

**Lee, Carie - PGPL-5**

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**From:** Palmer, Katie L - PS-6 on behalf of Hairston, John L - PS-6  
**Sent:** Wednesday, July 02, 2003 9:59 AM  
**To:** Lee, Carie - PGPL-5  
**Subject:** FW: NRU Letter on KPMG Audit

FYI

-----Original Message-----

**From:** Geoff Carr [mailto:ghcarr@pacifier.com]  
**Sent:** Wednesday, July 02, 2003 8:18 AM  
**To:** jlhairston@bpa.gov  
**Subject:** FW: NRU Letter on KPMG Audit

Could you send our letter to Carie Lee so that she will understand our perspective on this?

Geoff Carr  
Northwest Requirements Utilities  
phone: (503) 233-5823  
cell: (503) 819-6173  
email: [ghcarr@pacifier.com](mailto:ghcarr@pacifier.com)

-----Original Message-----

**From:** Geoff Carr [mailto:ghcarr@pacifier.com]  
**Sent:** Thursday, June 26, 2003 4:36 PM  
**To:** 'jlhairston@BPA.gov'; 'tdmiller@bpa.gov'  
**Cc:** jsaven@pacifier.com ; susan.k.ackerman@attbi.com  
**Subject:** NRU Letter on KPMG Audit

Attached is NRU's letter to BPA on the KPMG Slice True-up audit.

We are only sending it along to you at this point given the confidentiality sensitivity surrounding this document. We felt it important that you know our views about this audit before you meeting with the Slice customers next Monday.

Please give us a call to discuss wider distribuion of this letter.

Geoff Carr  
Northwest Requirements Utilities  
phone: (503) 233-5823  
cell: (503) 819-6173  
email: [ghcarr@pacifier.com](mailto:ghcarr@pacifier.com)

12/12/2003

June 26, 2003

John Hairston  
Bonneville Power Administration  
P.O. Box 3621  
Portland, OR 97232

Dear John,

We have had the opportunity to review the KPMG Audit of the Slice True-up for 2002 and would like to let you know our deep concerns about its findings. At the outset you need to be aware that our association, Northwest Requirements Utilities, represents 45 of BPA's full requirements PF customers, many of whom are now facing power rates that are nearly 50% higher than they were in 2001. Our projection of the KPMG audit is that if BPA were to agree with its findings, the 15% SN CRAC we are now faced with in 2004 would grow to 25%, as Slice-related costs are shifted to BPA's other customers.

Generally, the KPMG Audit appears incorrect, unfounded and beyond the scope of the audit permitted by the Slice Contract. Most important, the scope of any audit is limited by the Slice Contract as follows: "BPA's methods for allocation of overheads and indirect costs accounting policies or procedures, **management decisions, activities, or authorities** or any decisions related to the operation of the FCRPS shall not be included in any audit and shall not be subject to dispute pursuant to section 14." (Slice Contract page 28 and 29, emphasis added) KPMG did not mention this aspect of the Slice Contract when it recited its understanding of the permissible scope of their audit. They neglected to quote the above fundamental "carve out".

NRU's preliminary analysis of the KPMG audit results in disagreements in these key areas:

1. KPMG states that BPA should not have included accelerated amortization payments of \$242 million in the Slice Revenue Requirement related to the ENW Debt Optimization Program (DOP) on the basis that these are not "necessary" payments. However, in our view, the DOP is the type of management decision that is left to BPA under the terms of the Slice Contract. It was a **necessary** result of this decision that Slice customers should also bear their share of DOP costs in the Slice Revenue Requirement.
2. In January 2001, BPA stopped selling power to the California ISO and PX due to the lack of payments for receivables. In contract year 2002, BPA booked an allowance of \$24 million for these bad debts. KPMG states that BPA should not have included \$24 million in allowances for uncollected receivables in the actual Slice revenue requirement. NRU disagrees with KPMG's reasoning. Prior to October 1, 2001 there were no Slice customers. If they had stayed PF customers, today's Slice customers would have enjoyed the benefits of BPA's transactions with California. Just because these utilities became Slice customers on October

1 of 2001 does not mean they should be exempt from costs that were assumed for their benefit, and BPA's other customers, before they became Slice customers. Also, NRU believes that this recommendation is beyond the permissible scope of the Audit since the decision to book an allowance for uncollected receivables was a management decision within the Administrator's discretion.

3. KPMG states that BPA should not have included the \$29 million allowances for uncollected DSI receivables in the Actual Slice Revenue Requirement because this is a new cost item that does not meet the test for inclusion in the Actual Slice Revenue Requirement. NRU disagrees and believes that this new cost meets the test of 4(b)(5)(A) because it benefits neither Slice nor non-Slice customers. KPMG seems to believe that if a cost benefited *any* customer other than a non-Slice customer, then it must be excluded. In our opinion, this is a strained interpretation. NRU's members are PF customers of BPA, and this cost was not incurred to provide a service or benefit to our members any more than it was incurred to provide service to Slice customers. A more reasonable interpretation is that uncollectibles are a cost to PBL of doing business, and they benefit no customer in particular. The fact that an individual DSI customer may benefit does not alter our reasoning here, since BPA is undoubtedly continuing to pursue collection.
4. KPMG found that BPA has included \$263,000 in Slice Implementation costs above the rate specified in the contract of \$80,000 times the number of additional PBL Staff positions required to implement the Slice product. KPMG states that because these costs are above the cap and they only benefit Slice customers they should be recovered from the rest of BPA's customers. From our perspective this reading of the contract is absurd and will lead to cost shifts, which BPA was determined to avoid in the development of the Slice product.

We appreciate your attention to our review of these key issues in the KPMG audit. Please note that just because we have not mentioned additional areas of concern with the KPMG audit does not mean that we agree with their findings. We have a number of additional comments about the KPMG audit which we would be happy to share with you as soon as possible.

Thank you for your attention to this matter.

Sincerely,

*(signed by)*

Geoffrey H. Carr  
Assistant Director  
Northwest Requirements Utilities

**Hairston, John L - PS-6**

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**From:** Geoff Carr [ghcarr@pacifier.com]  
**Sent:** Thursday, August 14, 2003 8:31 AM  
**To:** jlhairston@bpa.gov  
**Subject:** FW: NRU Letter on KPMG Audit

FYI

Geoff Carr

Northwest Requirements Utilities

Phone: (503) 233 5823

E Mail: ghcarr@pacifier.com

-----Original Message-----

**From:** Geoff Carr [mailto:ghcarr@pacifier.com]  
**Sent:** Thursday, August 14, 2003 8:14 AM  
**To:** 'Ladavidson@BPA.gov'  
**Cc:** susan.k.ackerman@attbi.com ; jsaven@pacifier.com  
**Subject:** NRU Letter on KPMG Audit

Larry,

After talking with John Hairston I decided to send you the attached NRU letter concerning the KPMG audit of the Slice True up. NRU represents BPA's full requirements customers. As such we are very concerned about the implications of KPMG's findings for our members. Please review this letter and note that we have not distributed this and request that you do not do so either given the sensitive nature of the confidentiality agreement within the audit.

We would like to meet with you about this when you have an hour or so. Please give me a call so we can schedule a time.

Geoff Carr

Northwest Requirements Utilities

Phone: (503) 233 5823

12/12/2003

**Hairston, John L - PS-6**

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**From:** Loffink, Jennifer - KFR-2  
**Sent:** Monday, September 08, 2003 8:43 AM  
**To:** Hairston, John L - PS-6; Lee, Carie - PGPL-5  
**Cc:** Miller, Thomas D - LP-7; Davidson, Larry - KFR-2  
**Subject:** RE: BPA Letter on KPMG Audit

John,

If you remember, we had an early redacted version, but it went on CCIS and everyone wanted to take it off. Since then, Tom had additional items he wanted redacted. I was under the impression that someone in your group was going to take Tom's version and do the redaction up there and then put it in a .pdf and send it to Geoff Carr. So I wasn't worrying about it any more.

