because they are directly allocated REP costs pursuant to section 7(b)(1) of the Northwest Power Act, and section 7(b)(2) does not eliminate all REP costs except where the REP is completely eliminated, a situation that has not occurred in any rate test that BPA has conducted. 16 U.S.C. §§ 839e(b)(1), 839e(b)(2).

WPAG argues that even if BPA's 7(b)(2) rate tests were statutorily sufficient, the results do not demonstrate that the Settlement protects the position of preference customers, or in this instance non-signing preference customers, with regard to section 7(b). WPAG Br. Ex., REP-12-R-WG-01, at 38. This argument is already addressed in this ROD, where BPA established that BPA's rate test projections demonstrate in all cases prior to review of litigation scenarios, and in all but one litigation scenario (which contains two issues), that the Settlement provides rate protection superior to that provided in the absence of the Settlement. *See* Issues 3.5.3 and 5.7.1.

WPAG states that BPA asserts the proper standard for judging whether the Settlement should be executed and implemented by BPA is whether it is consistent with law and reasonable under the totality of the circumstances. WPAG Br. Ex., REP-12-R-WG-01, at 39, *citing* Draft ROD, REP-12-A-01, at 264-273, 327-328. WPAG first argues that it was the settling preference customers and IOUs, and not the objecting minority, who decided to craft the Settlement such that BPA will establish rates for all customers that reflect the Settlement costs. WPAG Br. Ex., REP-12-R-WG-01, at 39. Establishing consistent rates makes perfect sense, however, because setting separate rates for non-signing customers would require BPA to make final determinations regarding section 7(b)(2) and 7(b)(3) issues, Lookback Amounts, and other disputed issues. These are the issues the parties wish to settle in the Settlement, but only if no formal or precedential decision is made on such issues in the REP-12 proceeding. If such decisions were made, most of the benefits gained from the Settlement would be lost. The prospect of continuing generations of legal challenges to BPA's rates, beginning with rates established for FY 2002, would continue the specter of uncertainty that most of BPA's customers are striving to eliminate. In addition, the administrative challenges of maintaining two sets of PF Public rates, one set for signing utilities and another set for non-signing utilities, with the latter subject to continued legal challenge and uncertainty, raises further concerns for BPA. It makes little sense to establish different rates for the same class of customers, with the attendant administrative burdens, when the Settlement establishes lower REP costs that are recovered through BPA's rates. Rather, setting rates for all of BPA's customers in accord with the ratemaking-related elements of the Settlement makes more sense. As explained previously, such rates do not violate BPA's statutory ratesetting directives. They also provide greater amounts of rate protection than in the absence of the Settlement and, thus, lower rate levels for BPA's public body and DSI customers. BPA believes that one set of rates is the better course of action for the region as a whole.

As noted above, WPAG argues it is inappropriate to use a reasonableness standard to determine if the rate provisions of the Settlement should be used to set the rates for non-signing preference customers. WPAG Br. Ex., REP-12-R-WG-01, at 39. WPAG argues that the cases cited by BPA are drawn from contested litigation and class action settings that are materially different than the situation in this proceeding, where Congress provided preference customers cost protection through the operation of the 7(b)(2) rate test and non-signing preference customers have not surrendered their right to that cost protection. *Id.* at 39-40. WPAG ignores, however, that the administrative record and this ROD establish that the Settlement does not require non-signing preference customers to surrender their rights to 7(b)(2) cost protection. Indeed, the record and this ROD establish that the Settlement provides greater 7(b)(2) cost protection than in the absence of the Settlement. WPAG does not specify which of the cases in the cited pages of the Draft ROD are materially different than the instant case, particularly given that some of the

cases involve the review of BPA actions. Because the Settlement does not require any preference customers to forgo cost protection, however, the citations remain relevant.

WPAG claims that BPA suggests that section 2(f) of the Bonneville Project Act provides it with the authority to set the rates of non-signing preference customers based on the Settlement, even over their objections. WPAG Br. Ex., REP-12-R-WG-01, at 40. WPAG's characterization of BPA's position is misleading. BPA noted that section 2(f) of the Bonneville Project Act provides BPA the authority to adopt contested settlements, noting that it is commonplace for agencies to adopt contested settlements based on general settlement authority. In adopting a contested settlement, however, BPA must assure that the settlement is "not arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). In this case, BPA thoroughly reviewed the Settlement and determined that it is consistent with BPA's statutory ratemaking directives, including section 7(b)(2). BPA is unequivocally not stating that it can use its settlement authority to replace or ignore its statutory ratemaking directives.

WPAG claims that this issue was addressed in the *PGE* case, where the Court held that BPA could not use its settlement power to override its statutory obligations, such as those contained in section 7(b)(2). WPAG Br. Ex., REP-12-R-WG-01, at 40-41. As noted above, however, BPA is not using its settlement power to override its statutory obligations in the Settlement. Instead, the Settlement was thoroughly reviewed for compliance with BPA's statutory directives and expressly found to comply with such directives. This is distinctly different than the 2000 REP Settlements reviewed in *PGE*, which simply ignored the requirements of section 7(b)(2).

WPAG claims that BPA has asserted that it can use its settlement authority to deprive certain preference customers (in this case non-signers) of their ability to have their BPA rates determined in the manner set out in section 7 of the Northwest Power Act. WPAG Br. Ex., REP-12-R-WG-01, at 41. Once again, WPAG has mischaracterized BPA's position. BPA unequivocally has not asserted that it can use its settlement authority to deprive certain preference customers of the establishment of their rates in accordance with section 7. Quite the opposite, from the inception of the REP-12 proceeding BPA stated that the Settlement must comply with BPA's statutory ratemaking directives. During the course of the REP-12 hearing, BPA thoroughly reviewed the Settlement for compliance with these directives. After examination of the record and the parties' arguments in brief, BPA has concluded that rates for all of BPA's customers, including those choosing not to sign the Settlement, will be established in a manner consistent with BPA's section 7 ratemaking directives.

WPAG argues that BPA would suffer no great administrative burden by formulating one set of rates pursuant to the statutory rate directives, including section 7(b)(2), and another set based on the Settlement in each rate case during its term. WPAG Br. Ex., REP-12-R-WG-01, at 41-42. First, however, as discussed in greater detail elsewhere in this ROD, by establishing rates consistent with the Settlement, BPA is establishing rates consistent with its statutory rate directives. Thus, there is no need to establish an additional and redundant set of rates. Furthermore, such an approach would impose an additional administrative burden upon BPA and the parties, although BPA acknowledges that such burden would likely be manageable. More significant, however, is that WPAG's proposed approach would undermine the Settlement. As

noted in this ROD, the settling parties agreed to the Settlement on the basis that BPA would not make any final determinations on the issues pending in the litigation that would be rendered moot by the Settlement. In order to establish separate rates for non-signing customers, however, BPA would have to make definitive decisions on these contested issues. As noted above, the prospect of continuing generations of legal challenges to BPA's rates, beginning with rates established for FY 2002, would continue the specter of uncertainty that most of BPA's customers are striving to eliminate. Instead, setting rates for all of BPA's customers in accord with the Settlement, which (1) complies with the ratemaking directives; (2) provides greater amounts of rate protection than in the absence of the Settlement; and (3) provides lower rate levels for BPA's public body and DSI customers, makes more sense. Finally, WPAG's approach would result in similarly situated customers paying different rates for the same product, which would foster discontent among such customers. In summary, one set of rates is the better course of action for the region as a whole.

JP02 recognizes that a settlement does not need the unanimous consent of all parties affected by it to be valid, binding, and enforceable, as long as the settlement does not violate any "clear statutory directive." JP02 Br., REP-12-B-JP02-01, at 4, *citing Utility Reform Project v. BPA*, 869 F.2d 437, 443 (9th Cir. 1989); *cf. PGE*, 501 F.3d at 1032-1033 (concluding that BPA ignored §§ 5(c) and 7(b) in its 2000 REP Settlements and thereby exercised its settlement authority inconsistent with the Northwest Power Act). Although APAC argues that its previous arguments on rate determinations in the WP-07 Supplemental and WP-10 cases would have to be resolved by the Court, this is contrary to a primary purpose of the Settlement; namely, to resolve parties' disputes regarding REP issues without requiring BPA to make a formal decision on the contested issues. JP02 states that insofar as one significant goal of the parties entering into the Settlement is to avoid the need for a definitive resolution of the many specific, complex legal issues surrounding BPA's implementation of section 7(b)(2) and to avoid establishing precedent on these issues, BPA should make no detailed resolution of those issues in its adoption of the Settlement. JP02 Br., REP-12-B-JP02-01, at 5. JP02 states that BPA should conclude that the Settlement results are within a range of reasonable outcomes that do not contravene any clear statutory authority limiting its discretion. *Id.*

JP02 notes that Staff has correctly recognized that the legal issues concerning construction and implementation of section 7(b)(2) are vigorously contested by the parties and involve highly complex issues. *Id.*, *citing Bliven et al.*, REP-12-E-BPA-12, at 50. Ninth Circuit authority suggests that any BPA resolution of these issues would receive a high degree of deference from the Court, especially where the statute may be regarded as "silent or ambiguous with respect to the specific issue," such that "the question for the court is whether the agency's answer is based on a permissible construction of the statute," *Chevron U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 843 (1984). Accordingly, BPA would likely be regarded as having discretion in aspects of its implementation of section 7(b)(2).

JP02 notes that such discretion is even broader in the settlement context. JP02 Br., REP-12-B-JP02-01, at 5. For example, in *Utility Reform Project v. BPA*, 869 F.2d 437 (9th Cir. 1989), certain preference customers challenged BPA's decision to enter into a settlement agreement with the IOUs concerning the mothballed WNP-3 generating station, arguing that BPA's

settlement promises violated statutory restrictions on BPA’s authority. *Id.* at 442. The Ninth Circuit noted the powerful public interest in settling significant disputes (IOUs claimed damages “exceeding \$2.5 billion”), and concluded: “This is not to say that BPA could act contrary to a clear statutory directive in settling, but if there is room for doubt, we ought not to resolve it in a manner that sends the parties back to litigation. This settlement will therefore be set aside only for the strongest of reasons.” *Id.* at 443; *see also Ass’n. of Pub. Agency Customers v. BPA*, 126 F.3d, 1158, 1170-1171 (9th Cir. 1997).

Here, the IOUs, state public utility commissions, the Citizens’ Utility Board of Oregon, and over 84 percent of preference customers (by number of such customers) have brought to BPA a Settlement that they state should be reviewed by BPA only for potential violation of a “clear statutory directive.” JP02 Br., REP-12-B-JP02-01, at 5, citing *Utility Reform Project*, 869 F.2d at 443. BPA has gone well beyond that, ensuring that the Settlement comports with sections 5(c) and 7(b)(2). The disputes in this case are at least as significant as those at issue in *Utility Reform Project*. JP02 Br., REP-12-B-JP02-01, at 5. “The scope of these challenges spans a decade of BPA ratemaking” and “not a single consumer-owned utility (COU) or IOU ratepayer of BPA knows whether or not the rates it has paid, the REP benefits it has distributed, or the refunds it has received are lawful.” Stiffler *et al.*, REP-12-E-BPA-13, at 4. JP02 states that Staff has presented testimony from which the Administrator may conclude that a range of section 7(b)(2) implementation options does not transgress a “clear statutory directive,” and that the Settlement outcome falls within that range. JP02 Br., REP-12-B-JP02-01, at 6, *citing* Bliven *et al.*, REP-12-E-BPA-12, at 3 (“the negotiated values in the Settlement do not violate any statutory provisions as we understand them”). JP02 notes that BPA need not make any further determinations in order to adopt the Settlement.

JP02 further notes that such an approach is routinely taken in other areas of complex Federal litigation. *Id.* at 7. For example, in *Grunin v. International House of Pancakes*, 513 F.3d 114 (8th Cir. 1975), the Eighth Circuit considered settlement of an antitrust class action which was alleged to “perpetuate illegal tying requirements.” *Id.* at 123. As in *Utility Reform Project*, the court agreed that it could not “lend its approval to any contract or agreement that violates the antitrust law,” but it emphasized that:

... ‘neither the trial court in approving the settlement, nor this Court in reviewing the approval have the right or the duty to reach any ultimate conclusions on the issues of fact and law which underlie the merits of the dispute.’ *City of Detroit*, 495 F.2d [448,] 456 [(2d Cir. 1974)]. As stated in *Young v. Katz*, 447 F.2d 431, 433 (3d Cir. 1971), ‘In examining a proposed compromise for approval or disapproval ... the court does not try the case. The very purpose of compromise is to avoid the delay and expense of such a trial.’ [Citations omitted.] Thus, unless some of the terms of the agreement are per se violations of antitrust law, we must apply a ‘reasonableness under the totality of the circumstances’ standard to the court’s approval.

*Grunin*, 513 F.3d at 123-124. The *Grunin* court then reviewed the “vigorously contested” theories of antitrust deficiencies advanced by objecting parties and upheld the settlement because “the alleged illegality of the settlement agreement is not a legal certainty.” *Id.* at 124. *See also*

*State of West Virginia v. Pfizer & Co.*, 440 F.2d 1079, 1086 (2d Cir. 1971) (court “need not and should not reach any dispositive conclusions on the admittedly unsettled legal issues which the case raises, yet at the same time . . . attempt to arrive at some evaluation of the points of law on which the settlement is based;” to determine if objectors had shown “that the rules of law for which [they are] contending are so clearly correct that it was an abuse of discretion for the district court to approve the settlement”).

JP02 notes that, in short, in the class action context where complex issues are frequently settled over the objections of a minority of participants, the Federal courts have long recognized a specialized approach, akin to that taken in *Utility Reform Project*, to resolution of complex legal issues: unless the outcome is indisputably contrary to a clear statutory directive, a settlement agreement must be upheld without resolving the underlying complex legal issues, if it is reasonable under “the totality of circumstances” and should be set aside “only for the strongest of reasons.” JP02 Br., REP-12-B-JP02-01, at 7-8.

JP02 adds that the same approach is taken in multi-party environmental cases, where settlements by fewer than all parties—with significant consequences to non-settling parties—are upheld on the same basis. JP02 Br., REP-12-B-JP02-01, at 8. For example, in *City of New York v. Exxon Corp.*, 697 F. Supp. 677 (S.D.N.Y. 1988), the district court reiterated that it should not reach any ultimate conclusion on the underlying issues of fact and law, and noted that deference to a proposed settlement was especially appropriate “where ‘a government agency committed to the protection of the public interest’ has participated in and endorsed the settlement.” *Id.* at 692 (citation omitted); *see also In re Acushnet River*, 712 F. Supp. 1019, 1027-1028 (D. Mass. 1989). In the proceeding now before BPA, three state utility commissions and many public utility districts and municipal utilities, all of which are committed to protecting the public interest, have participated in and endorsed the Settlement. JP02 Br., REP-12-B-JP02-01, at 8. BPA is also a governmental agency committed to the protection of the public interest.

JP02 states that Staff’s careful attention to the statutory requirements of sections 5(c) and 7(b)(2) in the record of these proceedings distinguishes the present circumstances from those in the *PGE* case. *Id.* There, according to the Court, BPA “took the position that the [settlement] agreement was governed by § 2(f) only, and it expressly denied that the settlement agreement would be subject to §§ 5(c) and 7(b).” *PGE*, 501 F.3d at 1027. Here, Staff and the settling Parties recognize that “the Settlement must have a clear and direct connection to the protections and requirements set forth in the Northwest Power Act.” Evaluation Study, REP-12-E-BPA-01, at 179; *see also Carrasco et al.*, JP02-01 at 3. JP02 states that based on the Staff’s detailed analysis, BPA can and should find that the rate protection and REP benefits under the Settlement fall within a range that does not contravene any clear requirements of sections 5(c) and 7(b). JP02 Br., REP-12-B-JP02-01, at 9.

