

PRELIMINARY COMMENTS OF THE WESTERN PUBLIC AGENCIES GROUP

ON THE

PROPOSED AVERAGE SYSTEM COST METHODOLOGY

1. Introduction

The following preliminary comments are submitted in response to the request for comments from the Bonneville Power Administration (“BPA”) on behalf of the preference customers that comprise the Western Public Agencies Group (“WPAG”) on the proposed Average System Cost Methodology (“Proposed ASCM”). These preliminary comments set out the issues that have been identified to date that the WPAG utilities expect to discuss and comments upon during the Average System Cost Methodology Consultation. The WPAG utilities reserve the right to provide comments on these and other issues as information becomes available throughout the process.

2. Preliminary Issues

Issue – Submission of Cost of Service Analysis

The Proposed ASCM requires a preference customer participating in the residential exchange to submit a detailed cost of service analysis prepared by a consultant or accounting firm, approved by the governing board and used to set retail rates.

Position and Support Statement

There should be no requirement that the cost of service analysis provided by preference customers be prepared by an accounting firm or consultant.

There is no objection to providing BPA with the cost of service study used to set retail rates, or to the requirement that such cost of service study be approved by the governing body. However, there is no reason to require that a consultant or accounting firm prepare such document. This imposes an additional, unnecessary expense on the participating utility, and adds nothing to the accuracy or veracity of the cost of service study. Since no comparable requirement is imposed on the documentation provided by participating investor owned utilities (“IOUs”), it is unfair and unnecessary to impose such a requirement on preference customers.

Issue – Notice of Retail Rate Change

The Proposed ASCM would require preference customers to give BPA six months prior notice of any expected retail rate change.

Position and Support Statement

Preference customers participating in the residential exchange should be required to provide a minimum of 60 days prior notice to a retail rate change.

Changes to preference customer retail rates are driven by increases to BPA's Priority Firm wholesale rate. It is not unusual for a preference customer not to know until shortly before the end of the BPA wholesale power rate cases whether they will need to increase their retail rates to accommodate the cost increase they will see from BPA. As a result, it is on many occasions impractical or impossible to give as much notice as the Proposed ASCM would require.

Further, there is no substantial reason why such a long notice period has been proposed. Since BPA will receive the cost of service study used to set the rates, and will have an absolute right to participate in the rate process, a shorter and more realistic notice period is warranted.

Issue – Treatment of Transmission Investments and Related Expenses

The Proposed ASCM would permit the inclusion of transmission plant and related expenses in the ASC calculation.

Position and Support Statement

The current ASCM permits the inclusion of transmission investment necessary for generation integration and investments made prior to 1984. That approach should be retained in the revised ASCM.

Transmission that is used for generation integration is clearly a resource related cost. However, other transmission serves multiple purposes, most of which are not generation resource related. As a consequence, including all transmission in the ASC calculation will result in preference customers subsidizing costs that are not strictly resource related. This is contrary to the underlying purpose of the residential exchange.

Issue – Return on Equity

The Proposed ASCM would permit the inclusion of return on equity, and would use the most recent retail rate order to determine the return on equity to be included.

Position and Support Statement

Return on equity used in the ASC calculation should be derived from the relevant FERC Form 1.

The return on equity has been one of the areas where BPA has found prohibited costs included in the ASC under the jurisdictional approach. The proposed use of the retail rate orders to determine the return on equity used in the ASC calculation reintroduces this problem into the

Proposed ASCM. This will require BPA to police this aspect of IOU retail ratemaking, with the attendant increase in BPA's administrative burden.

Since all other aspects of the Proposed ASCM rely on the FERC Form 1 as the data source, it is recommended that the allowable rate of return be computed based on the actual performance of the utility as reflected in the FERC Form 1. This will ensure that BPA's preference customers, who will pay the costs of this program, will only be required to pay a level of return on equity actually earned by the exchanging utility.

Issue – Gross Up of Return for Income Taxes

The Proposed ASCM would authorize the gross up of return on equity using the marginal income tax rate of the exchanging utility.

Position and Support Statement

Return on equity should be grossed up using the actual income tax rate as reflected in the relevant FERC Form 1.

IOUs do not routinely pay their marginal income tax rate, due to a variety of considerations. Actual taxes paid are usually substantially lower than taxes accrued, or computed on the marginal income tax rate. Permitting the return on equity to be grossed up based on the marginal income tax rate results in costs being included in the ASC calculation that are not actually paid by the exchanging utility. This is contrary to the intent of the residential exchange, and unfairly increases the costs of the residential exchange borne by preference customers.

The income taxes actually paid by an IOU are reflected in the FERC Form 1. There is no need to depart from the use of FERC Form 1 information for purposes of determining the appropriate income tax rate for use in the ASC filing. The income tax rate actually paid, as reflected in the appropriate FERC Form 1 should be used to gross up the return on equity.

Issue – Exclusion of Resource Costs Based on BPA Power Contract Type

The Proposed ASCM reserves to BPA the right to modify the ASCM to accommodate the Tiered Rates Methodology finally adopted, including the ability to exclude from the ASC calculation of preference customers who sign High Water Mark ("HWM") power contracts resource costs that would otherwise be includable in their ASC.

Position and Support Statement

The vintage of resource costs that can be included in the ASC calculation should not be based on the type of power sales contract the preference customer has with BPA.

There is no objection to BPA retaining the right to make changes to the ASCM. However, modifications to the ASCM must be done in a manner that is consistent with other provisions of

the Regional Act. Preference customers cannot be forced to forego one statutory right in order to exercise another. In short, there is no statutory basis for excluding a certain vintage of otherwise exchangeable resource costs based on the type of power sales contract a preference customer has with BPA.