Here's the latest version I had from Tom (see attached) with lines through the parts he wanted redacted (from his 8/25 e-mail). I didn't know if he ever got comments back from anyone but me on it.

Thanks,

*Jennifer Loffink*

-----Original Message-----

**From:** Hairston, John L - PS-6  
**Sent:** Monday, September 08, 2003 7:44 AM  
**To:** Loffink, Jennifer - KFR-2; Lee, Carie - PGPL-5  
**Cc:** Miller, Thomas D - LP-7; Davidson, Larry - KFR-2  
**Subject:** FW: BPA Letter on KPMG Audit

Jennifer,

Where were we on the redacted version. I'd like to get Geoff Carr a version per his request below.

Thanks

John

-----Original Message-----

**From:** Geoff Carr [mailto:ghcarr@pacifier.com]  
**Sent:** Thursday, September 04, 2003 3:30 PM  
**To:** 'Hairston, John L - PS-6'  
**Subject:** RE: BPA Letter on KPMG Audit

How is that "redacted" letter coming?

Geoff Carr

Northwest Requirements Utilities

Phone: (503) 233 5823

12/12/2003

E Mail: [ghcarr@pacifier.com](mailto:ghcarr@pacifier.com)

-----Original Message-----

**From:** Hairston, John L - PS-6 [mailto:[jlhairston@bpa.gov](mailto:jlhairston@bpa.gov)]  
**Sent:** Friday, August 22, 2003 10:38 AM  
**To:** 'Geoff Carr'  
**Subject:** RE: BPA Letter on KPMG Audit

Geoff,

We're in the process of preparing a redacted version that won't put us at risk of breaching our confidentiality agreements. Once that is completed, I believe I can make it available electronically, but will need to verify.

Thanks  
John Hairston

Slice Product Manager  
905 N.E. 11th Ave.  
Portland OR 97232  
Office (503) 230-5262  
Fax (503) 230-7333  
Cell (503) 819-6897  
[jlhairston@bpa.gov](mailto:jlhairston@bpa.gov)

-----Original Message-----

**From:** Geoff Carr [mailto:[ghcarr@pacifier.com](mailto:ghcarr@pacifier.com)]  
**Sent:** Friday, August 22, 2003 10:06 AM  
**To:** [jlhairston@bpa.gov](mailto:jlhairston@bpa.gov)  
**Subject:** BPA Letter on KPMG Audit

John,

Can you send me the BPA Report on the KPMG Slice Audit by e mail?

Geoff Carr

Northwest Requirements Utilities

Phone: (503) 233 5823

E Mail: [ghcarr@pacifier.com](mailto:ghcarr@pacifier.com)

2003 10 09/011

**Block and Slice Power Sales Agreement**  
**Independent Audit By Slice Purchasers Pursuant to 4(b)(6)(D) of the Slice**  
**Agreement**

**Bonneville Power Administration Response to the Final Report**

**August 18, 2003**

Redacted version: The Slice purchasers' final audit report was provided to BPA under a confidentiality agreement with the firm of KPMG. In this version, BPA has blacked out direct quotations from the Slice purchasers' final audit report and provides a general description of each audit issue.

**Introduction**

On January 9, 2003, BPA provided the Slice customers an accounting of the following cost items under the PF Slice Rate for Contract Year (CY) 2002: (i) the Actual Slice Revenue Requirement; (ii) the Slice Implementation Costs; (iii) the Total Individual Charges and (iv) the Annual True-Up for Actual Costs. In accordance with section 4(b)(6)(D)(iii)(I) of the Block and Slice Power Sales Agreement (Block/Slice PSA), the Slice customers decided to exercise their right to conduct an independent audit of the Actual Slice Revenue Requirement and the True-Up Adjustment Charge. The Slice customers retained the firm of KPMG LLP (KPMG) to conduct an independent audit and BPA received a final report of an "Independent Audit by Slice Purchasers pursuant to 4(b)(6)(D) of the Slice Agreement" (Slice Customers Final Audit Report) on June 13, 2003. This Response is BPA's final determination of cost adjustments to the Slice Revenue Requirement and the CY 2002 True-Up Adjustment Charges associated with implementation of the PF Slice Rate.

**Background**

Slice is a requirements power product that sells a fixed percentage of the energy generated by the Federal Columbia River Power System (FCRPS) to the public preference customers based on their annual net requirement loads. The Slice product differs from traditional requirements products in that the power sold through Slice is shaped to BPA's generation output of the FCRPS rather than to the purchaser's load. The customer is responsible for reshaping the power for load service. Because the Slice sale is a percentage of the generation output of the FCRPS, the actual deliveries of power will vary month by month and annually. During certain parts of the year and under certain water conditions, power deliveries will exceed the purchaser's net firm requirements. As a consequence, the Slice product combines both the sale of requirements and surplus power.

Rather than paying a rate which sets a price on a per megawatt (MW) and megawatt hour (MWh) basis, Slice purchasers assume the obligation to pay a percentage of BPA's costs of service, proportional to the percentage of the FCRPS that the Slice purchaser elected to purchase. The costs for the Slice product are referred to collectively as the Slice Revenue Requirement. The Slice Revenue Requirement is set out in the Slice Product Costing and True-up Table (Table). This Table is the basis for the Slice Rate and is incorporated into the General Rate Schedule Provisions (GRSPs) in Table D. 2002 GRSPs at 132 and 133.

BPA made fundamental decisions on the Slice product design in the Subscription Strategy and the Power Subscription Strategy Record of Decision (Subscription ROD) of December 21, 1998. Detailed aspects of the Slice product were developed in further public discussions and in collaboration with prospective Slice purchasers over the following months. The Slice product was fully developed and, following public input, documented in a detailed product description that was published on October 8, 1999. The detailed Slice product was included in BPA's section 7(i) rate proposal for its post 2001 rates in the May 2000 Power Rate Case and the 2002 Supplemental Power Rate Case in order to address the rate design aspects of the Slice product. The Slice Rate, the Slice Revenue Requirement, and the Slice True-Up Adjustment Charge were developed and documented as part of the Priority Firm Power (PF) rate as adopted by the Administrator in the 2000 Final Power Rate Proposal Administrator's Record of Decision (May 2000 ROD), WP-02-A-02, Part 3 of 3. In addition, the Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge (Slice Methodology) was included as part of the Administrator's decision on the Slice product's rate design in the May 2000 ROD, WP-02-A-02, Attachment, at A-1. The Slice Methodology is designed as a means for providing a consistent method of calculating the PF rate for the Slice product and conducting the annual true-up for 10 years of the Block/Slice PSA. Because there is some uncertainty regarding the calculation of the PF Slice Rate in a rate period subsequent to the CY 2002 - 2006 rate period, the Slice Methodology was intended to bring some certainty to the calculation of that rate. The Slice Methodology is not intended to predetermine the actual PF rate a Slice purchaser will pay in any specific rate period; rather the Slice Methodology lays out a set of cost categories and their subcategories that will be included in the Slice Revenue Requirement. It also addresses the manner in which such costs may be true'd up annually to actual costs (Slice True-Up Adjustment Charge). *Id.* On July 21, 2003, the Federal Energy Regulatory Commission (FERC) granted final approval of the Slice Rate for the CY 2002 - 2006 rate period, and for the Slice Methodology for the 10-year period term of the Block/Slice PSA.