JP02 concludes that BPA would not be relying upon its settlement authority to transgress statutory requirements and “ignore[] the exchange program that Congress created in the [Northwest Power Act] and that BPA has implemented through its regulations.” JP02 Br., REP-12-B-JP02-01, at 9, *citing PGE*, 501 F.3d at 1036. Rather, BPA would be adopting a program that can fairly be characterized as within the governing legal framework, while

eschewing the adoption of definitive rulings on the specific and highly contested issues that most of its customers wish to settle for the next 17 years without precedent. JP02 Br., REP-12-B-JP02-01, at 9.

APAC states that it and many COUs have properly asserted challenges to rate determinations made by the Administrator in the WP-07 Supplemental and WP-10 rate cases. APAC Br., REP-12-B-AP-01, at 16. APAC objects to the decision to impose the Settlement on non-settling parties as a violation of the legal rights of those parties. APAC Br. Ex., REP-12-R-AP-01, at 4. APAC notes that it and some COUs have not accepted the settlement and have not waived their statutory protections. *Id.* at 13-14.

WPAG's and APAC's arguments are not persuasive. BPA recognizes that APAC and many COUs have asserted challenges to rate determinations made by the Administrator in the WP-07 Supplemental and WP-10 rate cases. However, most of those COUs have agreed to the Settlement as a resolution of their pending legal challenges. The fact that APAC and some non-settling COUs may wish to pursue those challenges does not, in and of itself, make the Settlement contrary to the Northwest Power Act. Because the Settlement is consistent with BPA's ratesetting directives, the statutory protections of non-settling entities are not being violated by the Settlement.

Furthermore, because setting rates for non-signing customers would require BPA to make final determinations regarding section 7(b)(2) and 7(b)(3) issues, Lookback Amounts, and other disputed issues, most of the benefits gained from the Settlement would be lost. As noted previously, one of the critical elements of the Settlement was to avoid decisions on the contested issues, which would establish peace for the 17-year term of the Settlement. Continuing generations of legal challenges to BPA's rates, beginning with rates established for FY 2002, would continue the specter of uncertainty that most of BPA's customers are striving to eliminate. In addition, the administrative challenges of maintaining two sets of PF Public rates, one set for signing utilities and another set for non-signing utilities, with the latter subject to continued legal challenge and uncertainty, raises further concerns for BPA. It makes little sense to establish different rates for the same class of customers, with the attendant administrative burdens, when the Settlement establishes conservative REP costs that are recovered through BPA's rates.

Rather, the course of setting rates for all of BPA's customers which reflect the Settlement makes more sense. As explained previously, such rates do not violate BPA's statutory ratesetting directives. They also provide greater amounts of rate protection than in the absence of the Settlement and, thus, lower rate levels for BPA's public body and DSI customers. BPA believes that one set of rates is the better course of action for the region as a whole.

### **Decision**

*BPA can apply rates reflecting the Settlement to non-settling customers. Such rates comply with the Northwest Power Act's ratemaking directives.*

**9.4 The Waiver Provisions of the Settlement Are Uncontested and thus the Signing IOUs’ REP Benefits and the Level of REP Costs to be Included in the Signing COUs’ Rates Are Binding for the Settlement Term**

The record establishes that the Settlement would provide the IOUs fewer REP benefits than they would receive in the absence of the Settlement under the traditional implementation of the REP. See Chapters 3, 4, and 5. The Ninth Circuit has held that utilities may waive their statutory REP rights provided under section 5(c) of the Northwest Power Act. *Avista Corp v. Bonneville Power Admin.*, 380 Fed. Appx. 652 (9th Cir. 2010); see section 4.5. BPA allocates REP costs to its customers pursuant to the rate directives in section 7 of the Northwest Power Act. 16 U.S.C. § 839e. The Settlement reflects these facts. Sections 7.2 and 7.3 of the Settlement provide:

**7.2 COU Group’s Waivers.** Each entity in the COU Group waives any and all past or future rights it may have to have included in the COU Parties’ PF Rates an amount of REP Benefit Costs that is different from the COU Parties’ Allocated Share as defined in section 3. This waiver includes (i) a waiver of any claims that BPA should set rates inconsistent with this Settlement Agreement, (ii) a waiver of statutory rights or rate protections greater than are provided for in this Settlement Agreement, notwithstanding any past or future legal interpretations of section 5(c), 7(b)(2), or 7(b)(3) of the Act by BPA, any court, or any other entity, and (iii) except as provided in section 10.6, a waiver of any existing or future rights to refunds, credits, cash payments, or any other adjustments that, if applied, would allow COU Parties to bear REP Benefit Costs that are lower than the COU Parties’ Allocated Share. Each entity in the COU Group intends and agrees that the COU Parties’ PF Rates will reflect the COU Parties’ Allocated Share provided for in section 3 regardless of whether BPA is required to reflect a different amount of REP Benefit Costs in the rates applicable to Non-Settling Entities. Each entity in the COU Group also intends and agrees that (a) the REP Settlement Benefits paid to the IOUs under this Settlement Agreement will be consistent with section 3 regardless of any REP Benefit Costs reflected in the rates applicable to Non-Settling Entities, and (b) such REP Settlement Benefits will be allocated among the IOUs as provided in this Settlement Agreement.

**7.3 IOU Group’s Waivers.** Except as provided in section 7.5, each IOU waives any and all past or future rights it may have to receive REP Benefit Payments for the Payment Period that differ from its share of the REP Settlement Benefits provided for in this Settlement Agreement. This waiver includes (i) a waiver of any claims that BPA should set rates inconsistent with this Settlement Agreement, (ii) a waiver of any statutory rights to REP Benefit Payments for the Payment Period that are greater than the REP Settlement Benefits provided for in this Settlement Agreement, notwithstanding any past or future legal interpretations of section 5(c), 7(b)(2), or 7(b)(3) of the Act by BPA, any court, or any other entity, and (iii) except as provided in section 10.6, a waiver of any existing or future right to refunds, credits, cash payments, or any other adjustments that, if applied, would otherwise change the COU Parties’ Allocated Share. Each entity in the IOU Group that is not an IOU waives any right to assert in any administrative or

judicial proceeding that REP Benefit Payments for any IOU for the Payment Period should differ from its share of the REP Settlement Benefits provided for in this Settlement Agreement. Each entity in the IOU Group intends and agrees that each IOU's share of REP Settlement Benefits for the Payment Period will be as provided for in this Settlement Agreement. No entity in the IOU Group will seek to have included in COU Parties' PF Rates costs of REP Settlement Benefits that exceed the COU Parties' Allocated Share irrespective of whether BPA is required to reflect a different amount of REP Benefit Costs in the rates applicable to Non-Settling Entities.

Settlement, REP-12-A-02A, § 7.2, 7.3.

In summary, the foregoing Settlement sections provide that, even if a reviewing court were to make any legal interpretations of sections 5(c), 7(b)(2), or 7(b)(3) of the Act,<sup>27</sup> the signing IOUs have waived their rights to any greater or lesser amount of REP benefits, and the signing COUs have waived their right to any greater or lesser amount of REP costs included in their rates, than those agreed to in the Settlement.

The Settlement, including sections 7.2 and 7.3, was made available for review in BPA's formal evidentiary REP-12 hearing. This hearing was conducted pursuant to section 7(i) of the Northwest Power Act. 16 U.S.C. § 839e(i). During the REP-12 proceeding, no party contested the waiver provisions in sections 7.2 and 7.3 of the Settlement. Moreover, no party contests BPA's authority to implement, as to the settling parties, the provisions of the Settlement. Consequently, once executed and subject to section 10.6 of the Settlement, BPA will provide REP benefits to the signing IOUs in the amounts specified in the Settlement for FY 2012–2028 and will recover the designated share of such costs from the signing COUs in BPA's power rates for such customers for FY 2012–2028 in the manner specified in the Settlement.

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<sup>27</sup> Section 10.6 of the Settlement provides that specified consequences will occur “[i]f a court with jurisdiction enters a final order that finds BPA's execution of this Settlement Agreement to be invalid or unenforceable in any material respect as to any Party and the Parties are, notwithstanding their good faith efforts, unable to develop mutually acceptable amendments as described in section 10.5.”

## 10.0 IMPLEMENTING THE REP FOR COUS UNDER THE SETTLEMENT

### 10.1 Introduction

As described in Chapter 1, section 5(c) provides that *any* regional utility may offer to sell power to BPA under the REP. 16 U.S.C. § 839c(c)(1). While Congress expected the IOUs to be the primary beneficiaries of the REP, COUs are also eligible to participate in the REP if their respective ASCs exceed BPA's applicable PF Exchange rate. Currently, two COUs, Snohomish PUD (Snohomish), and Franklin PUD, are participating in the REP. Clark Public Utilities (Clark) is in the last year of a REP settlement. BPA anticipates that beginning in FY 2012–2013, only Clark and Snohomish will be eligible for REP benefits.

The 2012 REP Settlement will resolve conflicts among BPA's IOU REP participants and most of BPA's COU customers over BPA's response to the Court's decisions in *PGE* and *Golden NW*, and resolve BPA's future implementation of the REP for the IOUs. The Settlement resolves these issues by, among other things, establishing a fixed stream of REP benefits payable to the IOUs as a class. The actual amount of REP benefits for each IOU will be pursuant to the IOU's ASC, which each IOU will continue to file pursuant to BPA's 2008 ASC Methodology.

While the Settlement addresses BPA's IOU customers' participation in the REP, it does not speak to the treatment BPA will afford COUs that participate in the REP. *See Gendron et al.*, REP-12-E-BPA-14, at 2. The negotiating parties' silence on this subject was intentional because the Settlement was not intended to resolve the COUs' participation in the REP.

As such, at the beginning of this proceeding, Staff was presented with two choices for implementing the REP for COUs: (1) use the traditional REP methods, including a traditional implementation of the section 7(b)(2) rate test, to calculate a PF Exchange rate applicable to COUs in the REP; or (2) develop a solution consistent with the Settlement, as nearly as possible, to calculate a PF Exchange rate for COUs participating in the REP.

In considering which of these two paths to take, Staff recognized that one of the fundamental objectives the negotiating parties were attempting to achieve under the Settlement is the resolution of existing disputes over the REP *without* BPA making binding, final decisions on the specific issues involving the section 7(b)(2) rate test. As described by one group of COUs:

Insofar as one significant goal of the Parties entering into the Settlement Agreement is to avoid the need for a definitive resolution of the many specific, complex legal issues surrounding BPA's implementation of § 7(b)(2) and to avoid establishing precedent on these issues, we urge BPA to make no detailed resolution of those issues in its adoption of the Settlement Agreement. BPA should conclude that the Settlement Agreement results are within a range of reasonable outcomes that do not contravene any clear statutory authority limiting its discretion.

JP02 Br., REP-12-B-JP02-01, at 5. BPA believes that Staff's analysis in this proceeding, as described in Chapters 3 and 5, largely achieves this objective. BPA has determined in this ROD that REP benefits are less, and rate protection more, under the Settlement than when compared to Staff's Reference case and when compared to the vast majority of the scenarios considered in the analysis. *Id.*

However, the objective of the settling parties to reduce further contentious and divisive litigation over the REP would be jeopardized if BPA were to reach final decisions on the implementation of the 7(b)(2) rate test in order to establish a PF Exchange rate just for the two remaining COUs eligible to participate in the REP. To avoid this, Staff proposes in the Initial Proposal to calculate the PF Exchange rate for COUs participating in the REP in a manner similar to the methodology set forth in the Settlement. Below is a brief description of Staff's proposal.

## **10.2 Staff's Initial Proposal for COU REP Participants**

In the Initial Proposal, Staff proposes to calculate REP benefits for COUs by applying a method that is generally similar to the calculations described in the Settlement. Thus, COUs would still be required to file ASCs with BPA pursuant to the 2008 ASC Methodology. The COUs' REP benefits would also be determined by comparing each COU's ASC to BPA's applicable PF Exchange rate. COUs with an ASC below BPA's applicable PF Exchange rate would receive no REP benefits.

The primary difference in Staff's proposed treatment of COU and IOU REP participants arises in the calculation of the PF Exchange rate. To understand these differences, it is helpful to review a brief step-by-step description of the calculation of the PF Exchange rate under the parameters of the Settlement, and the resulting amount of REP benefits. This description is a general overview of the calculations used in determining each IOU's respective share of REP benefits using the terms described in the Settlement. At the same time, it must be understood that the following discussion does not precisely describe the ratemaking steps BPA uses to achieve these results in rates.

### **10.2.1 Overview of IOU Calculation**

In general, each IOU's share (if any) of the REP benefits provided in the Settlement is determined by applying the following formula:

$$[(\text{Scheduled Amount}) \div \Sigma \text{IOU Unconstrained Benefits}] \times \text{IOU Unconstrained Benefits}$$

This formula is comprised of four steps.

**Step 1.** The first step is to determine the Scheduled Amount. This is done by referencing Table 3.1 in the Settlement for the appropriate year. The Scheduled Amount reflects the amount of REP benefits "paid" to the IOUs each year after taking into account reductions associated with the Refund Amount. For example, in the first year of the Settlement, FY 2012, the Scheduled Amount is \$182.1 million.

**Step 2.** The next step is to determine the IOUs' REP benefits prior to any reduction due to sections 7(b)(2) and 7(b)(3) of the Northwest Power Act. This reflects the pre-rate test amount of REP benefits that would be available to the IOUs based on a comparison of each IOU's ASC and the pre-rate test IOU PF Exchange rate, with the difference multiplied by each IOU's exchange load. The resulting amounts of REP benefits are aggregated to determine the IOU "Unconstrained Benefits." The term "unconstrained" reflects the fact that the REP benefits have not been reduced by the operation of sections 7(b)(2) and 7(b)(3). For example, Staff's calculations from the Initial Proposal show that the IOU Unconstrained Benefits for FY 2012 are \$747,253,738. Evaluation Study Documentation, REP-12-FS-BPA-01A, Table 2.4.14.

**Step 3.** In step three, the Scheduled Amounts provided under the Settlement are divided by the IOU Unconstrained Benefits to produce a ratio that calculates the totality of rate protection to BPA's preference customer rates. This calculation is performed as follows:

$$\$182.1 \text{ million} \div \$747,253,738 = 0.244, \text{ or } 24.4 \text{ percent}$$

This ratio is referred to in the Settlement as the Constrained Total Benefit Ratio. This ratio measures the constraining effect the Settlement has on total REP benefits. The ratio is used in the calculations leading to the determination of the amount of 7(b)(2) rate protection costs that are allocated to the IOU REP participants for the purpose of setting each IOU participant's PF Exchange rate. As noted in this ROD, this constraint is larger than what BPA believes would be required by a traditional application of the section 7(b)(2) rate test and section 7(b)(3) reallocations.

**Step 4.** The fourth and final step is to determine each IOU's respective piece of the Scheduled Amounts. This determination is made by multiplying the Constrained Total Benefit Ratio (23 percent in this example) by the IOU's individual Unconstrained Benefits. (Note that if the IOU's ASC does not exceed BPA's pre-rate test IOU PF Exchange rate, the IOU receives *no* REP benefits.)

To use a simple example, if Puget Sound Energy's portion of the Unconstrained Benefits is \$277 million in FY 2012, the calculation is as follows:

$$24.4\% \text{ (the Constrained Benefit Ratio)} \times \$277 \text{ million} = \$68 \text{ million}$$

Thus, the Settlement "constrains" Puget's REP benefits from a pre-rate test amount of \$277 million to a post-Settlement amount of \$68 million. To put this amount in perspective, under BPA's traditional (and disputed) implementation of section 7(b)(2), Puget's post-7(b)(2) rate test REP benefits for FY 2012 (after setoff for Lookback Amounts) would be approximately \$84 million. Evaluation Study, REP-12-FS-BPA-01, Table 9.4.

BPA would then allocate costs of rate protection and Refund Amounts to Puget's PF Exchange rate to achieve this result.