Subsequent to the May 2000 ROD, BPA filed a Supplemental Power Rate Proposal in February 2001. The 2002 Supplemental Power Rate Proposal proposed and implemented cost recovery methods through the Cost Recovery Adjustment Clauses (CRACs). These CRACs assure sufficient cost recovery for the additional loads placed on BPA during escalating, volatile western power markets. The 2002 Supplemental Power Rate Proposal made some corresponding modifications to the Slice Methodology. The 2002 Supplemental Record of Decision (2002 Supplemental ROD), WP-02-A-09, contains the revised Slice Methodology, which is consistent with a CRAC that affects the Slice Rate, the Load Based Cost Recovery Adjustment Clause (LB CRAC), 2002 Supplemental ROD, WP-02-A-09, Attachment, at 8-A-1 - 8-A-6.

An underlying principle of the Slice product design and included in the rate design proposal was no cost shifts either to or from the Slice purchasers. Wholesale Power Rate Development Study, WP-02-E-BPA-05, at 160. The Slice product and Slice Methodology are designed so that the overall financial impact would be revenue-neutral for all parties. *Id.* In adherence to this principle of no cost shifts either to or from the Slice purchasers, BPA established the Slice Revenue Requirement in its May 2000 Power Rate Proposal for the CY 2002 - 2006 rate period. The Slice Revenue Requirement will not be adjusted until the next general BPA power rate case(s) for the CY 2007 - 2011 period. The Slice product, by its rate design, is attributed with all the same costs for its revenue requirement as other Subscription products, with specific

exceptions that are described below under Allowable Costs. The Slice Rate is based on the Slice Revenue Requirement and is “trued-up” annually for the difference between the forecasted Slice Revenue Requirement, which is the basis for the Slice Rate, and the actual expenses (and credits) of the Slice Revenue Requirement. This True-Up Adjustment Charge is applied to the Slice product. BPA issued bills containing the Contract Year 2002 annual True-Up Adjustment Charge for the Slice Revenue Requirement to the Slice purchasers beginning in February 2003, and that True-Up is the subject of an audit conducted by KPMG for the Slice purchasers, as described below.

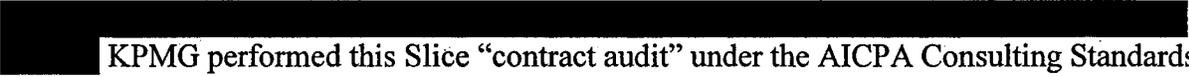
Customers who purchase the Slice product executed their power purchase contracts with BPA on or about October 1, 2001. Section 18 of the Block/Slice PSA specifies that the Block/Slice PSA shall be consistent with the language contained in the Methodology to Calculate Slice Rate and the Slice True-Up Adjustment Charge and the Administrator’s Final Record of Decision for BPA’s 2002 Wholesale Power Rates as approved by FERC. The provision states that the Block/Slice PSA cannot alter, vary, or modify in any way the decisions set forth in the Administrator’s Final Record of Decision.

BPA finds that the True-Up Adjustment Charge for CY 2002 was calculated in accordance with the decisions set forth in the Administrator’s Final Record of Decision for BPA’s 2002 Wholesale Power Rates. The following report supports and documents this conclusion.

#### **Conduct of the Audit**

In an effort to ensure the quality of the audit for both parties, Section 4(b)(6)(D)(iv) of the Block/Slice PSA was written to establish the scope and standards to be observed during the audit. As stipulated in this section, “The audit shall be conducted in accordance with the standards established by the American Institute of Certified Public Accountants and in accordance with Generally Accepted Auditing Standards.”

The American Institute of Certified Public Accountants (AICPA) establishes a variety of standards that cover different services provided by CPA’s. Established standards include Generally Accepted Accounting Principles (GAAP), Generally Accepted Auditing Standards (GAAS), and other financial accounting standards. Among the U.S. Auditing Standards [AU] is AU 150 – Generally Accepted Auditing Standards. This AU states that “Auditing standards provide a measure of audit quality and the objectives to be achieved in an audit.” It then goes on to list the 10 Generally Accepted Auditing Standards including general, field work, and reporting standards. In addition, the AICPA establishes Consulting Standards that provide guidance in conducting consulting engagements. Although these standards are established by the AICPA, the Consulting Standards do not comport to the quality or scrutiny of Generally Accepted Auditing Standards.

 KPMG performed this Slice “contract audit” under the AICPA Consulting Standards [CS]. While these standards are established by the AICPA, these Consulting Standards do not fall under the definition of Generally Accepted Auditing Standards and they do not provide the quality and assurances warranted in the contract provisions.

## Audit Scope

Section 4(b)(6)(D)(iv) of the Block/Slice PSA specifies the scope of the independent audit by the Slice customers.

- First, this section states, “The audit shall include reasonable audit procedures and tests to insure that **costs allowable** in the Actual Slice Revenue Requirement and the True-Up Adjustment Charge pursuant to this Agreement have been included and those costs not so allowable have been excluded.” [emphasis added]
- This section further clarifies what is **outside the scope of this independent audit**, “BPA’s methods for allocation of overheads and indirect costs, accounting policies or procedures, management decisions, activities, or authorities, or any decisions related to the operation of the FCRPS shall not be included in any such audit and shall not be subject to dispute...”
- Lastly, the section specifies “the audit shall be conducted in accordance with the standards established by the American Institute of Certified Public Accountants and in accordance with **Generally Accepted Auditing Standards.**” [emphasis added] BPA’s financial statements used as the basis for calculating the Slice True-Up Adjustment Charge have been audited by its own external auditor, PricewaterhouseCoopers in accordance with GAAS, and contain expenses and credits that are in accordance with Generally Accepted Accounting Principles.

## Allowable Costs

The Block/Slice PSA contains provisions on the costs that BPA is allowed to include in and required to exclude from the Slice Revenue Requirement. These provisions include the PF Slice Rate, Slice Rate Methodology, and the GRSPs applicable to the PF Slice Rate.

Section 2(a) of the Block/Slice PSA states:

“Actual Slice Revenue Requirement” means, for any Contract Year, the final audited expenditures as reflected on BPA’s books of account, corresponding to those PBL cost categories identified in Exhibit I and described further in section 4(b)(5).

Section 5(C) of the Block/Slice PSA states:

### Costs Excluded from the Slice Revenue Requirement

The following costs are excluded from the Slice Revenue Requirement:

- (i) All transmission costs (other than those associated with the transmission of System Obligations and General Transfer Agreements);
- (ii) All power purchase costs (with the exception of Net Cost of the Inventory Solution);

- (iii) All planned net revenues for risk and hedging costs, with the exception of those hedging costs incurred to implement the Forecasted Inventory Solution. The Parties understand and agree that there are no hedging costs to implement the Forecasted Inventory Solution for the CY 2002 through 2006 rate period; and
- (iv) All costs not permitted to be included in the Slice Revenue Requirement pursuant to section 4(b)(5)(A) above.” (which are defined as new costs)

The 2002 Wholesale Power Rate Schedule PF-02 Section II. D and G, adopted by the Administrator identifies costs and charges applicable to the Slice Product. Such charges include a specific monthly cost charge in Section II.D and a product charge and adjustments to charges and special rate provisions identified in Section II.G.

### **Slice Rate is a Priority Firm Rate**

The Slice Rate is a Priority Firm (PF) rate, and as such, is designed to cover all Power Business Line (PBL) costs, except for those costs expressly excluded by the Block/Slice PSA. The True-Up Adjustment Charge is an adjustment to the Slice Rate that ensures coverage of actual PBL costs. BPA has included in the Actual Slice Revenue Requirement all PBL costs with limited exclusions as specified by the Block/Slice PSA. By agreeing to purchase the Slice product at the Slice Rate, the Slice customers have agreed to pay all PBL costs that all PF customers agreed to pay, with the exceptions noted above. By design, the Slice product must recover the appropriate share of PBL costs in order to avoid cost shifts to non-Slice BPA customers. The Slice Rate and True-Up Adjustment Charge is designed to ensure that Slice purchasers pay a proportionate share of costs equivalent to that which would be expected to be recovered from purchasers of traditional Subscription products (Mesa et al., WP-02-E-BPA-32, page 6, lines 18-20).

### **Equity in Cost Treatment with Other PF Ratepayers**

BPA's inclusion of costs (other than those costs expressly excluded as per section 3b in the Methodology, WP-02-A-09, Attachment) in the Actual Slice Revenue Requirement was governed by the principle of equity in cost treatment with other PF ratepayers. BPA's direct testimony on the Slice product in the May 2000 rate case states, "Even if BPA elected to expense a particular cost that was not anticipated in rates or whose magnitude was not anticipated, the payment of that cost in the Slice True-Up will be consistent with the treatment of other ratepayers." Mesa et al., WP-02-E-BPA-32, page 6, lines 2-4. If Slice purchasers want BPA to consider cost treatment that deviates from this general principle, then the forum for this discussion needs to include other ratepayer groups, as this is a rate case issue that affects more than the Slice purchasers.

### **BPA Summary Response**

BPA has reviewed the final report on the independent audit by Slice customers and has concluded the following:

- “New costs” identified in the final report are not “new costs” (as defined in section 4(b)(5)(A) of the Block/Slice PSA) according to the Slice Rate methodology and the Block/Slice PSA. Rather, they are costs that are part of specific entries allowable in the Actual Slice Revenue Requirement and True-Up Adjustment Charge.
- Some costs are identified in the final report as not includable because they are argued to be “not necessary.” The Block/Slice PSA does not contain any language that excludes costs from the Actual Slice Revenue Requirement because they are “not necessary.” Rather, the Slice product is attributed with the same costs for its revenue requirement as other Subscription products, with the four exceptions stated above. Therefore, costs cannot be excluded from the Actual Slice Revenue Requirement, unless the cost is in one of the categories listed above.
- Some costs are identified in the final report as not includable because they are “out-of-period costs.” All costs included in the Actual Slice Revenue Requirement are includable in CY 2002 because these costs have been accounted for as expenses in CY 2002 in accordance with GAAP and have been audited by BPA’s external auditor. GAAP is an integral part of BPA’s accounting policies and procedures and serves as a key basis for management decisions regarding financial accounting. BPA’s inclusion of these costs that are characterized by KPMG as “out-of-period costs” in the Actual Slice Revenue Requirement is consistent with the treatment of these costs for other ratepayers. GAAP is applied in preparing BPA’s financial statements, as well as in the calculation of PBL’s Accumulated Annual Net Revenues, which is the basis for financial adjustments to the Priority Firm rate for non-Slice customers.

Following are BPA’s responses to specific items identified in the final report of the independent audit by Slice customers:

**Item #1 - True-Up to Actual Payments**

**Report Conclusion:** [REDACTED] BPA used the wrong Slice Revenue Requirement figure when calculating the True-Up Adjustment Charge. [REDACTED] A 5-year average figure should be used rather than an annual cost. [REDACTED]

[REDACTED]

**BPA Response:** Slice purchasers believe that the Slice True-Up Amount should be calculated based on the difference between actual audited expenses/credits for CY 2002 and the five-year average Slice Revenue Requirement amount, \$1,703,316,000, instead of the annual Slice

Revenue Requirement amount, \$1,654,443,000. If calculated in the way that the audit report recommends, the True-Up Amount is lowered by \$48,873,000. BPA disagrees based on the following:

BPA designed the Slice Rate to collect the same initial amount each year from the Slice purchasers, based on the average annual planned cost total for the 5-year rate period (CY 2002 – 2006). BPA then would compute the difference between BPA's actual costs in any given year and BPA's planned cost levels in that year. This difference between BPA's actual costs in any given year and BPA's planned cost levels in that year is the basis for the Slice True-Up Adjustment Charge. If the calculated difference is a positive amount (that is, actual costs exceed planned costs), then Slice purchasers would owe BPA their share of that difference. If the calculated difference is a negative amount (that is, actual costs are below planned costs), then BPA would pay Slice purchasers their share of that difference. In CY 2002, the calculated difference was a negative amount, and Slice purchasers paid BPA their share of that difference. The Slice True-Up Adjustment Charge is designed to ensure that Slice purchasers pay their share of BPA's actual costs over the 5-year rate period.

The "Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge" (Methodology) is contained in the Attachment to Chapter 8, in the 2002 Supplemental Power Rate Proposal Administrator's Record of Decision (2002 Supplemental ROD), WP-02-A-09, pages 8-A-1 through 8-A-6. This Methodology describes the process that BPA is following for the True-Up Adjustment calculation for CY 2002. This Methodology was written to guide the calculation of the Slice Rate and Slice True-Up Adjustment Charge through the 10-year life of Block and Slice Power Sales Agreement.

Section C.1. of the Methodology on page 8-A-5 describes the calculation:

"The Annual Slice True-Up Adjustment shall be calculated to be the **annual Slice Revenue Requirement for the CY** subtracted from the Actual Slice Revenue Requirement for such CY as Shown in Attachment (Table) 1." [emphasis added] The key words are in bold – **annual Slice Revenue Requirement for the CY**. This clearly shows that BPA intended for the calculation to take the annual amount and subtract it from the actual amount for the year.

If BPA's rate design had intended for a 5-year annual average Slice Revenue Requirement to be the basis for the Slice True-Up Amount calculation, then BPA would have used those words in the description of the calculation. The intent of the Methodology was for the True-Up Adjustment to track the annual costs for the CY and there is no mention anywhere in section C.1. of the Methodology about a **5-year annual average Slice Revenue Requirement**.

The Slice product was designed to bear an appropriate share of BPA's financial risk. One of the ways that would ensure that financial risks were addressed was by "incorporating an annual true-up adjustment charge for differences between **planned and actual costs**, (and credits) of the Slice Revenue Requirement" [emphasis added] (Mesa, et al, WP-02-E-BPA-32, page 17, lines 9-10). This language in BPA's direct testimony on the Slice product demonstrates that BPA intended to collect the difference between **planned and actual costs**, not the difference between the Slice payments and actual costs. Furthermore, had BPA been

aware of and agreeable to the Slice purchasers' desire to use a 5-year annual average Slice Revenue Requirement as the basis for the calculation, BPA would have set different Slice rates for each year of the rate period. Slice purchasers did not raise any issues related to BPA's Methodology for calculating the Slice True-Up Adjustment Charge during the May 2000 or the Supplemental Rate Cases.

The SN-03 rate case presented a forecast of the Slice True-Up for the period CY 2003 through CY 2006. The True-Up Amount was calculated, based on annual CY Slice Revenue Requirement numbers. For example, the CY 2003 Slice Revenue Requirement was compared with a forecast of what the actual CY 2003 Slice Revenue Requirement would be as the basis for the Slice True-Up Adjustment. The Slice purchasers submitted a data request for details surrounding this forecasted True-Up Adjustment amount, but did not challenge the manner in which it was calculated. The Slice purchasers did not raise the issue of an alternative method in the rate case, thereby acquiescing to the method for calculation that is consistent with BPA's method.

In addition, this conclusion challenges BPA's implementation of the Slice Rate and the Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge. The Methodology is included in the 2002 Supplemental Power Rate Proposal Administrator's Final Record of Decision (2002 Supplemental ROD) and was approved by the Federal Energy Regulatory Commission (FERC) on July 21, 2003.

**Item #2 - PBL – TBL Allocations**

**Report Conclusion:** [REDACTED] BPA inaccurately applied a cost allocation causing the Slice customers to pay about \$75,000 less. [REDACTED]  
[REDACTED]

**BPA Response:** BPA agrees with [REDACTED] the conclusion.

**Item #3 - Capitalization of Slice Implementation Costs**

**Report Conclusion:** [REDACTED] BPA inaccurately charged Slice customers the full amount of capital investments instead of capitalizing them and charging the Slice customers the depreciation for CY 2002 [REDACTED]  
[REDACTED]

**BPA Response:** BPA disagrees with [REDACTED] the conclusion for the following reasons:

- BPA's inclusion of 100 percent of the costs of the Slice Computer Application Project in the Actual Slice Revenue Requirement, as opposed to the inclusion of only the capitalized costs

of the Slice Computer Application Project, is appropriate. Inclusion of 100 percent of these costs is appropriate because these are Slice Implementation Costs.