### 10.2.2 Overview of Staff's Calculation for COU REP Participants

The foregoing describes, in general, the methodological approach to calculating IOU REP benefits following the general parameters outlined in the Settlement. Again, this does not precisely describe BPA's ratemaking, but it does generally follow the terms of the Settlement. The discount that the IOUs accept as part of the Settlement (77 percent in the above example) reflects a reduction for both section 7(b)(2) rate protection cost exposure and a reduction to account for past (disputed) overpayments under the 2000 REP Settlements.

Staff could have proposed to apply the same discount in REP benefits that the IOUs receive under the Settlement to the COU participants in the REP. To use FY 2012 as an example, the COUs' REP benefits would have been 24.4 percent of the pre-7(b)(2) adjusted amounts (*i.e.*, 24.4 percent of the COUs' Unconstrained Benefits). Staff ultimately rejected this approach, however, because the COU parties do not share all of the same risks in the pending litigation as the IOUs. Gendron *et al.*, REP-12-E-BPA-04, at 35. Significantly, the COUs did not participate in the REP during FY 2002–2006 and, as such, were not overpaid or otherwise assigned a Lookback obligation. Bliven *et al.*, REP-12-E-BPA-05, at 3.

To reflect this difference, the Initial Proposal does not base the COUs' REP benefit calculation on the amount of REP benefits "paid" to the IOUs under the Settlement. *Id.* Instead, Staff proposes to calculate the COUs' REP benefits by referencing the total amount of REP costs included in rates as a result of the Settlement (*i.e.*, the Scheduled Amounts *plus* the Refund Amounts). *Id.* Thus, Staff proposes to calculate REP benefits for the COUs using the same steps as described above, except in Step 1, Staff does not exclude REP benefits that are being reduced as a result of the Refund Amounts. *Id.* Scheduled Amounts and Refund Amounts are included in the numerator of the equation. *Id.* at 7. Except for this one difference, the remaining features of the calculation would remain the same.

The resulting calculation for COU REP benefits is performed as follows:

$$\frac{[(\text{Scheduled Amount} + \text{Refund Amounts}) \div \Sigma \text{IOU Unconstrained Benefits}] \times \text{COU Unconstrained Benefits.}}$$

Gendron *et al.*, REP-12-E-BPA-14, at 2.

Using the same illustration as before, one can see how the REP benefits for COUs are affected by Staff's adjustment. *Id.* Using FY 2012 figures, the Scheduled Amounts are \$182.1 million, the Refund Amount is \$76.5 million, and the sum of IOU Unconstrained Benefits is \$747.3 million. Assume Clark's Unconstrained Benefits are \$43 million. *Id.* The Constrained Benefit Ratio is thus computed as  $(\$182,100,000 + \$76,537,617) \div \$747,253,738$ , or 34.61 percent, approximately 10 percentage points greater than the 24.4 percent ratio calculated for the IOUs above. *Id.* The Constrained Benefit Ratio is then applied to Clark's Unconstrained Benefits, yielding REP benefits of \$14.9 million for FY 2012. *Id.*

Staff views this adjusted ratio (34 percent as opposed to 24 percent in the above example) as an appropriate means of reflecting the fact that COUs participating in the REP do not share *all* of the same legal risks as the IOUs under the Settlement. Gendron *et al.*, REP-12-E-BPA-04, at 35. At the same time, this method of providing REP benefits to the COUs under the Settlement is still reasonable because it produces REP benefits below what Staff calculates would be permissible under the section 7(b)(2) rate test. Under the traditional REP implementation, Clark would be entitled to an average of \$14.6 million in FY 2012–2013 REP benefits. Evaluation Study, REP-12-FS-BPA-01, Table 10.6. Staff proposes that some discounting of COUs’ REP benefits is appropriate because, as participants in the REP, COUs share with the IOUs the same exposure to disputes over BPA’s implementation of section 7(b)(2). Gendron *et al.*, REP-12-E-BPA-04, at 35. Staff concludes that a reasonable discount can be calculated by including the Refund Amounts in the numerator, which is the component of the legal risk the COUs do not face, and basing the COUs’ REP benefits on the adjusted ratio. *Id.*

Staff proposes to apply this larger ratio for as long as Refund Amounts are deducted from the IOUs’ REP benefits, which under the Settlement would occur for a period of eight years (*i.e.*, FY 2012–2019). *Id.*; *see also* Settlement, REP-12-A-02A, Table 3.2. After FY 2019, Refund Amounts would no longer be deducted from REP benefits provided under the Settlement, with the result that BPA would use the same Constrained Benefit Ratio to reduce the REP benefits of both COU and IOU REP participants.

### **10.2.3 Staff’s Modified Proposal for COU REP Participants**

Clark objects to BPA’s proposal in its direct case. Latendresse *et al.*, REP-12-E-CL-01, at 6-16. Clark argues that applying the terms of the discount the IOUs agreed to is not appropriate because the COU REP participants are not in the same position as the IOU REP participants. *Id.* Clark raises the following differences: (1) COU participants were not signatories to the 2000 REP Settlements; (2) COU participants do not face the same legal risks as the IOU participants; (3) COU participants have no Lookback liability; (4) COU participants have no deemer account liability; and (5) COU participants have no claims that any liabilities were under-calculated by BPA. *Id.* at 8. Because COU participants do not face the same risks as the IOU participants, Clark argues that COU participants should not be asked to make the same concessions regarding the level of their REP benefits if the Settlement agreed to by the IOU participants is implemented. *Id.*

As an alternative to Staff’s approach, Clark proposes that the Refund Amount for the first eight years of the Settlement term should continue to be used for the numerator of the calculation for the last nine years of the Settlement term. *Id.* at 15. This, Clark reasons, would produce COU participant benefits that recognize the different position of such COU participants compared to the IOU participants. *Id.* In Clark’s view, this would appropriately address the distinct position of COU participants by producing REP benefits for COU participants that more closely approximate REP benefits available to them under the traditional, “statutory,” calculation. *Id.*

Staff responds that it finds “considerable merit in” Clark’s proposal. Gendron *et al.*, REP-12-E-BPA-14, at 5. Although not adopting Clark’s proposal, Staff alternatively proposes to spread out the Refund Amount payments provided under the Settlement for the entire 17 years. *Id.* at 7. To do so, Staff proposes to reduce the Refund Amounts included in the numerator of the COU calculation (again for purposes of the COU calculation only) to \$51.5 million (as opposed to \$76.5 million). *Id.* Staff reviews this modified approach to calculating REP benefits for COUs in light of the criteria BPA was using to evaluate the overall settlement and finds that this proposal meets the criteria. *Id.* at 10-11.

### **10.3 Issues Regarding Staff’s Proposed Treatment of COU REP Participants**

Subsequent to the filing of initial briefs, Clark signed the 2012 REP Settlement. Subsequent to the filing of briefs on exceptions, Clark signed a COU REP settlement. Upon consummation of the settlement between BPA and Clark regarding the calculation of the elements of REP benefits for Clark, Clark withdrew its initial brief and a portion of its brief on exceptions. *See* Notice of Withdrawal of Briefs, REP-12-M-CL-01. This action removes the discussion of issues raised in Clark’s initial brief and BPA’s response in the Draft ROD. Hence, the following discussion regards a limited number of issues necessary to determine COU REP benefits.

#### **Issue 10.3.1**

*Whether BPA should employ the Settlement-based ratio for purposes of calculating a COU’s PF Exchange rate.*

#### **Parties’ Positions**

Clark presents an alternative to Staff’s proposed construction of the ratio. Clark suggests that BPA could fashion a ratio patterned after Staff’s proposed ratio, but revised to recognize the different circumstances faced by the IOUs and COUs regarding their PF Exchange rate. Latendresse *et al.*, REP-12-E-CL-01, at 12. Continuing to use that same numerator for the last nine years of the Settlement term produces COU REP benefits that recognize the different position of such customers compared to that of the IOUs. *Id.*

Clark and Snohomish have signed COU REP settlements that specify the use of Clark’s proposed construction of the ratio.

#### **BPA Staff’s Position**

Staff proposes a ratio for use in calculating the PF Exchange rate for COU REP participants. Gendron *et al.*, REP-12-E-BPA-14, at 2. In rebuttal testimony, Staff adds two other permutations to the composition of the ratio. *Id.* at 7-8. Staff believes that the proposed ratios properly take into account the diverse effects of the 2000 REP Settlements among COU participants and IOU participants. *Id.* at 11. Staff supports settlement of the COU REP.

## **Evaluation of Positions**

As discussed in the introduction to this ROD, there is severe disagreement among all parties, including BPA, on how to interpret section 7(b)(2) of the Northwest Power Act in order to conduct the rate test. Staff has presented but a handful of the 2,200 possible combinations of contested issues. Using the 7(b)(2) rate test to implement the COU REP would require BPA making definitive resolutions on section 7(b)(2) and 7(b)(3) issues, which would then be contested.

In testimony, Clark presents an alternative to Staff's proposed construction of the ratio. Clark suggests that BPA could fashion a ratio patterned after Staff's proposed ratio, but revised to recognize the different circumstances faced by the IOUs and COUs regarding their PF Exchange rate. Latendresse *et al.*, REP-12-E-CL-01, at 12.

Clark suggests that the numerator proposed by Staff for the first eight years of the Settlement term produces COU REP benefits that roughly track those that would have been available under the Reference Case calculation in the absence of a settlement. *Id.* Continuing to use that same numerator for the last nine years of the Settlement term produces COU REP benefits that recognize the different position of such customers compared to that of the IOUs. *Id.* Since the COU REP participants do not face the same litigation risks as the IOUs, and have not settled their REP benefits as have the IOUs, using a numerator that produces REP benefits for COUs that more closely approximates REP benefits available to them under the Reference Case is both fair and recognizes how their position differs from the IOUs. *Id.* at 15. BPA would be able to use a relatively uniform approach to the calculation of both IOU and COU PF Exchange rates, and would be able to avoid the necessity of running the 7(b)(2) rate test and related implementation steps. *Id.* And as opposed to Staff's proposed ratio, it would garner support from COUs that participate in the REP. *Id.* at 16.

Clark cites three differences in its position relative to the IOUs: no Lookback liability, no deemer account liability, and no claims that those liabilities were under-calculated by BPA. *Id.* at 13. Clark recognizes that the COU challenges to BPA's implementation of the 7(b)(2) rate test and the 7(b)(3) reallocation would, if successful, reduce REP benefits available to COUs and IOUs alike. *Id.* However, unlike the IOUs, Clark notes that COU REP participants would benefit from such REP cost reductions by paying a lower PF rate for their requirements service. *Id.*

In response to Clark's suggested alternative, Staff proposes two other ratio constructs. Gendron *et al.*, REP-12-E-BPA-14, at 7-8. Both derive from the source of the Refund Amount used in the numerator of the ratio. *Id.* Staff proposes to amortize the Refund Amount over the 17 years in a fashion that would modify the \$76.5 million for eight years into \$51.5 million for 17 years. *Id.* As an alternative, Staff next proposes to modify the \$76.5 million for eight years into \$76.5 million for the first two years and into \$43.1 million for the next 15 years. *Id.*

The Settlement-based ratio recognizes the differences between the COU REP participants and the IOU REP participants by omitting the first three factors cited by Clark from affecting the

PF Exchange rate applicable to COU REP participants but recognizing that COUs and IOUs are in an equal position relative to 7(b)(2) and 7(b)(3) issues in the pending litigation.

The question for BPA is whether one of Staff's three proposals or Clark's proposal provides the better construct of the ratio in terms of best recognizing the difference in position between COU and IOU REP participants. As stated earlier, BPA believes that Staff's initial proposal adequately addresses the differences due to Lookback, LRA, and deemer issues. While BPA continues to believe that the COUs and IOUs are in an equal position with regard to the definitive resolution of 7(b)(2) and 7(b)(3) issues, Clark's concern is not without merit that COUs, in the absence of signing the Settlement, would realize different effects from a definitive resolution than would IOUs. Further, BPA recognizes that COUs and IOUs are unequally exposed to deemer balance accruals and the potential for the *in lieu* provision.

BPA will use the ratio in calculating the PF Exchange rates for COU REP participants. In constructing the ratio, BPA believes that the proposal set forth in Clark's testimony, including the full \$76.5 million in the numerator, best reflects the differences between COU and IOU REP participants in the calculation of their respective PF Exchange rates. Therefore, for the reasons set forth in Clark's testimony, BPA adopts the use of the \$76.5 million in the numerator of the ratio for the full 17 future years of the Settlement. *See Latendresse et al.*, REP-12-E-CL-01, at 11-16. BPA agrees that Clark's proposal would result in a relatively uniform approach to the calculation of both IOU and COU REP benefits, and would avoid the necessity of conducting prospective additional 7(b)(2) rate tests and related implementation steps. *Id.* at 16. Also, as opposed to BPA's proposed calculation, Clark's proposal would garner support from COU customers that participate in the REP. *Id.* This support has been evidenced by both Clark and Snohomish signing a COU REP settlement that specifies the use of Clark's proposed modification to the ratio.

### **Decision**

*BPA will employ the Settlement-based ratio for purposes of calculating a COU's PF Exchange rate. BPA will adopt Clark's proposal to include the \$76.5 million in the numerator of the Settlement-base ratio for the full 17 future years of the Settlement.*

### **Issue 10.3.2**

*Whether BPA should execute REP settlements with eligible COU REP participants.*

### **Parties' Positions**

Clark states that offering the COU settlement for comment in this proceeding is the appropriate action for BPA to take, and recommends that BPA execute the COU settlement in its current form if it is signed by any of the COU participants in the REP. Clark Br. Ex., REP-12-R-CL-01, at 3.

JP02 states its support for the COU settlements. JP02 Br. Ex., REP-12-R-JP02-01, at 5.

### **BPA Staff's Position**

It is a matter of public record that there is a REP settlement proposal that is being considered by BPA and Clark. Wright, Oral Tr. at 122.

### **Evaluation of Positions**

Although the accrual of deemer account balances and the operation of the *in lieu* provision for COU REP settlement are not addressed in the Settlement, they are issues that must be addressed in any COU REP settlement. While Clark is correct that BPA has not offered similar protection to Clark on the record in this proceeding, Clark has been offered such protections in the context of a settlement. Wright, Oral Tr. at 122.

Nonetheless, BPA wishes to extend offers of settlement to any COU that is eligible to participate in the REP. This offer of settlement consists of (1) a contractual guarantee to the use of the ratio as decided in Issue 10.3.1; (2) removal from the settlement contract all provisions that provide for accrual of deemer account balances; (3) the expanded right of entry and exit from the REP equal to the expanded right included in the Settlement; and (4) a contractual waiver of BPA's statutory right to implement the *in lieu* provision.

At the time the Draft ROD was issued, an offer of settlement was before the two COUs that are eligible to participate in the REP: Clark Public Utilities and Snohomish PUD. Draft ROD, REP-12-A-01, at 297-298. In the Draft ROD, BPA asked any party that wishes to comment on this offer of settlement take the opportunity to do so in its brief on exceptions. *Id.*

Clark states that offering the COU settlement for comment in this proceeding is the appropriate action for BPA to take, and recommends that BPA execute the COU settlement in its current form if it is signed by any of the COU participants in the REP. Clark Br. Ex., REP-12-R-CL-01, at 3. Clark cites several benefits that arise from the COU settlement: (1) the elimination of certain uncertainties for both BPA and all of its preference customers, *id.* at 4-5; (2) the effectuation of the primary objective of the Settlement, *id.* at 5-7; and (3) the offer of immediate benefits to all preference customers, *id.* at 7-8.

JP02 indicates that it would accept the ratio method for calculating COU REP benefits for any COUs that joined the Settlement with the IOUs. JP02 Br. Ex., REP-12-R-JP02-01, at 5. JP02 notes that all COUs potentially eligible to participate in the REP have executed the Settlement Agreement, so JP02 accepts the ratio method. *Id.* JP02 also believes that BPA's proposed treatment of the *in lieu* and deemer issues for the COU settlements is acceptable. *Id.*

No other party commented on the COU REP settlement offer.