- The Block/Slice PSA in section 2(qqq) defines "Slice Implementation Costs." Slice Implementation Costs are defined as "those costs reasonably incurred by PBL in any CY for the sole purpose of implementing the Slice Product, and which would not have been incurred had PBL not sold Slice Output under this Agreement." This definition makes no distinction of these costs being expense or capital. PBL incurred the Slice Implementation Costs in CY 2002. Slice purchasers are "responsible for paying all direct and indirect costs (including overhead) incurred by BPA that are attributable to the set-up and implementation of the Slice product." *Mesa et al.*, WP-02-E-BPA-32, page 15, lines 22-24.
- BPA's treatment of the Slice Computer Application Project costs is consistent with BPA's treatment of other project costs of a similar nature under its "Advance Payments Received for Work or Service Performed for Others" Financial Policy. BPA's applicable business practice and Financial Policy on cost treatment for projects undertaken for non-BPA entities (where the project would otherwise not have been undertaken by BPA) is to collect the funds for such work through a Reimbursable agreement or a Project Funded In Advance (PFIA) agreement.<sup>1</sup> Under either the Reimbursable or PFIA agreement, the cost of the project is fully charged to the non-BPA entity, no later than the completion of the project, in accordance with the language of these agreements. In addition, the cost of the project is fully charged to the non-BPA entity, regardless of whether or not BPA capitalized the project costs. The Slice Computer Application Project is similar in nature to those projects that are governed by BPA's Reimbursable or PFIA agreements. The Slice Computer Application Project was developed for the sole purpose of implementing the Slice product and would not have been developed had it not been for the Slice product. Therefore, BPA included 100 percent of the Slice Computer Application Project costs in the Slice Implementation Costs, regardless of whether or not these costs were capitalized.
- Projects that are initiated under Reimbursable or PFIA agreements would be paid for by the completion of the project. The Slice Computer Application Project was completed at the end of CY 2002 and implemented on October 1, 2002. Therefore BPA billed the Slice purchasers for the related costs through the True-Up Adjustment Charge for CY 2002.
- Having collected these costs in the Slice True-Up Adjustment Charge for CY 2002, these costs will not be recovered again from Slice customers through depreciation expense in the Slice True-up in future years.

Furthermore, KPMG's conclusion is outside the scope of the independent audit because it challenges BPA's accounting policies and procedures. In addition, this conclusion challenges BPA's implementation of the Slice Rate and the Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge. The Methodology is included in the 2002 Supplemental Power Rate Proposal Administrator's Final Record of Decision (2002 Supplemental ROD) and was approved by the Federal Energy Regulatory Commission (FERC) on July 21, 2003.

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<sup>1</sup> Note that this treatment is consistent whether the customer holds title or BPA becomes the titleholder of the assets.

#### Item #4 – Federal Debt and Appropriation Retirements

**Report Conclusion** [REDACTED] BPA inaccurately charged the Slice Customers for the early payments of debt through the Debt Optimization program [REDACTED]

BPA understands Issues # 4 and # 5 as one issue that KPMG separated into two separate matters.

**BPA Response:** BPA disagrees with KPMG's conclusion.

The Debt Optimization program was undertaken with Energy Northwest (ENW) to restore Federal borrowing authority in order to provide funding for necessary infrastructure projects in both the power and transmission business lines while providing reductions in combined Federal/non-Federal annual debt service. The optimization is accomplished by refinancing (extending the maturities of) ENW bonds as they come due and repaying an equivalent amount of Federal debt. In total, the same amount of debt is repaid that rates were set to recover, but with an emphasis toward repaying Federal debt rather than non-Federal debt. The financial effects from the refinancing and the related advance amortization of Federal debt were properly and fully accounted for in the Actual Slice Revenue Requirement, in accordance with GAAP.

[REDACTED] If the repayment of Federal debt is [REDACTED] not [REDACTED] charged to the Slice purchasers. [REDACTED] it results in the Slice purchasers reaping the benefit of the ENW debt service reduction, without the corresponding repayment of an equivalent amount of Federal debt. As stated in the previous paragraph, BPA's Debt Optimization program and the corresponding agreement with ENW requires that the financial effects from refinancing ENW bonds be directed strictly toward repayment of Federal debt. Simply stated, Slice purchasers cannot reap the benefits of refinancing ENW bonds without incurring the corresponding costs of repayment of Federal debt.

This fiscal policy decision on the agency's debt management not only affects the Slice Rate, but is a recognized factor of BPA's rate of general application through implementation of the FB CRAC, and inclusion of these transactions in the Slice True-Up is a recognition of Slice customers' share of these obligations. In "determining if the FB CRAC threshold has been reached, actual and forecasted expenses will include BPA expenses associated with ENW debt service as forecasted in the WP-02 Final Studies." 2002 GRSPs, at 111. This recognizes that although the annual ENW debt service is decreased as a result of the bond extensions, there is no increase in cash in the BPA fund because the cash is used to repay Federal debt. If the Slice True-Up recognized only the reduction in ENW debt service, the recovery of the equivalent amount applied to Federal debt would be borne entirely by the non-Slice customers, yet the Slice customers would also receive the benefit of the debt reduction through decreased Federal interest expense in subsequent Slice True-Ups.

KPMG's [REDACTED] conclusion [REDACTED] is an inaccurate interpretation and recitation regarding the "as necessary" phrase in Section 4(b)(6)(C)(i)(II). Section 4(b)(6)(C)(i)(II) provides:

"PBL shall subtract the Slice Implementation Costs and the Total Individual Charges, both as identified in section 4(b)(6)(C)(i)(I) above, from the Actual Slice Revenue Requirement. As necessary, the Actual Slice Revenue Requirement shall include a component (Minimum Required Net Revenues) for the amount in a CY by which BPA's actual generation amortization and irrigation assistance payments to the U.S. Treasury exceed the total actual non-cash expenses in the Slice Revenue Requirement."

The phrase "as necessary" does not afford the Slice customers a right to decide what costs are necessary or what BPA's fiscal policy should be. Section 4(b)(6)(C)(i)(II) calls for BPA's actual generation amortization and irrigation assistance payments to the U.S. Treasury to be used in the Minimum Required Net Revenue calculation. Section 4(b)(6)(C)(i)(II) requires that, as necessary (i.e., when circumstances warrant), the Actual Slice Revenue Requirement will include this calculation whenever actual amortization/irrigation assistance payments exceed the total actual non-cash expenses in the Slice Revenue Requirement. A calculation of Minimum Required Net Revenues is not needed when amortization/irrigation assistance do not exceed the total non-cash expenses in the Slice Revenue Requirement and so is not necessary or warranted in that circumstance.

The Minimum Required Net Revenues component of the Actual Slice Revenue Requirement was established in the May 2000 Administrator's Record of Decision, WP-02-A-02, page 16-20. It states that inclusion of the Minimum Required Net Revenues as BPA defines it, allows for comparable treatment of Slice purchasers with non-Slice customers. "In order to have the Slice Revenue Requirement comport with the generation revenue requirements for other Subscription products, the Slice Revenue Requirement *and, more importantly, the true-up to actual costs* [emphasis added] should include a Minimum Required Net Revenue component. This will ensure sufficient funds to cover the cash payments for debt reduction from which Slice purchasers, as well as other purchasers of Subscription products, will benefit." If the audit report finding were adopted, significant costs would be shifted to non-Slice customers.