Both currently eligible COUs signed the COU REP settlement offered to them. Based in part of the support received by parties that commented, BPA has chosen to counter-sign the COU REP

settlements. If other COUs become eligible during the term of the Settlement, they will be offered the same COU REP settlement as signed by Clark and Snohomish.

**Decision**

*After reviewing parties' comments, BPA elected to execute REP settlements with the two eligible COU REP participants. BPA will offer the same settlement to any other COU that becomes eligible for the REP.*

## **11.0 SECTION 7(b)(2) RATE TEST AND LOOKBACK CONSTRUCT WITH NO SETTLEMENT**

### **11.1 The Section 7(b)(2) Rate Test**

#### **11.1.1 Introduction**

Section 7(b)(2) of the Northwest Power Act directs BPA to conduct, after July 1, 1985, a comparison of the projected amounts to be charged its preference and Federal agency customers for their general requirements with the costs of power (hereafter called rates) for the general requirements of those customers if certain assumptions are made. 16 U.S.C. § 839e(b)(2). The effect of this comparison (the section 7(b)(2) rate test or rate test) is to protect BPA's preference and Federal agency customers' wholesale firm power rates from certain costs resulting from the provisions of the Northwest Power Act. The section 7(b)(2) rate test can result in a reallocation of costs from the general requirements loads of preference and Federal agency customers to other BPA loads.

Insofar as it represents BPA's positions on section 7(b)(2) if there was no settlement, an explanation of section 7(b)(2), its historical background, and its implementation in BPA's ratemaking is presented in section 10.1 of the WP-10 ROD. That section is incorporated herein by reference. WP-10 ROD, WP-10-A-02, at 97-109.

#### **11.1.2 Preservation of Previous 7(b)(2) Issues Through Standstill Agreement**

Many of the issues that would likely have been litigated in the REP-12 Settlement proceeding have already been fully briefed by the parties and responded to in BPA's WP-07 Supplemental ROD, WP-07-A-05; WP-10 ROD, WP-10-A-05; and 2008 RPSA ROD. Because these issues have been thoroughly argued in the prior proceedings, it would not be a prudent use of BPA's or the parties' resources to require them to be re-litigated in the REP-12 Settlement proceeding in order to preserve them or have them considered by the Administrator in this proceeding. Consequently, in the interest of administrative and judicial economy, BPA filed a motion requesting that an order be issued (i) preserving in the REP-12 Settlement proceeding the evidence from the WP-07 Supplemental Wholesale Power Rate Case (WP-07 Supplemental proceeding), the WP-10 Wholesale Power Rate Case (WP-10 proceeding), and the 2008 RPSA notice and comment proceeding (2008 RPSA Proceeding) and (ii) preserving in the REP-12 Settlement proceeding certain parts of the parties' arguments, and BPA's responses, from the WP-07 Supplemental Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding.

In response to BPA's motion, the Hearing Officer issued an "Order Incorporating Arguments and Evidence from the WP-07 Supplemental, WP-10, and 2008 RPSA Records into the REP-12 Settlement Proceeding," REP-12-HOO-11. The Order provided:

- (1) By issuance of this Order, all evidence admitted in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding is hereby

preserved, shall be deemed to have been admitted in this proceeding, and is hereby incorporated into the record of this REP-12 Settlement Proceeding. Parties need not present evidence in this REP-12 Settlement Proceeding that was previously admitted into evidence in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding. In addition, by issuance of this Order, all arguments made by a party in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, and the 2008 RPSA Proceeding for the issues identified in Sections 5, 6, and 7 of this Order are hereby preserved, shall be deemed to have been made by that party in this proceeding, and are hereby incorporated into the record of this proceeding. Parties and BPA need not repeat arguments in this REP-12 Settlement Proceeding that were previously submitted in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, or the 2008 RPSA Proceeding for the issues identified in Sections 5, 6, and 7. Duplicates of evidence may be subject to motions to strike pursuant to Section 1010.11(a)(4) of BPA's Rules of Procedure Governing Rate Hearings. This Order does not preclude any party to this proceeding or BPA from adding to or modifying in this proceeding evidence or arguments offered in the WP-07 [Supplemental] Proceeding, the WP-10 Proceeding, or the 2008 RPSA Proceeding, to the extent such evidence or arguments are within the scope of this proceeding.

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(5) The arguments submitted by parties and BPA regarding the decisions made in the following sections of the WP-07[ Supplemental] ROD are hereby deemed to have been made in the REP-12 Settlement Proceeding, except to the extent a party or BPA expressly modifies such arguments in this proceeding:

- (a) Legal Issues Regarding BPA's Response to the Court's Decisions (*e.g.*, Section 2.6);
- (b) Calculation of the Lookback Amounts (*e.g.*, Chapters 3 – 8);
- (c) Lookback Recovery and Return (*e.g.*, Chapter 9);
- (d) Allocation of 7(b)(3) Trigger (*e.g.*, Section 15.2);
- (e) 7(b)(3) – Multiple PF Exchange Rates (*e.g.*, Section 15.3);
- (f) Section 7(b)(2), Section 7(b)(2) Legal Interpretation (WP-07-A-06), and Section 7(b)(2) Implementation Methodology (WP-07-A-07) (*e.g.*, Chapter 16).

(6) The arguments submitted by parties and BPA regarding the decisions made in the following sections of the WP-10 ROD are hereby deemed to have been made in the REP-12 Settlement Proceeding, except to the extent a party or BPA expressly modifies such arguments in this proceeding:

- (a) Section 7(b)(2), Section 7(b)(2) Legal Interpretation, and Section 7(b)(2) Implementation Methodology (*e.g.*, Chapter 10);

- (b) Lookback Recovery and Return (*e.g.*, Chapter 15);
- (c) Allocation of 7(b)(3) Trigger (*e.g.*, Chapter 8).

Order, REP-12-HOO-11.

In their initial briefs, APAC and the IOUs raise a number of 7(b)(2) issues that were previously raised and addressed in BPA's rate proceedings. APAC Br., REP-12-B-AP-01, at 2, 16-18; JP04 Br., REP-12-B-JP04, at 1-2, 24-35. APAC reiterates five of these issues: (1) improper and inconsistent financing assumptions as between the Program and 7(b)(2) Cases; (2) overstated purchase prices for the conservation that BPA has improperly added to the resource stack; (3) augmentation of preference customer (or COU) electric power loads based on conservation resources; (4) faulty calculation of the 7(b)(2) "trigger" protection due to an inappropriate discounting method that biases the 7(b)(2) result against preference customers; and (5) exclusion of Mid-C resources from the stack of resources available to serve 7(b)(2) loads. APAC Br., REP-12-B-AP-01, at 2, 16-18.

The IOUs reiterate the following issues: (1) the costs of any conservation in PF Preference rate customer service areas paid for by BPA should be included in the section 7(b)(2) resource stack; (2) BPA's treatment of conservation is flawed because it fails to recover the costs of conservation in the year that it is selected from the section 7(b)(2)(D) resource stack; (3) secondary energy from BPA's resources should be treated as providing reserve benefits that must be added to the 7(b)(2) Case costs; (4) BPA should continue its longstanding use of its projected borrowing rate for each year to discount projected Program Case rates and 7(b)(2) Case rates in arriving at a section 7(b)(2) trigger amount; and (5) BPA continues to erroneously allocate (i) the 7(c)(2) Delta solely to the preliminary unbifurcated PF rate and the NR rate and (ii) the 7(b)(2) Industrial Adjustment 7(c)(2) Delta solely to the PF Exchange rate. JP04 Br., REP-12-B-JP04, at 1-2, 24-35. The IOUs also note that if the Administrator determines to sign the Settlement, the IOUs' issue of identification and quantification of costs of uncontrollable events for purposes of the 7(b)(2) rate test need not be addressed. *Id.* at 36.

Pursuant to the Standstill Agreement, the parties' positions on these issues are preserved in the REP-12 proceeding.

APAC argues that if the Settlement is not accepted, the Administrator must reconsider each of APAC's reserved 7(b)(2) issues and revise his determinations consistent with the consolidated evidence and argument in this case. APAC Br. Ex., REP-12-R-AP-01, at 15. If the Settlement is not affirmed by the Court, however, rates and any refunds insofar as applicable to the Non-Settling Entities would have to be consistent with the Court's decision. BPA would conduct a section 7(i) hearing to address the proper manner of responding to the Court's decision.

### **11.1.3 New 7(b)(2) Issues**

#### **Issue 11.1.3.1**

*Whether APAC's supplementation of its evidence with additional testimony demonstrates that the discounting method distorts the results of future years and reduces rate protection.*

#### **Parties' Positions**

APAC argues that in addition to preserving its previous arguments with respect to the issue of how a discounting method is used in the calculation of the trigger protection, APAC supplemented its evidence with additional testimony that demonstrates how the use of the discounting method distorts the results of future years and reduces the rate protection properly due to preference customers. APAC Br., REP-12-B-AP-01, at 17. APAC states that in running the 7(b)(2) rate test, the Northwest Power Act requires the comparison of the costs incurred in the Program Case and the 7(b)(2) Case over the rate period plus the following four years. *Id.* APAC claims that BPA Staff agreed that the purpose for making the comparison over the longer period of time is to compensate for any aberrant result in the forecast for any one year. *Id.*, citing Cross-Ex. Tr. at 13, lines 15-25. APAC states that the effect of discounting the costs in future years is to give them "somewhat less weight than rates in the earlier years." *Id.*, citing Cross-Ex. Tr. at 17, lines 15-16. APAC argues that in setting rates for 2012, the goal should be to compare the most accurate forecast of the costs in the Program Case and the 7(b)(2) Case. APAC Br., REP-12-B-AP-01, at 18. APAC claims that BPA and the parties are more assured of the accuracy of the costs for 2012 if they are close to the costs forecast for the next four years. *Id.* APAC argues that with such close and corroborating estimates for the next four years, the effect of discounting is to automatically create unnecessary and deceptive disparity among those forecasts. *Id.*

#### **BPA Staff's Position**

BPA's discounting method does not distort the results of future years or reduce the proper amount of rate protection. Doubleday *et al.*, REP-12-E-BPA-15, at 15. BPA's historical practice of discounting the adjusted Program Case rates and the 7(b)(2) Case rates to the beginning of the rate test period using BPA's borrowing rate was first established in the 1984 Section 7(b)(2) Rate Test Implementation Methodology ROD, b2-84-F-02, at 33. APAC raised this and related issues in the WP-10 rate proceeding. WP-10 ROD, WP-10-A-02, at 168-177. Staff performs the rate test in accordance with the Administrator's determination in the WP-10 ROD. Similarly, APAC's claim that BPA uses an inordinately high interest rate for discounting in the calculation of the section 7(b)(2) rate test trigger was raised by APAC in the WP-10 rate proceeding and was addressed there. WP-10 ROD, WP-10-A-02, at 168-177.

Since the early 1980s, BPA has used the concept of the time value of money to support its practice of using its borrowing rate as a discount rate when calculating the 7(b)(2) rate test trigger. BPA's direct testimony in the 1984 rate proceeding explained why BPA uses its projected borrowing rate for each year to discount projected Program Case rates and 7(b)(2) Case

rates in arriving at a section 7(b)(3) trigger amount. Melton and Armstrong, b2-84-E-BPA-02, at 34-36.

APAC claims that BPA Staff agreed that the purpose for making the rate comparison over the longer period of time is to compensate for any aberrant result in the *forecast for any one year*. APAC Br., REP-12-B-AP-01, at 1, *citing* Cross-Ex. Tr. at 13, lines 15-25 (emphasis added). APAC has mischaracterized BPA Staff's cross-examination testimony. The question asked by APAC counsel describes a situation where the rate differential, presumably the difference between some individual test period year's Program Case and 7(b)(2) Case rates, may be different from the annual differentials for the other rate test period years. This comparison of individual annual differentials is strictly an APAC construct, because BPA does not calculate individual annual rate differentials as part of the 7(b)(2) rate test. *Id.* at 17, lines 17-21. As can be seen from an accurate reading of the testimony cited by APAC, BPA Staff believes the use of the rate period and the ensuing four years is to help stabilize the 7(b)(2) rate test results from rate case to rate case, not within an individual rate case:

Q. Would you agree that the purpose, or one of the purposes, for looking at the following four years is to smooth out or to, I guess, average out the effect of any one year that might be -- have a very different rate differential than the rest of the rate period and the other four years?

A. (Mr. Doubleday) I think using the four ensuing years does tend to make the rate test more steady, if you will, rate period to rate period.

Q. Do you mean that between, for instance, the 7(b)(2) test in the 2010 rate case and the rate test for the 2012 rate case, that the results would be closer?

A. (Mr. Doubleday) Yes. The results would not -- in one -- say, the WP-10, if the WP-10 had an aberrant set of data in one of those years, using the forecasts for all six years would make that result more like the result in 2012.

Cross-Ex. Tr. at 13, lines 15-25.

APAC states that the effect of discounting the costs in future years is to give them "somewhat less weight than rates in the earlier years." APAC Br., REP-12-B-AP-01, at 18, *citing* Cross-Ex. Tr. at 17, lines 15-16. BPA Staff's cited testimony, however, merely verifies that in a financial "time value of money" calculation where the present value of an uneven stream of dollars is to be determined, a dollar earned today has more weight than the prospect of earning a dollar six years from now. In a ratemaking context, with rates as a proxy for dollars, the annual rates are discounted back to the start of the rate test period to get a present value for an uneven stream of rates. Melton and Armstrong, b2-84-E-BPA-02, at 34-36. APAC confuses the concept of "inflation adjustment" with the concept of "the time value of money." Even accepting the assumption of years on end without inflation, the rational person will have a preference for a dollar today rather than a dollar six years from today. APAC calculates a 16 percent difference in rate protection, but this difference is exaggerated, because BPA's borrowing rate includes an inflation component. Presumably, if inflation was forecast to be zero for many years, BPA's borrowing rate would reflect that fact.

Furthermore, APAC's argument is internally inconsistent. APAC argues that APAC states that the effect of discounting the costs in future years is to give them "somewhat less weight than rates in the earlier years." APAC Br., REP-12-B-AP-01, at 17. APAC then argues that in setting rates for 2012, the goal should be to compare the most accurate forecast of the costs in the Program Case and the 7(b)(2) Case. *Id.* at 18. APAC claims that BPA and the parties are more assured of the accuracy of the costs for 2012 if they are close to the costs forecast for the next four years. *Id.* This line of reasoning supports the use of a higher discount rate by giving less weight to years further into the future, the less "accurate" forecasts. Yet APAC illogically argues that the effect of discounting is to automatically create unnecessary and deceptive disparity among those forecasts. *Id.*

BPA should continue to use its borrowing rates as discount rates for the purpose of calculating the 7(b)(2) rate test trigger. Staff performs the rate test in accordance with the Administrator's determination in the WP-10 proceeding. WP-10 ROD, WP-10-A-02, at 168-177.

### **Evaluation of Positions**

The Administrator is making a decision to sign the Settlement. Insofar as one significant goal of the parties entering into the Settlement is to avoid the need for a definitive resolution of the many complex legal issues surrounding BPA's implementation of section 7(b)(2) and to avoid establishing any precedent on these issues, JP02 urges BPA to make no detailed resolution of those issues in its adoption of the Settlement. JP02 Br., REP-12-B-JP02-01, at 5. BPA agrees. By adopting the Settlement, it is not necessary to resolve 7(b)(2) issues. This avoids setting a precedent that could exist for post-settlement implementation of the 7(b)(2) rate test.