The intent of incorporating the Minimum Required Net Revenues into the Slice True-Up was to address both the Federal debt actually repaid and actual non-cash expenses, in that either might differ from the corresponding amounts projected in the rate case. This is consistent with the testimony presented by the Slice Purchasers Group that urged, in years when actual amortization exceeded actual depreciation expense; the excess would be recovered through the Slice true up. Carr et al., WP-02-E-SG-01, at 25. This was clarified in the Administrator's Record of Decision to reflect actual total non-cash expenses rather than only depreciation expense. ROD, at 16-8 to 16-20. The actual debt repaid, both as to amount and type, would be the result of BPA's debt management decisions at the time payment was made. The Minimum Required Net Revenues recognizes this fact.

BPA's treatment of early payments of federal debt and appropriations retirement charges through the Minimum Required Net Revenues line item in Exhibit I (also known as Table D in the 2002

GRSPs) is addressed thoroughly in the May 2000 ROD and in the Methodology included in the 2002 Supplemental ROD, with supporting analyses and conclusions.

Furthermore, KPMG's conclusion is outside the scope of this independent audit because the conclusion challenges BPA's fiscal policy and management decisions regarding the agency's debt optimization activities. Nothing in the Block/Slice PSA allows for a veto of BPA's management decisions with respect to its fiscal policy. Section 4(b)(6)(C)(iv) of the Block/Slice PSA expressly states that "BPA management decisions, activities, or authorities shall not be included in any such (independent) audit."

In addition, KPMG's conclusion challenges BPA's implementation of the Slice Rate and the Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge (Methodology). The Methodology is included in the 2002 Supplemental Power Rate Proposal Administrator's Final Record of Decision (2002 Supplemental ROD) and was approved by the FERC on July 21, 2003.

#### **Item # 5 – Out-of-Period Treasury Payments**

**Report Conclusion:** [REDACTED] The early payments to Treasury were out of period costs that BPA inaccurately included in CY 2002 [REDACTED]

**BPA Response:** KPMG's conclusion [REDACTED] addresses [REDACTED] a subset of the \$242,394,000 of early payments of Federal debt through BPA's Debt Optimization program. [REDACTED] \$81,465,000 [REDACTED] as excludable from the CY 2002 Slice True-Up for the additional reason of being an "out-of-period" charge. BPA's response to Item # 4 is relevant to BPA's response to Item # 5.

BPA disagrees with KPMG's conclusion on this item as well, for the following reasons:

[REDACTED] This is inappropriate because it would result in the Slice purchasers reaping the benefit of the ENW debt service reduction, without the corresponding repayment of an equivalent amount of Federal debt. BPA's Debt Optimization program and the corresponding agreement with ENW requires that the financial effects from refinancing ENW bonds be directed strictly toward repayment of Federal debt. Simply stated, Slice purchasers cannot reap the benefits of refinancing ENW bonds without incurring the corresponding costs of repayment of Federal debt.

The additional advance amortization payment of \$81,465,000 should be included in the Minimum Required Net Revenues calculation for CY 2002 because any payment made in the

CY is related to that year by the fact the payment is made in that CY. BPA does not simply pay bonds when due, but rather makes payments in a manner that keeps the Revenue Requirement as low as possible. In some years that means paying bonds before they are due. In addition, BPA determines which bonds to retire early by analyzing the bonds to determine which has the highest interest rate. These decisions are made at the time the Treasury payments are made and are decisions of the CY in which they are made. These transactions are properly included in the Actual Slice Revenue Requirement because these transactions have been accounted for in accordance with GAAP for CY 2002.

The revenue requirement of this additional advance amortization payment is covered by the PF rates of both Slice and non-Slice customers. The treatment of this kind of payment was determined in the May 2000 ROD in section entitled "Minimum Required Net Revenues," WP-02-A-02, page 16-20. It states, "In order to have the Slice Revenue Requirement comport with the generation revenue requirements for other Subscription products, the Slice Revenue Requirement and, more importantly, the true-up to actual costs should include a Minimum Required Net Revenues component. This will ensure sufficient funds to cover the cash payments for debt reduction from which Slice purchasers, as well as other purchasers of Subscription products, will benefit." The audit in effect seeks to change this component of the Slice Rate design inconsistent with the ROD.

The Block/Slice PSA does not contain language that excludes costs because they do not "relate to a particular Contract Year for which the True-Up is being conducted" or because they are "out-of-period" costs.

KPMG's conclusion is outside the scope of this independent audit because it challenges BPA's fiscal policy and management decisions regarding the agency's debt optimization activities. Nothing in the Block/Slice PSA allows for a veto of BPA's management decisions with respect to its fiscal policy. Section 4(b)(6)(C)(iv) of the Block/Slice PSA expressly states that "BPA management decisions, activities, or authorities shall not be included in any such (independent) audit."

In addition, KPMG's conclusion challenges BPA's implementation of the Slice Rate and the Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge (Methodology). The Methodology is included in the 2002 Supplemental Power Rate Proposal Administrator's Final Record of Decision (2002 Supplemental ROD) approved by the Federal Energy Regulatory Commission (FERC) on July 21, 2003.

#### **Item #6 – Fish Credits**

**Report Conclusion:** [REDACTED] BPA was inconsistent in how it treated the FCCF credits compared to the 4(h)(10)(c) credits. [REDACTED]

**BPA Response:** BPA disagrees with KPMG's conclusion based on the following:

BPA receives financial credits for the Fish Cost Contingency Fund (FCCF) and 4(h)(10)(C) only when conditions exist that allow us to receive them. (2001 was the first and only year that FCCF credits were received.) BPA accrues these credits throughout the fiscal year in which they apply. Since the amount of these financial credits is based on analyses that incorporate dam allocation for power, actual stream flow, and power market price data for the CY in question, there is often a 'true-up' of the credit amount that is originally accrued in BPA's accounting system. This 'true-up' occurs when actual stream flow and power market price data is available *after the end of the CY*.

The 'true-up' of the Fiscal Year (FY) 2001 4(h)(10)(C) credit was complicated by the implementation of a revised cost allocation for Grand Coulee dam. The FCCF was not complicated by this change resulting in the ability to book the FCCF amount in FY 2001. The 4(h)(10)(C) credit could not be reasonably estimated in FY 2001 and therefore could not be booked under GAAP. Final determination of the 4(h)(10)(C) credit occurred in CY 2002. The 4(h)(10)(C) credit is includable in CY 2002 under GAAP and now must be recovered.

The accounting treatment for both 4(h)(10)(C) and FCCF credits was appropriate, accounted for in the correct years and consistent with Generally Accepted Accounting Principles.

KPMG's review of this item is in the scope of the audit. However, KPMG's conclusion is outside the scope of this independent audit because it challenges BPA's accounting policies and procedures and this conclusion is inconsistent with GAAP.

**Item # 7 – California ISO and California PX Uncollectible Receivables**

**Report Conclusion:** [REDACTED] BPA improperly charged the Slice customers for expenses related to uncollectible receivables from the California ISO and PX [REDACTED]

**BPA Response:** BPA disagrees with KPMG's conclusion for the following reasons.

*GAAP – Financial Statement Audit*

Section 2(a) of the Block/Slice PSA states:

“Actual Slice Revenue Requirement” means, for any Contract Year, the final audited expenditures as reflected on BPA's books of account, corresponding to those PBL cost categories identified in Exhibit I and described further in section 4(b)(5).

The KPMG assertion that the items relate to events outside of the contract year is not consistent with Section 2 (a). BPA's financial statements are audited each year by an Independent Auditing

firm, which issues an opinion on whether the statements have been prepared in accordance with GAAP. In Contract Year 2002, PricewaterhouseCoopers (PwC), BPA's auditor, issued a "clean" opinion on BPA's financial statements, meaning that the statements had been prepared in accordance with GAAP.

In today's energy world, not all accounts receivables are collectible. Uncollectible receivables are a standard business expense across the industry and are a **normal cost of doing business**. The expense associated with the Allowance for Uncollectible Receivables of \$24 million for Cal ISO & Cal PX was properly included in the "Operations and maintenance" line item of BPA's audited financial statements for Contract Year 2002. Therefore, the expense is part of the "final audited expenditures..." and is includable in the Actual Slice Revenue Requirement.

#### *Exhibit I & New Costs*

While Exhibit I (which is also Table D in the 2002 GRSPs) does not contain a specific line item for "Allowance for Uncollectible Receivables," it does contain a line item labeled "Other" under the Operating Expenses category. This "Other" category was intended to capture all other PBL operating expenses that had not been given a specific line item on Exhibit I. The Allowance for Uncollectible Receivables is a normal and ordinary operating expense and is shown as such in BPA financial statements and is therefore consistent with the intent of Exhibit I under the "Other" category.

Furthermore, the \$24 million expense associated with the Allowance for Uncollectible Receivables for Cal ISO & Cal PX benefits neither Slice participants nor non-Slice participants and therefore would be includable as a new cost in the Slice true up.

#### *BPA's Rate Structure – Recover All Costs*

BPA's rate structure is designed to recover all costs. **"The Slice product, by design, is attributed with the same costs for its revenue requirement as the other (Subscription) products,** with four exceptions. In general, the four exceptions are power purchases, inter-business line transmission costs, Planned Net Revenues for Risk (PNRR), and all new costs. These items are excluded because these costs or risks have been transferred to the Slice participant through the product design." [emphasis added] *Mesa et al*, WP-02-E-BPA-32, page 5, lines 3-7. The Allowance for Uncollectible Receivables is a normal and ordinary operating expense that should be, and is, included in the revenue requirement for all Subscription products. To exclude this expense from the Slice product would inappropriately shift costs to non-Slice customers. This principle is well stated in the ROD: "However, because Slice purchasers will pay a proportionate share of all costs of BPA's system attributable to it, and **those are costs that are shared with non-Slice purchasers,** there should be no costs shifts to non-Slice customers. Also, since Slice purchasers will avoid paying the costs of risk mitigation for only those risks that Slice purchasers will assume directly, there should be no shifting or risks or costs from Slice purchasers to purchasers of other BPA products. **Slice should not adversely affect the prices for Subscription power and other products.**" [emphasis added] Power Subscription Strategy, Administrator's Record of Decision, pages 84-85.

*Time Period*

Under GAAP, expenses are recognized as incurred. In an ideal world, expenses related to uncollectible receivables would be recognized in the same period as the revenue is earned in order to uphold the Matching Principle. However, it is generally not known that the receivables are uncollectible until some point in the future. GAAP requires that the Allowance for Uncollectible Receivables be evaluated on a regular basis and adjusted accordingly. Expenses for uncollectible receivables are recognized when receivables are determined to be uncollectible. Therefore it is reasonable and proper to record expenses related to uncollectible receivables in periods after the revenue was earned. It is BPA's policy to evaluate all receivables for collection on a regular basis in accordance with GAAP.

In Contract Year 2001, based on then-current information and analysis, BPA recognized an expense of ~\$15 million related to uncollectible receivables for the Cal ISO & Cal PX. In Contract Year 2002 (consistent with policy), BPA's management reevaluated the receivable from the Cal ISO & Cal PX. Based on new information and analysis, management determined that an additional \$24 million should be expensed and put in the allowance in Contract Year 2002. Therefore, this expense is reasonable and proper under GAAP. Furthermore, the probability of the collection of receivables is a management decision and is therefore outside the scope of this independent audit.

*Summary*

The \$24 million expense related to Uncollectible Receivables for the Cal ISO & Cal PX was properly expensed in Contract Year 2002 under GAAP, was includable on Exhibit I under the "other" category, and is a normal and ordinary operating expense that was properly included as part of "the final audited expenditures as reflected on BPA's books of account." BPA also notes that the expense is based on a management decision and is outside the scope of this independent audit. In addition, KPMG's conclusion challenges BPA's implementation of the Slice Rate and the Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge (Methodology). Therefore, BPA concludes that the expense should not be removed from the Actual Slice Revenue Requirement.

**Item #8 – Allowance for DSI Uncollectible Receivables**

**Report Conclusion:** [REDACTED] BPA improperly charged the Slice customers for expenses related to uncollectible receivables from DSI customers related to Liquidated Damages. [REDACTED]

**BPA Response:** BPA disagrees with KPMG's conclusion for the following reasons.

*GAAP – Financial Statement Audit*  
Section 2(a) of the Block/Slice PSA states:

“Actual Slice Revenue Requirement” means, for any Contract Year, the final audited expenditures as reflected on BPA’s books of account, corresponding to those PBL cost categories identified in Exhibit I and described further in section 4(b)(5).

BPA’s financial statements are audited each year by an Independent Auditing firm, which issues an opinion on whether the statements have been prepared in accordance with GAAP. In Contract Year 2002, PwC, BPA’s auditor, issued a “clean” opinion on BPA’s financial statements, meaning that the statements had been prepared in accordance with GAAP.

In today’s energy world, not all accounts receivables are collectible. Uncollectible receivables are a standard business expense across the industry and are a **normal cost of doing business**. The expense associated with the Allowance for Uncollectible Receivables of \$29.2 million for Direct Service Industry customers’ (DSI) Liquidated Damages was properly included in the “Operations and maintenance” line item of BPA’s audited financial statements for Contract Year 2002. Therefore, the expense is part of the “final audited expenditures....”

#### *Exhibit I & New Costs*

While Exhibit I (which is also Table D in the 2002 GRSPs) does not contain a specific line item for “Allowance for Uncollectible Receivables,” it does contain a line item labeled “Other” under the Operating Expenses category. This “Other” category was intended to capture all other PBL operating expenses that had not been given a specific line item on Exhibit I. The Allowance for Uncollectible Receivables is a normal and ordinary operating expense and is shown as such in BPA financial statements and is therefore consistent with the intent of Exhibit I under the “Other” category.

Furthermore, the \$29.2 million expense associated with the Allowance for Uncollectible Receivables for DSI Liquidated Damages benefits neither Slice participants nor non-Slice participants and therefore would be includable as a new cost in the Slice true up.

#### *Revenue & Expense Recognition*

BPA properly accounted for these DSI transactions for the following reasons:

GAAP requires that revenue should be recognized when:

- 1) Persuasive evidence of an arrangement exists.
- 2) Delivery has occurred or services have been rendered.
- 3) Price is fixed or determinable.
- 4) Ability to collect is reasonably assured.

In CY 2002, the first 3 criteria of Revenue Recognition were clearly met. The DSI contracts were the arrangement (1), the delivery period for the remarketed power had passed (2), and the price was determinable based on the calculations in the contract (3). The issue of whether the Liquidated Damages amounts were collectible was the issue to analyze (4).

BPA had been hearing rumors that several of the DSIs may be going bankrupt or unable to pay the Liquidated Damages since their plants were not operating. However, at the time, it was difficult to know if these rumors were "noise" in the market or if they had any legal validity. BPA management evaluated the probability of collection and decided that it was "probable" that these damages would be collected. Therefore BPA recorded the revenue in CY 2002 in accordance with GAAP and billed the Liquidated Damages in November 2002 in accordance with the DSI contracts.

Several of the DSIs paid their Liquidated Damages bills (including CFAC and Vanalco). However, Longview and Golden Northwest (GNA) did not pay their Liquidated Damages by their due dates. Given the nonpayment of the damages and the continued "bad news" on these companies, BPA reassessed the likelihood of collecting these damages and decided to fully (100%) reserve against the \$29.2 million for Longview and GNA for CY 2002. (Note that Kaiser had not incurred any Liquidated Damages in CY 2002 and therefore is irrelevant to this issue.) The probability of the collection of receivables is a management decision and is therefore outside the scope of this independent audit.