### **Decision**

*The issue of whether APAC's supplementation of its evidence with additional testimony demonstrates that the discounting method distorts the results of future years and reduces rate protection is moot because the Settlement resolves this issue. A review of parties' positions and Staff's position leads to the conclusion that it is not necessary to resolve this issue to adopt and execute the Settlement.*

### **Issue 11.1.3.2**

*Whether the RAM should be changed to remove any cost added to the 7(b)(2) Case attributable to the value of DSI reserves.*

### **Parties' Positions**

APAC argues that in addition to the perpetuation of five legacy issues, BPA erred in determining the costs of DSI reserves included in the 7(b)(2) Case. APAC Br., REP-12-B-AP-01, at 18-19. APAC states that the 7(b)(2) rate test allows inclusion in the 7(b)(2) Case of a cost for the value of reserves available from DSI service. *Id.* APAC states the benefit to BPA's ratepayers from

the reserves provided by the DSIs has been measured by BPA in prior cases as the difference between the value to BPA's ratepayers of the reserves provided by the DSIs and the credit paid to the DSIs in their rates for their reserves for the upcoming rate period. *Id.* APAC states that if the DSIs were assumed to have been paid a credit equal to the full value of those reserves, there would be no net benefit to ratepayers to include as a cost in the 7(b)(2) rate test calculation. *Id.* APAC states that the benefit ceases to exist when the full value of the reserves is paid. *Id.* APAC states that BPA has proposed to recover in rates the full cost of DSI reserves. *Id.* APAC argues that based on the comparison of value and contract credit described above, the amount of benefit to the other ratepayers is zero. *Id.* APAC states that the RAM should be corrected to remove any cost added to the 7(b)(2) Case attributable to the value of DSI reserves. *Id.*

### **BPA Staff's Position**

In the 7(b)(2) Case, DSI reserves are an added cost due to their unavailability pursuant to section 7(b)(2)(E) of the Northwest Power Act. In the Program Case, the value of the DSI reserves is treated as a credit to the DSI rate, with the cost of the credit being spread to the Priority Firm Power, Industrial Firm Power, and New Resource Firm Power rates. The WP-07 Supplemental ROD clearly spells out the difference between two issues. WP-07 Supplemental ROD, WP-07-A-05, at 643.

The first issue, addressed under section "b." of the cited page, is the amount of reserve costs applied to the 7(b)(2) Case due to the unavailability of DSI-provided reserves. Such costs are calculated by determining the value per megawatt of reserves and then multiplying that value by the number of megawatts of reserves. That calculation is not affected in any way by the amount of reserve credit applied to the DSI rate in the Program Case. The second issue, the amount of reserve credit applied to the DSI rate in the Program Case, is separately described in section "c." of the cited page.

The crediting of 50 percent of the value of the reserves to the DSIs does not set a precedent for future BPA rate cases. The form of availability credit or other reserve credit mechanism to be applied is not meant to be specified or prejudiced by the assumptions in the legislative history. When costs are equal in the two Cases, there are no quantifiable monetary savings pursuant to section 7(b)(2)(E). In summary, BPA has not considered the difference between the value of the DSI reserves and the credit given to them as constituting the benefit to offset the cost of the REP under the 7(b)(2) rate test.

The value is measured as the difference between the costs in the two Cases of the rate test. If the full cost of the reserves is credited to the DSIs, then there is no benefit to the PF rate as measured by a cost differential between the Program Case cost and the 7(b)(2) Case cost.

APAC confuses the disposition of the benefit due to the availability of DSI reserves in the Program Case with the added cost to the 7(b)(2) Case because those reserves are not available. In the first instance, the value of DSI-provided reserves necessarily reduces the amount of standby generating reserve costs in the Program Case. Early on, the DSI rate in the Program Case was credited with half of this cost savings. The reduced DSI rate revenue left the other half

of the reserve savings to be enjoyed by all other rate classes. The separate issue of the added cost to the 7(b)(2) Case due to the unavailability of DSI-provided reserves is simply the cost of replacing these unavailable reserves. *See* Section 7(b)(2) Rate Test Study, REP-12-E-BPA-02, Attachment 2, 7(b)(2) Implementation Methodology, at 9.

APAC argues that because the DSIs are no longer receiving half-value for the reserves they supply, the 7(b)(2) Case alone should be adjusted. Staff points out that this makes no sense. The value of reserves is measured as the difference between the costs in the two Cases of the rate test. If the full cost of the reserves credited to the DSIs is in the Program Case, and the identical full cost is in the 7(b)(2) Case, then there is no benefit to the PF rate as measured by a cost differential between the Program Case cost and the 7(b)(2) Case cost. Doubleday *et al.*, REP-12-E-BPA-15, at 6. Thus, the rate test is unaffected by the cost of the DSI-supplied reserves. To remove the costs from the 7(b)(2) Case, as APAC argues, is to unbalance the costs in the two Cases and create a situation where the 7(b)(2) Case has no costs of providing reserves. *Id.* at 8.

The Implementation Methodology makes clear that the added reserve costs incurred by public customers in the 7(b)(2) Case are based on the value of the reserves provided by the designated resources or restriction rights in the Program Case. The allocation of the value of the DSI reserve credit in the Program Case does not affect the added cost of reserves in the 7(b)(2) Case. Currently, in the Program Case, BPA is crediting all of the value of DSI-provided reserves to the DSI rate. This in no way affects the added reserve costs in the 7(b)(2) Case. APAC proposes to improperly remove the cost of providing DSI reserves from only the 7(b)(2) Case without a corresponding removal of costs from the Program Case, biasing the results of the 7(b)(2) rate test in a manner contrary to the Implementation Methodology and the Northwest Power Act.

### **Evaluation of Positions**

The Administrator is making a decision to sign the Settlement. Insofar as one significant goal of the parties entering into the Settlement is to avoid the need for a definitive resolution of the many specific, complex legal issues surrounding BPA's implementation of section 7(b)(2) and to avoid establishing precedent on these issues, JP02 urges BPA to make no detailed resolution of those issues in its adoption of the Settlement. JP02 Br., REP-12-B-JP02-01, at 5. BPA agrees. By adopting the Settlement, it is not necessary to resolve 7(b)(2) issues. This avoids setting a precedent that could exist for post-settlement implementation of the 7(b)(2) rate test.

### **Decision**

*The issue of whether the RAM should be changed to remove any cost added to the 7(b)(2) Case attributable to the value of DSI reserves is moot because the Settlement resolves this issue. A review of parties' positions and Staff's position leads to the conclusion that it is not necessary to resolve this issue to adopt and execute the Settlement.*

### **Issue 11.1.3.3**

*Whether BPA properly includes in the 7(b)(2) resource stack a level of conservation resources that supports the Tier 1 CHWM power allocations for the 17-year Regional Dialogue contract term.*

#### **Parties' Positions**

APAC argues that the 7(b)(2) rate test has two errors in the treatment of conservation in addition to those raised before: (1) the preservation of a level of conservation through the 17-year contract period, and (2) the elimination from the resource stack of those conservation programs still achieving load reduction but no longer requiring BPA funding. APAC Br., REP-12-B-AP-01, at 19-21. APAC states that as part of the implementation of tiered rates, BPA Staff assumes the level of conservation that contributed to or “informed” the CHWM of the preference customers in 2010 must be maintained for the entire 17 years of the Regional Dialogue contracts. APAC Br., REP-12-B-AP-01, at 19. APAC states that this locking in of the contribution of a specific resource is contrary to BPA’s treatment of all other resources in the resource stack. *Id.* APAC states that all other resources that satisfy the CHWM in 2010 are allowed to age and their capacity to decrease, or their energy output to vary among rate periods, but the conservation programs existing in 2010 are replenished and replaced. *Id.* APAC states that for all other purposes BPA assumes that conservation programs expire, and in fact BPA Staff admits that certain programs that informed the CHWM would not be in the 7(b)(2) resource stack because they had “expired.” *Id.* APAC states that for this purpose, however, BPA Staff has determined that the conservation programs in 2010 cannot expire and must be preserved. *Id.*

APAC states that to maintain the current level of conservation in Tier 1, BPA Staff establishes five types of conservation, each with different characteristics. APAC Br., REP-12-B-AP-01, at 20. Types D and E are only usable in the 7(b)(2) resource stack because of the assumption that continuation of tiered rates requires maintenance of the conservation that “informs” the FY 2010 CHWM setting. *Id.* For instance, Type E conservation is defined as the conservation used by customers to self-supply their loads above their RHWM. *Id.* APAC claims that such conservation in no way satisfies the Administrator’s load obligation, yet BPA Staff would use that conservation if it is “needed to maintain the level of conservation savings that informed the determination of the customers’ CHWMs.” *Id.*

APAC argues that the effect of this construct is to artificially preserve a level of conservation, which also preserves an artificially high level of load augmentation in the 7(b)(2) rate test. APAC Br., REP-12-B-AP-01, at 21. APAC states that the conservation resources assumed to reduce the Administrator’s load obligation are also included in the 7(b)(2) resource stack. *Id.* APAC states that BPA Staff has increased the cost of those resources by removing from the resource stack any conservation program that BPA is no longer financing. *Id.* APAC states that although a conservation program may be reducing the Administrator’s load obligation, BPA Staff has removed it from the stack if BPA funding is no longer required. *Id.* APAC argues that the effect is to remove from the stack resources having zero cost, thereby raising the cost of the 7(b)(2) Case. *Id.*

## **BPA Staff's Position**

The amount of conservation resources contained in the resource stack supporting Tier 1 power commitments is based on BPA's Section 7(b)(2) Implementation Methodology. The 7(b)(2) Tier 1 loads (CHWM loads) require a level of conservation savings in the resource stack that support the CHWM determinations for the entire 17-year Regional Dialogue contract power delivery period. Doubleday *et al.*, REP-12-E-BPA-15, at 31-32. BPA's FY 2012–2013 rates are calculated with 60,362 GWh of Tier 1 loads and 337 GWh of Tier 2 loads; thus, the majority of BPA-funded conservation savings will be achieved by loads served with Tier 1 power. To support the adoption of tiered rates in performing the 7(b)(2) rate test for FY 2012–2013, Staff proposes a classification of conservation savings that takes into account customer loads that are below the customer's forecast RHW (all of its net requirements will be served at the Tier 1 rate, Type A conservation), and incremental customer load growth that is above the customer's RHW, together with customer elections on how that incremental load growth will be served (Types B–E conservation). The marginal load growth classification system does not address the issue of how much conservation savings should be contained in the resource stack to support the relatively fixed amount of CHWM "base load" service that is served at the Tier 1 rate. Doubleday *et al.*, REP-12-E-BPA-15, at 29.

APAC claims that "to maintain the current level of conservation in Tier 1, BPA established five types of conservation." APAC Br., REP-12-B-AP-01, at 20. This statement is incorrect. Only the first classification, Type A, deals with customer loads that are below utility RHW amounts, where the marginal load growth is still being met with Tier 1 resources. The other four types, B–E, all relate to incremental load growth that is served with BPA's Tier 2 resources (Types B and C), or that is met with the utilities' own respective resources (Types D and E). BPA's conservation program costs are all allocated to the Tier 1 rate pool. The classification of conservation savings using the tiered rates marginal load growth construct (conservation Types A–E), does not provide a level of conservation savings necessary to support Tier 1 power sales over the 17-year period. Doubleday *et al.*, REP-12-E-BPA-15, at 29-31, 35. The Staff proposal appropriately retains a portion of BPA-funded conservation savings associated with marginal load growth types D and E that will be served by the utilities' own resources in the resource stack to serve Tier 1 power sales that are governed by the CHWM and RHW determinations of the respective rate case. Total Type D and E conservation resources totaled 291 aMW, of which 123.7 aMW was included in the resource stack to achieve the 556.8 aMW of conservation needed to support Tier 1 CHWM power sales; the remainder of 167.3 aMW was excluded from the resource stack. The Staff proposal also properly includes the amount of BPA-funded conservation resources associated with incremental Tier 2 load growth power products (conservation Types B and C) in the resource stack (70.7 aMW). The conservation resources for FY 2003–2017 included in the REP-12 final resource stack total 627.5 aMW.

APAC's statement that "BPA has determined that the conservation programs in 2010 cannot expire and must be preserved" is incorrect and misleading. APAC Br., REP-12-B-AP-01, at 20. The Staff proposal properly quantifies the level of conservation resources that reduce the Tier 1 CHWM loads (the general requirements) as 556.8 aMW in the final REP-12 7(b)(2) rate test.

BPA is required to first consider meeting customer load growth in excess of the capabilities of the Federal Base System with conservation resources. 16 U.S.C. § 839d(a)(1). These conservation resources are selected, and their costs included, in the 7(b)(2) Case only if they are the least-cost resources. All generation and conservation resources have finite useful lives. The Staff proposal properly quantifies the years of conservation resources and related savings that have the ability to meet 7(b)(2) loads based on the composite useful lives of conservation resources as determined by the applicable Council Power Plan. APAC's statement that Staff does not let conservation programs expire and that it artificially preserved a level of conservation is incorrect. *Id.* APAC's argument fails to address the fact that the classification of conservation resources based on marginal load growth does not address the amount of BPA-funded conservation resources over the 17-year period that is needed to maintain CHWM determinations. APAC's arguments fail to recognize that the *general requirement loads* BPA is serving through the CHWM determinations are based on the sum of utility net requirements after their own generating resources and BPA-funded conservation resources in their load service area have been netted out, as provided by Northwest Power Act section 5(b)(1) and its following subsections. Staff's approach of quantifying a limited amount of conservation savings in support of the Tier 1 load service commitments is a reasonable approach to this issue that is supported by the principles embodied in the Section 7(b)(2) Implementation Methodology. Doubleday *et al.*, REP-12-E-BPA-15, at 36.

The amount of conservation resources that informed the CHWM determinations is based on the conservation savings associated with the years FY 1996–2010 that total 556.8 aMW in the proposed 7(b)(2) rate test. The years of conservation resources included in the resource stack are based on the composite useful life determinations by the applicable Council Power Plan. APAC is correct in stating that Staff assumes that conservation resources expire because they have a finite useful life and their value declines over time. Staff correctly amortizes capitalized conservation resource costs using the Council's independent composite useful life determinations. The 7(b)(2) Case resource stack composite useful life methodology was used in both the WP-07 Supplemental and WP-10 rate cases. No parties objected to the fundamental accounting principle that capitalized conservation resources have a finite useful life and are recovered ratably over a fixed period of years. Conservation resources that have become fully amortized before the end of the rate test period are considered obsolete resources and are not included in the resource stack. Staff correctly establishes the financing period (loan term in years) that matches the accounting amortization period for the capitalized costs that are based on the Council's composite useful life estimates contained in the respective Council Power Plans. Staff correctly allocates conservation debt service costs over the period of years in which the conservation resource provides benefits to the 7(b)(2) customers.

It is true, as noted by APAC, that Staff increases the cost of those conservation resources by removing from the resource stack any conservation program that BPA is no longer financing. APAC Br., REP-12-B-AP-01, at 21. This statement is misleading, however, because it does not indicate that all conservation resources whose debt obligations have been fully paid off are conservation resources that have become obsolete with the passage of time and are not eligible for inclusion in the resource stack. Doubleday *et al.*, REP-12-E-BPA-15, at 36-39. APAC's

approach of redefining obsolescence for conservation resources would require that the composite useful life determination for conservation resources that has been independently determined by the Council should be replaced by some other criterion. APAC does not offer any workable solutions for the issue it raises. Staff's response to a data request (AP-BPA-13) on the conservation obsolescence assumption is included as Attachment 1 to Doubleday *et al.*, REP-12-E-BPA-15. In the response, Staff states that it is confident in using the Council's composite useful life determination because of the substantial amount of discussion and peer review that surrounds the recommended list of conservation measures that are contained in the Council's Power Plans.

### **Evaluation of Positions**

The Administrator is making a decision to sign the Settlement. Insofar as one significant goal of the parties entering into the Settlement is to avoid the need for a definitive resolution of the many specific, complex legal issues surrounding BPA's implementation of section 7(b)(2) and to avoid establishing precedent on these issues, JP02 urges BPA to make no detailed resolution of those issues in its adoption of the Settlement. JP02 Br., REP-12-B-JP02-01, at 5. BPA agrees. By adopting the Settlement, it is not necessary to resolve 7(b)(2) issues. This avoids setting a precedent that could exist for post-settlement implementation of the 7(b)(2) rate test.

### **Decision**

*The issue of whether BPA properly includes a level of conservation resources that supports the Tier 1 CHWM power allocations for the 17-year Regional Dialogue contract term in the 7(b)(2) resource stack is moot because the Settlement resolves this issue. A review of parties' positions and Staff's position leads to the conclusion that it is not necessary to resolve this issue to adopt and execute the Settlement.*

### **Issue 11.1.3.4**

*Whether BPA has correctly calculated the amount of DSI load in the 7(b)(2) Case.*

### **Parties' Positions**

Alcoa argues that BPA should incorporate 1,197.4 MW of DSI load into its 7(b)(2) Case because it can be reasonably assumed that such amount of DSI load would be served by the COUs in the absence of the Northwest Power Act. Alcoa Br., REP-12-B-AL-02, at 35. Alcoa argues that section 7(b)(2) is intended to ensure that the PF rate will be no higher than it would have been in the absence of the Northwest Power Act. Alcoa Br., REP-12-B-AL-02, at 37. Alcoa argues that had Congress not passed the Act, "within or adjacent to" DSI loads would have exceeded the currently forecast 340 aMW. *Id.* Alcoa states that while it is likely that DSI loads would have been reduced below the 2,781.5 MW amount set out in the Senate Report (S. Rep. No. 96-272, App. B), for a variety of economic reasons BPA's service decisions have artificially depressed DSI load below levels that would have existed had the DSIs been customers of the COUs. *Id.* Alcoa states that BPA has systematically refused to enter into long-term contracts with DSIs

since 2001; has reduced the amount of power available to the DSIs below the levels set out in Appendix B to the Senate Report; and under some circumstances has refused to sell the DSIs physical power, and instead required them to accept “monetary benefit” contracts. *Id.* Alcoa claims BPA’s management of the DSI power supply has forced the DSI facilities to operate at lower, less cost-effective levels, or to purchase more expensive power from non-BPA sources, and as a result, DSI loads are significantly lower than they would have been but for the Act. *Id.* Alcoa’s testimony claims that, but for the Act, at least 1,197.4 MW of DSI load would be currently served by the COUs. *Id.*

### **BPA Staff’s Position**

BPA Staff properly includes an amount of DSI load in the 7(b)(2) Case that is equal to the amount forecast in the Program Case. Doubleday *et al.*, REP-12-E-BPA-15, at 21. In the BP-12 docket, Staff forecasts that the Administrator will serve 340 aMW of DSI load during the FY 2012–2013 rate period. Including this same amount of DSI load in the 7(b)(2) Case is consistent with the statutory direction given on this issue.

Section 7(b)(2)(A) directs that in order for a DSI load to be transferred to public load in the 7(b)(2) Case it must be a DSI load that is currently being “served by the Administrator” in the Program Case. 16 U.S.C. § 839e(b)(2)(A) (emphasis added). The statutory language “which are served by the Administrator” cannot reasonably be construed to mean “which would have been served by the Administrator but for the Northwest Power Act,” which is the interpretation advocated by Alcoa. Section 7(b)(2) does not compare a “with Northwest Power Act” and “without Northwest Power Act” world. Instead, it compares Program Case rates with rates reflecting the five assumptions in section 7(b)(2). Alcoa cites no statutory language to support its proposal. Having determined that all 340 aMW of DSI load is “within or adjacent,” 340 aMW is the appropriate amount that satisfies both sections 7(b)(2)(A)(i) and 7(b)(2)(A)(ii) of the Act. 16 U.S.C. §§ 839e(b)(2)(A)(i), 839e(b)(2)(A)(ii).

### **Evaluation of Positions**

The Administrator is making a decision to sign the Settlement. Insofar as one significant goal of the parties entering into the Settlement is to avoid the need for a definitive resolution of the many specific, complex legal issues surrounding BPA’s implementation of section 7(b)(2) and to avoid establishing precedent on these issues, JP02 urges BPA to make no detailed resolution of those issues in its adoption of the Settlement. JP02 Br., REP-12-B-JP02-01, at 5. BPA agrees. By adopting the Settlement, it is not necessary to resolve 7(b)(2) issues. This avoids setting a precedent that could exist for post-settlement implementation of the 7(b)(2) rate test.

### **Decision**

*The issue of whether BPA has correctly calculated the amount of DSI load in the 7(b)(2) Case is moot because the Settlement resolves this issue. A review of parties’ positions and Staff’s position leads to the conclusion that it is not necessary to resolve this issue to adopt and execute the Settlement.*

## 11.2 Lookback Construct

The “Lookback” is a construct BPA established in response to two decisions issued in May 2007 by the U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit). In *PGE*, the Ninth Circuit held that the 2000 REP Settlements executed by BPA and the IOUs were inconsistent with the Northwest Power Act. In a companion case, *Golden NW*, the Ninth Circuit remanded the WP-02 power rates to BPA on the grounds that BPA improperly allocated the costs of the 2000 REP Settlements, as amended, to BPA’s preference customers. Although the Ninth Circuit’s decision in *Golden NW* addressed only the WP-02 rates, the WP-07 wholesale power rates were implicated by the decisions because they contained the same infirmity identified by the Ninth Circuit. *Evans et al.*, WP-10-E-BPA-19, at 2-3.

To respond to the Ninth Circuit’s decisions, BPA revisited its WP-02 and WP-07 rate case assumptions through a comprehensive “Lookback” construct. As explained fully in the WP-07 Supplemental ROD, the Lookback construct compared the amounts paid under the 2000 REP Settlements for FY 2002–2008 with the amounts BPA would likely have paid qualifying IOUs under the traditional operation of the REP. *Id.* The difference between these two amounts, subject to certain specified rules, is generally referred to as the “Lookback Amount.” *Id.*; *see also* FY 2002–2008 Lookback Study, WP-07-FS-BPA-08, Chapters 13–15. Without a settlement of the REP, the Lookback Amount is to be recovered from the IOUs over time through reductions in future REP benefits and returned to the eligible consumer-owned utilities (COUs), with interest, as credits on their power bills. *Id.*; *see also* WP-07 Supplemental ROD, WP-07-A-05, Chapter 9. *Evans and Forman*, BP-12-E-BPA-09, at 3.

As discussed in the WP-07 Supplemental ROD, the Lookback Amount must be recovered and returned in a manner that balances (1) the need to provide a full and timely remedy to the COUs for the overcharges they incurred with (2) the impact of such recovery on the IOUs’ residential and small farm customers. *See* WP-07 Supplemental ROD, WP-07-A-05, section 9.3.2. Generally speaking, the WP-07 Supplemental ROD established that, in meeting these objectives, without a settlement of the REP BPA would return the Lookback Amount within a reasonable timeframe to the preference customers that incurred the overcharges, while also providing a reasonable level of lawful REP benefits to the residential and small farm consumers of the IOUs. *Id.* More specifically, the WP-07 Supplemental ROD established that these objectives would be met through a goal of returning the Lookback Amount within seven years, provided that the amount of REP benefits for any IOU would not fall below 50 percent. *Id.* at 266. The 50 percent threshold is to be reevaluated in each subsequent rate case. *Id.*

The total amount of overcharges incurred by the COUs for FY 2002–2008 is \$985 million. Lookback Recovery and Return Study, WP-10-FS-BPA-07, Table 1. At this point, as of the end of FY 2011, BPA will have returned \$587 million in refunds to preference customers, including interest.

Under the terms of the Settlement, COUs will receive \$76,537,617 per year from FY 2012 through FY 2019—the Refund Amount. The Refund Amount is functionally equivalent to the Lookback amounts the COUs would have otherwise received absent the Settlement.

The Administrator is making a decision to sign the Settlement. Insofar as one significant goal of the parties entering into the Settlement is to avoid the need for a definitive resolution of the many specific, complex legal issues surrounding BPA’s implementation of section 7(b)(2) and to avoid establishing any precedent on these issues, JP02 urges BPA to make no detailed resolution of those issues in its adoption of the Settlement. JP02 Br., REP-12-B-JP02-01, at 5. BPA agrees. By adopting the Settlement, it is not necessary to resolve Lookback issues. This avoids setting a precedent that could exist for post-settlement implementation of the Lookback. No issues were raised in parties’ briefs.

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## 12.0 PARTICIPANT COMMENTS

This chapter summarizes and evaluates the comments of participants in BPA's Residential Exchange Program Settlement Agreement Proceeding (REP-12). "Participants" are persons and organizations that comment on BPA's rate proposal but do not take part in the formal rate case hearings with the responsibilities of "parties." Parties to the case cannot submit comments as participants because parties can participate through the filing of testimony and briefs. Participant comments are part of the official record of the rate case and are considered when the Administrator makes his final decisions.

On December 16, 2010, BPA published in the Federal Register a Notice of "Proposed Residential Exchange Program Settlement Agreement Proceeding (REP-12) Public Hearing and Opportunities for Public Review and Comment," 75 Fed. Reg. 78694 (2010). This Federal Register notice may be viewed on BPA's Web site: Finance & Rates—Upcoming/Current Rate Cases—REP-12 Proceeding More Information—Federal Register Notice. The Federal Register notice set a deadline for participant comments of March 8, 2011.

Springfield Utility Board, which intervened in this proceeding as a member of a customer group, also submitted a comment as a participant (Comment No. REP100004). As stated in the Federal Register notice, "BPA customers whose rates are subject to this proceeding, or their affiliated customer groups, may not submit participant comments." 75 Fed. Reg. 78698 (2010). Therefore, Springfield Utility Board may not file participant comments, and its comments will not be addressed in this Record of Decision.

BPA received one comment, excluding the comment identified above. A summary of the issues discussed in the participant comment and BPA's responses are provided below.

### **REP100003**

**Comment 1.** Dr. Charles Pace states that as of March 8, 2011, the close of Participant Comment, the proposed REP Settlement is not complete. REP100003 at 1. He further states that if there are changes between the December 2010 draft and the final version of the REP Settlement, then the opportunity for members of the public and other entities "participating in" the REP-12 rate case to comment should be reopened. *Id.* at 2.

**Response.** Dr. Pace is mistaken with regard to the timing and availability of what is substantively the final version of the 2012 REP Settlement. The final version of the Agreement was posted on the BPA REP-12 Web site on March 3, 2011, as document REP-12-E-BPA-11. This version of the Settlement was available to rate case participants and the general public on March 3 for their review, five days before the close of participant comments. In addition, an earlier draft REP Settlement Agreement was available February 25, 2011. Given that the March 3, 2011, final version of the Settlement Agreement was not substantively different from the December 2010 draft with regard to the matters being considered in the REP-12 proceeding and that the final version was available to rate case participants five days prior to the close of

participant comments, BPA concludes that participants, including Dr. Pace, had sufficient opportunity to comment on the proposed REP Settlement under the schedule established in the Federal Register notice.

**Comment 2.** Dr. Pace states that BPA is not in compliance with the procedural safeguards or the substantive requirements of the Northwest Power Act, the National Environmental Policy Act, the Endangered Species Act, and the Magnuson-Stevens Fishery Conservation and Management Act. *Id.* at 2.

**Response.** BPA disagrees. The REP-12 proceeding addresses specifically and at length whether or not the Settlement Agreement is consistent with the Northwest Power Act. The many issues considered and reasoning for the conclusions reached are thoroughly documented elsewhere in this ROD.

**Comment 3.** Dr. Pace expresses a number of opinions and concerns regarding BPA's actions associated with the 2008 Fish Accords and fish and wildlife obligations and costs and refers at some length to portions of the *Golden NW* opinion addressing fish and wildlife costs. *Id.* at 3-6.

**Response.** Comments regarding the Administrator's decisions on cost and spending levels, including fish and wildlife costs and spending levels, are outside the scope of this proceeding. The Federal Register notice states that BPA's spending levels for investments and expenses (including but not limited to fish and wildlife investments and expenses) are not determined or subject to review in the REP-12 proceeding. 75 Fed. Reg. 78697 (2010).

BPA's decision to participate in the 2008 Columbia Basin Fish Accords was reached only after the consideration of many factors, and only after soliciting and analyzing comments from interested persons and organizations. Issues regarding the Fish Accords are outside the scope of the REP-12 proceeding.

**Comment 4.** Dr. Pace expresses a concern regarding BPA acting beyond its authority and suggests complicity by a number of other entities as follows: "no political or judicial presumption of validity or juristic imprimatur may attach to the Administrator's actions—and failures to act—in violation of law, especially if, as I believe here to be the case, they are the "*produit net*" of unbridled discretion that engulfs the region's publicly-owned utilities, investor-owned utilities, direct-service customers and other "non preference" customers, as well as the Northwest Power and Conservation Council, three states and several federally recognized tribes, which have aligned (or realigned) themselves with the agency, our elected representatives, officials at the highest (cabinet) level of the Executive Branch, and, quite possibly, the Federal district and appellate courts, in an ecosystem of corruption, extortion, bribery and fraud that reaches into virtually every aspect of the agency's business." REP100003 at 7-8.

**Response.** BPA respectfully disagrees with Dr. Pace's belief that BPA and the many other entities he cites are engaging in any form of corruption, extortion, bribery, or fraud. Dr. Pace has cited no evidence in support of his assertions.

**Comment 5.** Dr. Pace states that the REP benefits for IOUs proposed in the settlement strike him as excessive. *Id.* at 12. In support of his view, Dr. Pace refers to the REP benefits Net Present Value amount from the Agreement in Principle and calculates an annual amount of REP benefits he asserts would result if there were no tilting of payments. He states that if a lower discount rate is used, then the annual amount would be lower and offers this as evidence that the IOU REP benefits under the Settlement are excessive. *Id.* at 12-15.

**Response.** Dr. Pace’s reasoning and conclusions are not compelling. Parties to the Settlement negotiated a level of IOU REP benefits they believe to be reasonable based upon factors thoroughly evaluated elsewhere in this proceeding. The net present value (NPV) and the discount rate used to calculate the NPV were chosen by the settling parties as a means to ensure consistent communications over the value proposition being agreed to. However, it is not the NPV or the discount rate that is being evaluated in this proceeding, but the schedules of payments of REP benefits (Scheduled Benefits and Refund Amounts). The settling parties agreed to the tilting of payments. BPA has evaluated the level of REP benefits (more specifically the REP Recovery Amounts as that term is used in the REP Settlement) and determined that the REP Settlement provides superior rate protection and thus lower IOU REP costs in PF rates than would be the case under a broad range of litigation and alternative BPA and IOU cost scenarios in the absence of the Settlement. BPA notes that the tilting of REP Settlement benefits provides the added benefit that each year’s REP benefits are consistent with section 5(c) and 7(b)(2), rather than the REP benefits in total through the term of the Settlement. If there were no tilting, the annual compliance might have been more difficult to demonstrate. The record demonstrates that the IOU REP benefits under the Settlement are significantly constrained and not excessive.

**Comment 6.** Dr. Pace states that he does not believe that the Settlement in general is sustainable or in accord with the provisions of the Northwest Power Act. *Id.* at 16-19.

**Response.** Dr. Pace provides extensive text from the proposed REP Settlement Agreement and cites to or makes representations regarding the Northwest Power Act and the Bonneville Project Act, in particular regarding the preference rights of the COUs. *Id.* at 16-22. He does not, however, articulate in any discernable way how he draws his conclusions that the REP Settlement is not sustainable or in accord with the law. Some parties in the REP-12 proceeding, however, have alleged that the Settlement is contrary to law. Each of these arguments has been thoroughly reviewed and addressed in this ROD. The extensive record and analysis in this proceeding supports the proposition that the Settlement is lawful.

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### 13.0 THE NATIONAL ENVIRONMENTAL POLICY ACT

BPA has evaluated the potential for environmental effects from implementation of the 2012 Residential Exchange Program Settlement Agreement, consistent with the National Environmental Policy Act (NEPA), 42 U.S.C. § 4321 *et seq.* As discussed in other parts of this ROD, the primary purpose of the 2012 REP Settlement is to settle matters relating to the payment of benefits and the recovery of costs of IOU participation in the REP for the Settlement period, October 1, 2001, through September 30, 2028. As such, the Settlement is primarily administrative and financial in nature. In addition, no substantial change in consumer or utility behavior that could affect the environment is expected because there would be no resource or transmission development that would result from implementation of the Settlement. Accordingly, the Settlement would not be expected to result in reasonably foreseeable environmental effects.

Furthermore, the Settlement Agreement represents continued provision of REP benefits that were previously considered in BPA's Business Plan Environmental Impact Statement (Business Plan EIS) (DOE/EIS-0183, June 1995). Under the Settlement, long-term RPSAs with IOUs will terminate and be replaced by the Settlement. The REPSIAs that will be executed by the IOUs, described elsewhere in this ROD, are in many ways similar to the current RPSA. The REPSIA retains many elements of the RPSA but also adds a number of new administrative features in order to implement the provisions of the Settlement. Any environmental consequences of the REPSIA thus would not be expected to differ significantly from those already considered in the Business Plan EIS, which addressed the potential resource development and acquisition consequences of different scenarios under the REP. In addition, the essential parts of the Settlement are consistent with BPA's Market-Driven approach adopted in BPA's Business Plan ROD (August 15, 1995) (See Business Plan EIS, Table 2.4.1, on *Determination of Firm Loads* and the Market-Driven Alternative, page 2-36; see also *Delivery of Power Under Residential Exchange Agreements*, Business Plan EIS, page 4-10). The Settlement also incorporates and reflects several of BPA's existing methodologies and rate structures that have already undergone NEPA analysis, including BPA's Average System Cost Methodology, Tiered Rate Methodology, WP-07 ROD and 2010 BPA Rate Case Wholesale Power Rate Final Proposal: Lookback Recovery and Return (WP-10-FS-BPA-07).

The Settlement is primarily an administrative and financial action that largely continues to carry out the REP and accordingly would not be expected to result in reasonably foreseeable environmental effects. In addition, any environmental effects that could result from the Settlement would clearly be within the scope of the environmental analysis contained in BPA's Business Plan EIS, and would be consistent with BPA's Market-Driven approach adopted in its Business Plan ROD, as well as being within the scope of environmental analysis of the referenced associated NEPA documents.

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## 14.0 SETTLEMENT DECISION

### 14.1 Whether the 2012 REP Settlement Is Fair and Just

#### Issue 14.1.1

*Whether the Settlement is fair and just.*

#### Parties' Positions

APAC argues that the standard for reviewing a settlement agreement should be whether the agreement is fundamentally fair or just. APAC Br., REP-12-B-AP-01, at 12; APAC Br. Ex., REP-12-R-AP-01, at 13 n.26. APAC argues that the Settlement is not fair, just, or reasonable for several reasons, including the fact that it provides more benefits to the IOUs than to COUs. *Id.* at 12-13; *id.* at 13.

#### BPA Staff's Position

The standard of review for a settlement agreement is a legal issue upon which Staff took no position. Staff believes the Settlement is eminently fair: Staff's analysis demonstrates that the COUs receive "superior rate protection" from the Settlement and the IOUs gain certainty of REP benefit payments. Evaluation Study, REP-12-E-BPA-01, at 180. Staff also considered whether the Settlement "would resolve, in a fair and equitable manner, all of the outstanding issues with BPA's development and implementation of the Lookback for the FY 2002–2011 period." *Id.*

#### Evaluation of Positions

APAC argues that the standard of review used by courts in examining a settlement agreement is whether the agreement is "fundamentally fair or just," citing *Moore v. City of San Jose*, 615 F.2d 1265, 1271 (9th Cir. 1980) (*Moore*). APAC Br., REP-12-B-AP-01, at 12; APAC Br. Ex., REP-12-R-AP-01, at 13 n.26. APAC also argues that the Settlement is analogous to the settling of a class action, where only part of the affected class was permitted to actively negotiate the settlement agreement. APAC Br., REP-12-B-AP-01, at 12. APAC argues that a court approving a class action settlement must find "that the proposal must be fair, reasonable, and adequate in the way in which it addresses the interests of all those who will be affected by it." *Id.*

APAC applies an incorrect standard of review to the Settlement. BPA's broad authority to enter into settlement agreements consistent with other provisions of law permits the adoption of contested settlements. *See, e.g., APAC*, 126 F.3d at 1170. BPA's settlement authority comes from section 2(f) of the Bonneville Project Act, which provides that "[s]ubject only to the provisions of this chapter, the Administrator is authorized to enter into such contracts, agreements, and arrangements ... and the compromise or final settlement of any claim arising thereunder ... upon such terms and conditions and in such manner as he may deem necessary." 16 U.S.C. § 832a. Section 9(a) of the Northwest Power Act affirms BPA's authority to contract in accordance with section 2(f) of the Bonneville Project Act for purposes of carrying out the Northwest Power Act. 16 U.S.C. § 839f(a). The Ninth Circuit reviews BPA's final decision

under the Act, including the Settlement, using the Administrative Procedure Act's (APA) "arbitrary and capricious" standard. 16 U.S.C. § 839f(e)(2). Under APA review, the Court will uphold BPA's contested REP settlements as long as BPA's adoption of the settlement is supported by substantial evidence on the record as a whole, is not arbitrary and capricious, and is consistent with sections 5(c) and 7(b) of the Northwest Power Act. Differentiating this standard of review from the one suggested by APAC is important in order to distinguish the review of BPA's actions from the "just and reasonable" standard that applies to investor-owned utility ratemaking under the Federal Power Act and Natural Gas Act. The "just and reasonable" standard does not apply to BPA's ratemaking. Thus, APAC's alleged "standard of review" is incorrect. BPA does not say, however, that a court is precluded from reviewing the fairness or reasonableness of a settlement. Indeed, the contrary is true.

APAC argues that the appropriate criteria for reviewing the Settlement are whether it is "fair, just and reasonable," and notes BPA argued that such a standard of review was inapposite, but BPA then argues in the Draft ROD that the Settlement is reasonable. APAC Br. Ex., REP-12-R-AP-01, at 13 n.26. APAC confuses the standard of review of the Settlement with general review of the settlement and conclusions that demonstrate satisfaction of that standard of review. The fact that BPA demonstrates that elements of the Settlement are reasonable does not mean that the standard of review is whether the Settlement is "fair, just, and reasonable." Instead, the fact that an element of the settlement is reasonable demonstrates that such element is not "arbitrary and capricious" and is perfectly consistent with the APA standard of review. Indeed, as noted above, BPA acknowledges that a court may review the fairness and reasonableness of a settlement. Such review is commonplace:

This [Ninth] circuit has long deferred to the private consensual decision of the parties. *See Hanlon*, 150 F.3d at 1027. ... As we have emphasized,

'the court's intrusion upon what is otherwise a private consensual agreement negotiated between the parties to a lawsuit must be limited to the extent necessary to reach a reasoned judgment that the agreement is not the product of fraud or overreaching by, or collusion between, the negotiating parties, and that the settlement, taken as a whole, is fair, reasonable and adequate to all concerned.'

*Id.* (quoting *Officers for Justice*, 688 F.2d at 625).

*Rodriguez v. West Publishing Corp.*, 563 F.3d 948 (9th Cir. 2009).

APAC states that the Draft ROD relies in several places on the size of the COU load signing the Settlement as demonstration of its reasonableness. APAC Br. Ex., REP-12-R-AP-01, at 13, *citing* Draft ROD at 19, 147. APAC argues that popularity of a settlement does not prove its reasonableness. To the contrary, however, the courts have recognized that a district court may consider the reaction of the class members to the proposed settlement as a factor when considering the reasonableness of a settlement:

*Reaction to proposed settlement.* The court had discretion to find a favorable reaction to the settlement among class members given that, of 376,301 putative

class members to whom notice of the settlement had been sent, 52,000 submitted claims forms and only fifty-four submitted objections. *See, e.g.*, Churchill Village, 361 F.3d at 577 (affirming approval of a class action settlement where forty-five objections were received out of 90,000 notices).

*Rodriguez*, 563 F.3d at 967. BPA is not concluding the Settlement is reasonable simply because it is supported so broadly by BPA's customers. Instead, as APAC suggests is proper, BPA has made an objective judgment that the Settlement is lawful and reasonable based on extensive technical and legal analyses, which are contained in the studies, documentation, and testimony included in the record. This judgment is independent of the Settlement's unprecedented broad support.

APAC also argues that the Settlement is not fair because the IOUs receive stable REP benefits for 17 years while the COUs (a) forfeit all rights and protections of the 7(b)(2) rate test; (b) forfeit the right to have rates set for each rate period according to actual costs projected for the rate period (not those projected five or 10 years earlier for the rate period); (c) agree to forgo any further collections of the Lookback Amounts or any deemer balances; (d) relinquish the protections of the *in lieu* and CRAC mechanisms; and (e) give up the likelihood of a more favorable outcome in the pending litigation. APAC Br., REP-12-B-AP-01, at 13; APAC Br. Ex., REP-12-R-AP-01, at 13. APAC presents a one-sided description of the Settlement's benefits to COUs and IOUs.

In brief response to APAC's claims, which are thoroughly addressed earlier, first, the COUs do not forfeit all rights and protections of the 7(b)(2) rate test. As explained at length in the record and in this ROD, Staff conducts extensive analyses (including seventeen 7(b)(2) runs covering each year plus the following four years of the Settlement period), which conclude that the COUs will receive more 7(b)(2) rate protection under the Settlement than in the absence of the Settlement under nearly all litigation scenarios. Evaluation Study, REP-12-E-BPA-01, at 180. Second, the COUs' prospective rates will be set for each rate period according to actual costs projected for the rate period, with the only exception being the REP costs established by the Settlement. Third, the Lookback Amounts are part of a previous construct from BPA's WP-07 Supplemental proceeding, which is replaced by the Settlement, but the Settlement allows the COUs to retain without dispute over half a billion dollars in refunds already received under the Lookback construct, receive an additional \$612 million in guaranteed refunds over the next eight years, and receive even more hundreds of millions of dollars in future rate reductions from the discount in the REP benefits the IOUs would otherwise receive. The elimination of deemer balances is part of the consideration for the IOUs' receipt of REP benefits far below those projected for the Settlement period. Detailed responses to Lookback and deemer issues are addressed elsewhere in this ROD, particularly Chapters 4 and 6.

Fourth, BPA's use of the *in lieu* provisions of Northwest Power Act section 5(c) is discretionary and provides COUs with no certain future benefits, whereas the Settlement provides the ultimate in certainty, fixed REP costs. CRAC mechanisms need not apply to REP benefits because such benefits are fixed for the Settlement term and will not be helped or harmed by decreases or increases in BPA's costs. Detailed responses to *in lieu* and CRAC issues are addressed in

Chapter 4. Fifth, although APAC claims that the COUs would give up the likelihood of a more favorable outcome in the pending litigation, this is an optimistic characterization of the COUs' claims. The COUs would have to prevail over well-documented BPA decisions that are founded on reasonable and longstanding legal interpretations, which would receive a deferential standard of review from the Court. Furthermore, although the COUs have raised numerous arguments on appeal, so have the IOUs. Indeed, certain IOU arguments could eliminate any benefits the COUs previously received under the Lookback and could establish significantly higher prospective REP benefits than those provided by the Settlement. It is the risk of litigation to both sides that is part of the foundation of the Settlement. Finally, although APAC may not think the Settlement is fair, preference customers serving over 88 percent of BPA's public utility load and regional utilities serving 93 percent of total regional load disagree.

### **Decision**

*Although the Settlement is not reviewed under a "fair, just and reasonable" standard of review, the Settlement is fair, just and reasonable.*

#### **14.2 Decision to Adopt and Sign the 2012 REP Settlement**

In the FRN commencing this section 7(i) proceeding, BPA issued the following statement regarding the proposed 2012 REP Settlement:

Although BPA firmly believes that settlement of the existing REP litigation is in the interest of all BPA ratepayers, BPA must ensure that the terms and conditions in the 2012 REP Settlement are reasonable and comply with all relevant statutory provisions before executing the Agreement. BPA is conducting a section 7(i) proceeding to provide a forum in which BPA and other interested parties can evaluate the reasonableness and legal sufficiency of the proposed 2012 REP Settlement.

At the conclusion of the REP-12 proceeding, the Administrator will determine, after reviewing all evidence and arguments contained in the record, whether the terms of the proposed 2012 REP Settlement comport with BPA's statutory duties and authorities. If the Administrator determines that the settlement is consistent with applicable law, and is broadly supported by BPA's customers and other interested parties, he will sign the proposed 2012 REP Settlement and set BPA's FY 2012–2013 rates in accordance with the terms of the 2012 REP Settlement. In such case, the 2012 REP Settlement would replace BPA's current construct of withholding REP benefits due the IOUs and paying Lookback refund credits to eligible COUs as described in the WP-07 Supplemental ROD. In addition, the 2012 REP Settlement would settle the amount of rate protection afforded to COUs for the term of the agreement, obviating the need to continue the litigation over the section 7(b)(2) decisions BPA reached in the WP-07 Supplemental ROD and the WP-10 ROD.

If the Administrator determines the proposed 2012 REP Settlement is not consistent with BPA's statutory duties or is otherwise unreasonable, the

Administrator will not sign the 2012 REP Settlement but will instead continue to set rates, recover Lookback Amounts and issue refunds consistent with his decisions in the WP-07 Supplemental ROD and the WP-10 ROD.

75 Fed. Reg. 78694 (2010).

As BPA and the parties approach the end of this proceeding, BPA must determine whether the terms of the Settlement comport with BPA's statutory duties and authorities. In order to answer that question, BPA Staff prepared and presents a comprehensive analysis of the Settlement that compares the results of the Settlement to Staff's best forecasts of what would occur if there were no settlement. One of the concerns raised in the REP-12 proceeding is the ability to predict future events and outcomes with sufficient certainty so as to make reasoned judgments regarding the efficacy of the Settlement in meeting statutory directives. Notwithstanding concerns about the ability to predict the future, one prediction that no party in this case has taken exception to is that, in the absence of a settlement, a long and bitter battle would be waged in the courts for the next decade or so, most likely involving several campaigns.

At hand is an agreement that the vast majority of combatants in this ongoing battle have presented as an alternative to this unpalatable future. As stated in the Federal Register notice, this has been a forum in which BPA and other interested parties could evaluate the reasonableness and legal sufficiency of the Settlement. Each party has been given an opportunity to be heard on the merits of the Settlement. In what may be the first time in recent proceedings, no party sought to strike any testimony of another party, an amazing accomplishment given the contentious history of the topics examined in this case.

Now the time has come to finalize BPA's judgment regarding the reasonableness and legal sufficiency of the Settlement. For those that have read the many preceding pages of argument and evaluation, it will come as no surprise that BPA has made a decision to sign the Settlement and commit to its terms. This judgment comes after considering many contentious and well-argued issues.

At the beginning of the REP-12 proceeding, Staff proposed five criteria that it used to evaluate the Settlement:

- the Settlement would provide COUs with at least as much rate protection as the rate protection afforded under section 7(b)(2) of the Northwest Power Act;
- the Settlement would provide REP benefits in a manner consistent with section 5(c) of the Northwest Power Act and distribute such REP benefits among the settling IOUs in a manner consistent with BPA's current ASC Methodology and with rates that are consistent with section 7 of the Northwest Power Act;
- the Settlement would resolve, in a fair and equitable manner, all of the outstanding issues with BPA's development and implementation of the Lookback for the FY 2002–2011 period;

- the Settlement would recognize that not all COUs were equally harmed by the costs of the 2000 REP Settlements and that IOUs were differentially affected by BPA’s setting off REP benefits for Lookback Amounts;
- the Settlement would provide reasonable rates for non-settling parties and other classes of BPA’s customers.
- Evaluation Study, REP-12-E-BPA-01, at 179-180. Only one issue was raised with these criteria: whether they adequately include consideration of section 7(c) of the Northwest Power Act. In the Draft ROD, BPA offered assurance to Alcoa by modifying to explicitly mention section 7(c) in the fifth criterion. Draft ROD, REP-12-A-01, at 325.

Alcoa responded to that offer as a “tacit acknowledgement” that BPA failed to consider section 7(c) in its analysis. The record demonstrates otherwise. *See* section 5.9. Consequently, BPA will stand on the record developed in this proceeding and withdraws the explicit modification of the fifth criterion. BPA presents an evaluation of the Settlement that demonstrates satisfaction of the aforementioned criteria. *See generally*, Evaluation Study, REP-12-FS-BPA-01, Chapters 10 and 11. From an analytical perspective, the Settlement is reasonable and consistent with the protections and requirements of the Northwest Power Act. The Settlement also avoids the key concerns expressed over previous REP settlements.

In this ROD, BPA has addressed all of the issues and arguments raised by the parties regarding the Settlement, particularly with respect to its legality relative to sections 5(c), 7(b), and 7(c) of the Northwest Power Act. In addition, the Settlement has been examined in the light of *PGE and Golden NW*, as well other relevant case law.

The analysis of the Settlement performed by Staff has been tested and found sound. It presents a robust and comprehensive view of the future from different perspectives. While some parties have questioned whether more combinations of scenarios should have been performed, or that probabilities should have been assigned to outcomes, the scenarios presented are sufficient for anyone to observe their results, attach their own assessment of probability, and extrapolate to any combination they find interesting. The analysis lays a firm foundation on which to build conclusions.

The Settlement has been measured against section 5(c) of the Northwest Power Act and found to be on solid footing. It has been shown that the Settlement implements the REP in the same manner as BPA currently implements the REP, an implementation that has been challenged on only the question of whether deemer balances are legal. In examining section 5(c), it has been shown that the Settlement retains the purchase of power from the IOUs priced at each utility’s ASC, the sale of power to the IOUs priced at BPA’s PF Exchange rate for each utility, and the exchange of each utility’s qualifying residential load. It has also been shown that section 5(c) gives no direction about the determination of the total level of REP benefits. Section 5(c) concerns only BPA’s exchange with individual utilities.

The Settlement has also been measured against section 7(b) of the Northwest Power Act and found to be on solid footing. It has been shown that the Settlement implements the ratemaking

elements of the REP in the same manner as BPA currently implements the REP, but does so in a manner that addresses the many legal challenges regarding the implementation of sections 7(b)(2) and 7(b)(3). In examining section 7(b)(2), it has been shown that the Settlement retains the development of the PF Exchange rate using the same methodology BPA uses currently, but does so in a manner that does not require BPA to make specific findings on the contested issues. Section 7(b) addresses the determination of the total level of REP benefits through the section 7(b)(2) rate test. Once the total level of REP benefits is established through the limitations invoked by the rate test, the individual utility-specific PF Exchange rates can be determined that establish the amount of REP benefits payable to each REP participant. The Settlement does not alter this current rate methodology. It has been established with significant likelihood that the REP benefits payable under the Settlement will not exceed the REP benefits that would be paid if BPA continued performing the rate test in each rate proceeding through the next 17 years.

The Settlement has also been shown to be of an appropriate and legal duration. It is not an illegal delegation of BPA's statutory authority to other parties, and use of the negotiated results does not violate any statutory requirements. BPA is not relinquishing its ratesetting duties to the settling parties; rather, it finds that many of the parties contesting BPA's prior response to *Golden NW* have agreed to a legally acceptable solution that resolves their controversy for an extended period of time.

It has been shown that the Settlement appropriately reflects the Northwest Power Act's rate directives in the construction of the various BPA rates for sales of power. The allocation of rate protection costs under the Settlement not only does not conflict with section 7(b)(3), but BPA has shown that the allocations embodied in the Settlement are required by section 7(b)(3). In particular, the REP Surcharge has been shown to be a legal surcharge consistent with section 7(b)(3) and is constructed in such a way that it incorporates BPA's prior finding that surplus power sales should be allocated rate protection costs and does so in a manner that establishes no precedent on an issue that is disputed by the COUs and IOUs.

The Settlement has also been measured against section 7(c) of the Northwest Power Act, and it has been found that section 7(c) has little to say about the issues treated by the Settlement. The Settlement does not prescribe how the IP rate will be determined except for the establishment of the REP Surcharge, which is not a section 7(c) issue. The establishment of the IP rate in all other respects is reserved to the appropriate rate proceedings.

The inclusion of Refund Amounts in rates has been shown to be a proper exercise of cost determination and allocation. Whether or not parties agree with BPA that the Refund Amounts are properly included in rates, BPA does not claim that the inclusion of these costs is outside the purview of section 7(b)(2), as was claimed for the costs of the 2000 REP Settlements. In this proceeding, BPA has assumed that the Refund Amounts arise from REP benefits and has tested these amounts against the costs appropriately allowed in rates pursuant to section 7(b)(2).

Some parties have challenged the Settlement through comparisons to the Court's findings in *PGE* and *Golden NW*. BPA has shown that the Settlement does not conflict with the holdings of

the Court in either case. Staff sets forth 18 differences between the 2012 REP Settlement and the 2000 REP Settlements addressed in *PGE* and *Golden NW*. Every issue raised concerning *PGE* and *Golden NW* has been considered and answered; none has been found to hold the Settlement at odds with *PGE* or *Golden NW*. The 18 differences correct every aspect the Court found fault with in the earlier attempt to settle these issues.

The Settlement has been found to address all litigated issues in a manner that renders moot BPA's prior determinations. Under the Settlement, BPA can implement the statutorily mandated REP in a manner that does not upset the sensibilities of utilities serving about 93 percent of the region's retail loads, three state commissions, groups representing various COUs, or the retail ratepayers of the state of Oregon. These litigants are ready to put aside their differences regarding 27 years of the implementation of the REP in a manner that does not violate BPA's organic statutes and provides all of the region's ratepayers more certainty.

This is not a frivolous settlement solely founded on the broad settlement authority granted by Congress to BPA through section 2(f) of the Bonneville Project Act. 16 U.S.C. 832a(f). Rather, it is a regional settlement of particularly difficult issues painstakingly structured to comply with the congressionally imposed limitations on that authority as expressed in sections 5(c) and 7(b) of the Northwest Power Act.

In its brief on exceptions, Alcoa states that “[t]he parties that negotiated the Settlement provided BPA with precisely what it asked for—an agreement that provides far more than BPA ‘acting within the confines of the law, can provide.’” Alcoa Br. Ex., REP-12-R-AL-01, at 4, *citing in part* WP 07 Supplemental ROD, WP-07-A-05, at xx-xxi. To support this assertion, Alcoa selectively quotes from part of the Administrator's statement from the WP-07 Supplemental ROD. In this statement, a portion of which BPA has included in the preface of this ROD as well, the Administrator issued an appeal to the parties to find another lawful alternative to the path of never-ending and contentious litigation over BPA's implementation of the REP. WP-07 Supplemental ROD, WP-07-A-05, at xv. The Administrator noted that many of the issues in dispute focus on section 7(b)(2) of the Northwest Power Act, which he described as “a Byzantine sentence that nearly fills a page and that is, in my view, the most complicated section in the Act.” WP-07 Supplemental ROD, WP-07-A-05, at xv. The Administrator went on to issue his appeal:

This has been a very difficult undertaking, fraught with complexity and with large financial stakes. I believe we have done the best we could do to find a legally sustainable and politically equitable solution (in that order) to the challenge provided by the Ninth Circuit. Nevertheless, I would suggest there remains considerable uncertainty for the parties as to how REP issues may evolve in the future. For that reason I continue to urge the parties to work towards a *lawful settlement* that will provide greater long-term certainty and, because it will be defined by the parties, greater political equity than what any single Administrator, acting within the confines of the law, can provide.

*Id.* at xxi (emphasis added). As can be seen from the full context of the Administrator's original statement, the Administrator asked the parties to work towards a “lawful settlement” of the REP disputes. The Administrator's comment that a lawful settlement negotiated by the parties will

provide “greater political equity than what any single Administrator, acting within the confines of the law, can provide” was a reference to the simple fact that if the parties worked together to achieve a lawful settlement, their negotiated resolution of the issues would be more equitable than BPA’s attempt at giving the parties rough justice through contentious administrative proceedings and continued litigation.

Nevertheless, Alcoa in its brief on exceptions omits the full context of the Administrator’s statement and chooses, instead, to mischaracterize the Administrator’s words into a nonsensical request for the parties to act outside of the law. This contrived misstatement, however, is easily refuted because it ignores the Administrator’s clear request that such settlement be first, and foremost, “lawful.”

The utilities serving 93 percent of the region’s load believe a decade of litigation over the REP is enough if there is a viable legal alternative. The negotiating parties further believe they have found such an alternative in the Settlement, and BPA has conducted this proceeding to see for itself. Throughout this ROD, BPA evaluates many issues raised regarding the Settlement, but none more closely than whether the Settlement’s terms comport with BPA’s statutory authorities, particularly sections 5(c) and 7(b) of the Northwest Power Act. *See* Chapters 4 and 5. Over 60 pages of this ROD address the Settlement’s compliance with section 5(c), while over 100 pages address the Settlement’s compliance with section 7(b) and 7(c). *Id.* As set forth in these and other sections of this ROD, the Settlement complies with BPA’s statutory directives, is consistent with the Court’s decisions in *PGE* and *Golden NW*, and is both reasonable and equitable. In this way, the settling parties have offered to the Administrator precisely what he asked for: a “lawful settlement” of the REP disputes.

BPA finds that the case law described in this document offers much guidance in reaching the decision to sign the Settlement. Particularly, in *Utility Reform Project v. Bonneville Power Admin.*, 869 F.2d 437 (9th Cir. 1989), the Court noted that the settlement considered in that case benefited all participants in the BPA power system by ending protracted and costly litigation. Such is the case with this Settlement. The *Util. Reform Project* Court found that it should not resolve that settlement in a manner that sends the parties back to litigation and that, unless the outcome is indisputably contrary to a clear statutory directive, a settlement agreement should be upheld. A settlement can be upheld without resolving the underlying complex issues, if it is reasonable under “the totality of circumstances” and should be set aside “only for the strongest of reasons.” BPA believes this is the case with the Settlement. The issues in litigation now are much more complex than those considered in *Util. Reform Project*. BPA has shown that this Settlement is reasonable under the totality of circumstances.

In *Association of Public Agency Customers, Inc. v. Bonneville Power Admin.*, 126 F.3d 1158, 1163 (9th Cir. 1997), the Court found that the Administrator must make a reasoned business decision and be given authority to act in response to unforeseen eventualities. Such has been demonstrated here. Given the opportunity to consider a settlement that has a broad regional consensus, BPA believes that the reasoned decisions set forth in this ROD compel adoption of the Settlement and its application to all of BPA’s customers. While some have suggested that those that wish to litigate all substantive issues should have their day in court, BPA finds that this

is not the wisest course for the region. None of the litigating parties is willing to let the few that are not satisfied with the Settlement go to court alone. Each party would need to argue each and every issue in order to protect its interests. This debilitating future is exactly what the settling parties are trying to avoid. If the opposing few were allowed to litigate every issue, the Settlement would not save the settling parties, and the Court, the time and expense of such litigation. Thus, the full value of this Settlement is gained only if all of BPA's rates are established consistent with the Settlement. BPA has shown that setting rates in this manner does not violate any statutory ratemaking directive.

In reaching the decision to adopt the Settlement, BPA hearkens to *State of West Virginia v. Pfizer & Co.*, 440 F.2d 1079, 1086 (2d Cir. 1971), which concluded that the “court need not and should not reach any dispositive conclusions on the admittedly unsettled legal issues which the case raises, yet at the same time . . . attempt to arrive at some evaluation of the points of law on which the settlement is based” to determine if objectors had shown “that the rules of law for which [they are] contending are so clearly correct that it was an abuse of discretion for the district court to approve the settlement.” In other cases, the courts have reiterated that they should not reach any ultimate conclusion on underlying issues of fact and law, and noted that deference to a proposed settlement is especially appropriate “where ‘a government agency committed to the protection of the public interest’ has participated in and endorsed the settlement.” *City of New York v. Exxon Corp.*, 697 F. Supp. 677, 692 (S.D.N.Y. 1988). BPA takes the protection of regional interests seriously and believes that such interests have been appropriately considered in its decision to adopt the Settlement.

Finally, the ability to settle claims without resorting to litigation or full-throated regulatory proceedings is certainly an important aspect for making BPA a more efficient agency. *PGE*, 501 F.3d 1009, 1030 (9th Cir. 2007). Regulatory claims are rarely capable of a sum-certain determination and an either/or assessment of the likelihood of success on the merits. *Id.* BPA believes that this Settlement meets the standard set forth in *PGE* that a settlement must “protect the position of [BPA's] preference customers.” *Id.*

Specifically, BPA concludes that:

- (i) BPA will enter into the 2012 REP Settlement Agreement and, pursuant to this Agreement, pay to the IOUs as REP Settlement Benefits for each Fiscal Year in the entire Payment Period the Scheduled Amounts set forth in Table 3.1 of the Settlement;
- (ii) BPA will include in the COU Parties' PF Rates for the entire Payment Period a portion of the REP Recovery Amount equal to (i) the COU Parties' Allocated Share plus (ii) the COU Parties' Refund Share, both as determined in accordance with section 3.3.5 of the Settlement; and
- (iii) BPA may lawfully set rates and establish refund amounts applicable to non-settling entities consistent with the provisions of sections 3.2 through 3.5 of the Settlement, as applicable, and will do so for the entire Payment Period, as that term is defined in the Settlement.

Based on the foregoing review in this ROD, BPA's decision is for the Administrator to sign the 2012 REP Settlement and commit BPA to abide by its terms for FY 2012–2028.

### **14.3     Execution of 2012 REP Settlement as a Final Action**

For purposes of subjecting BPA's decisions in this proceeding to judicial review, the execution of the 2012 REP Settlement by the Administrator shall be considered a "final action" under the Northwest Power Act. 16 U.S.C. § 839f(e).

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## 15.0 CONCLUSION

The 2012 REP Settlement adopted in this ROD is designed to settle longstanding disputes and litigation regarding BPA's implementation of the Residential Exchange Program. As set forth above, the Settlement is grounded in and resembles the REP authorized by section 5(c) of the Northwest Power Act, and properly protects the position of BPA's preference customers consistent with sections 5(c) and 7(b) of the Act. The Settlement also complies with all other requirements of the Northwest Power Act and other provisions of law.

BPA evaluated this proposed Settlement in an evidentiary proceeding conducted pursuant to section 7(i) of the Northwest Power Act. The Hearing Officer has assured me that all interested parties and participants were afforded the opportunity for a full and fair evidentiary hearing, as required by law.

BPA also evaluated the potential environmental impacts of the proposed rate methodology and alternatives thereto, as required by NEPA. In this instance, the environmental analysis provided by the Business Plan Final EIS details the environmental impacts of the Settlement. 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 2012 REP Settlement attached hereto (REP-12-A 03) and commit the Bonneville Power Administration to abide by its terms.

Issued at Portland, Oregon, this 26th day of July, 2011.

/s/ Stephen J. Wright  
Stephen J. Wright  
Administrator and Chief Executive Officer

BONNEVILLE POWER ADMINISTRATION

DOE/BP-4306 July 2011