*Summary*

The \$29.2 million related to Uncollectible Receivables for the DSI Liquidated Damages was properly recognized as revenue and then later expensed in Contract Year 2002 under GAAP. The expense was includable on Exhibit I under the "other" category, as a normal and ordinary operating expense. These revenues and expenses were properly included as part of "the final audited expenditures as reflected on BPA's books of account." Furthermore, the expense is based on a management decision and is outside the scope of this independent audit. In addition, KPMG's conclusion challenges BPA's implementation of the Slice Rate and the Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge (Methodology). Therefore, BPA concludes that the expense should not be removed from the Actual Slice Revenue Requirement.

**Item #9 – Excess Slice Implementation Staff Costs**

**Report Conclusion:** [REDACTED] BPA inaccurately charged the Slice Customers for excess Slice implementation staff costs that were above \$80,000 per PBL FTE.

[REDACTED]

The Actual Slice Revenue Requirement should be reduced by the \$263,000.

**BPA Response:** BPA agrees with KPMG's conclusion that the Actual Slice Revenue Requirement should be reduced by approximately \$263,000. The net result is that BPA overcharged Slice customers approximately \$60,000 (rounded to the nearest thousand). (This is the product of \$263,000 and the Slice Percentage of 22.6278%.)

While this instance is inconsistent with the principle prohibiting cost shifts to non-Slice customers, unfortunately, clear contract language compels this result. This instance is but one example of clear contract language compelling a result. Some other examples are BPA's arguments on Items # 4, 5, and 11.

**Item #10 – Unsubstantiated Vendor Charges**

**Report Conclusion:** [REDACTED] BPA did not provide enough evidence to test certain vendor charges related to Slice Implementation costs. [REDACTED]

**BPA Response:** BPA disagrees with the audit report finding based on the following:

For purposes of the audit, sufficient information and documentation was provided to KPMG to validate the calculation of the Slice Implementation Costs. Slice purchasers are responsible for paying 100 percent of these Slice Implementation Costs.

Slice Implementation Costs are defined as "those costs reasonably incurred by PBL in any CY for the sole purpose of implementing the Slice Product, and which would not have been incurred had PBL not sold Slice Output under this Agreement." PBL provided proof that these costs were incurred, by providing copies of actual invoices, proof of approval, and proof of payment screens for each invoice. BPA provided the requested documents, but due to confidentiality agreements with these contractors, BPA blacked out information related to hourly rates and hours on the invoices. BPA has confidentiality agreements with the contractors to protect business-sensitive and competitive information regarding their operations. BPA explained to KPMG auditors that provision of hourly rates and hours data would be in violation of our confidentiality agreements with the contractors. BPA suggested that KPMG contact the contractor firms personally to obtain releases of the hourly rate and hours data from the invoices. KPMG requested a contact list for the contractors, which BPA was in the process of collecting and providing during the week of June 6, 2003. However, on or about June 11, Jim Crouser of KPMG called BPA and left a message stating that he did not need the contact list at this point.

Furthermore, KPMG had requested copies of relevant sections of the contractor employment contracts negotiated with BPA for work on the Slice Computer Application Project. BPA provided KPMG with copies of signature pages of these contracts, but could not provide any further information related to these contracts because of confidentiality reasons. Again, BPA advised KPMG that they needed to personally obtain releases of this contract information from the contractors firms. However, because Jim Crouser of KPMG retracted his request for a contractor contact list, the list was not provided.

One of the basic tenets of the Slice product is that there should be no risk or cost shifts to other customers. If the Slice purchasers do not pay any amount related to these costs, this would constitute a cost shift to non-Slice purchasers, a violation of the “no cost shift” principle established and upheld in both in the May 2000 and 2002 Supplemental Rate Cases.

KPMG’s review of this item is within the scope of the audit. However, BPA disagrees with KPMG’s conclusion because of the reasons stated in the explanation above.

**Item #11 – Conservation Augmentation Costs**

**Report Conclusion:** [REDACTED] BPA did not provide adequate documentation as to why costs related to Con Aug (also known as Inventory Solution) were not trued up at year-end.

**BPA Response:** BPA disagrees with KPMG’s conclusion.

KPMG asserts that BPA did not provide adequate documentation as to why costs related to Conservation Augmentation (ConAug) were not trued up at year-end. Documentation of why costs related to ConAug are not trued up at year-end is contained in the 2002 Supplemental ROD. Specifically, BPA established in its WP-02 rate proceeding that:

The net cost of the Inventory Solution was estimated and was not to be adjusted for actual expenses incurred for augmenting the system. *Mesa, et al.*, WP-02-E-BPA-32, at 15. The net cost of the Inventory Solution is contained in the Inventory Solution “box” in Exhibit I of the Block/Slice PSA (also known as Table D in the 2002 GRSPs). The net cost of the Inventory Solution includes ConAug costs. Slice purchasers were responsible for paying their share of the estimated net cost of the Inventory Solution. *Id.* at 15.

Subsequently, BPA determined that the net cost of the Inventory Solution (also referred to as Inventory Augmentation) was to be adjusted once for changes in BPA’s load obligations after the conclusion of BPA’s Subscription period. *Mesa, et al.*, WP-02-E-BPA-54, at 11. The net cost of the Inventory Solution = Inventory Solution aMW x 28.1 mills minus revenues associated with DSI and IOU sales. *Id.* This adjustment was for changes in load obligations only, and not for changes in ConAug amounts. *Id.*

After BPA determined that the cost of augmentation power was significantly above 28.1 mills/kwh and that significant increases in its public load obligations were evident nearing the end of its Subscription period, BPA designed and proposed its Load-Based Cost Recovery Adjustment Clause (LB CRAC) charge in its 2002 Supplemental Power Rate Proposal. 2002 Supplemental ROD, WP-02-A-09, at 1-12. The LB CRAC charge accounts for both the increase in augmentation power needed above the amount of augmentation power projected in the May 2000 Rate Case and the increase in the cost of that power above the cost of 28.1 mills and replaced the one-time adjustment to the Inventory Solution *Id.* at 2-6. Essentially, the LB CRAC charge handles the increases in amount of power and the cost of that power beyond what is included in the Inventory Solution “box” of Exhibit I (also known as Table D in the 2002 GRSPs). The LB CRAC charge computes the appropriate increases from the starting point of what Inventory Solution costs were included in the base Slice Rate and the base PF rate. This replaces what the one-time adjustment to the Inventory Solution had been designed to do. *Id.* at 8-2. The LB CRAC handles increases over and above the starting point of Inventory Solution costs, and therefore, the starting point assumptions of net costs are not trued up. *Id.* at 2-6.

The language in the Methodology that was related to the one-time adjustment of the Inventory Solution did contain a formula that ensured that this adjustment would never be a downward adjustment. *Id.* at 8-A-6. See the formula “ $(CL_R - FL_R)$  cannot be a value less than zero.” This means that there could have been an upward adjustment of the net cost of the Inventory Solution, but not a downward adjustment in this amount. The section containing this formula had been struck because it was replaced by the LB CRAC charge calculation process. However, the LB CRAC calculation process maintained the principles embodied in the one-time adjustment to the Inventory Solution. The LB CRAC is consistent with the principle in that the LB CRAC computes an appropriate upward adjustment to the base net cost of the Inventory Solution included in the Slice Rate.

Therefore, BPA has not adjusted the net cost of the Inventory Solution for the CY 2002 True-Up.

BPA provided KPMG with a copy of the 2002 Supplemental ROD that is referenced above. This documentation is sufficient to show that Conservation Augmentation costs of \$5,415,000 should be included in the Actual Slice Revenue Requirement and accordingly is the documentation for that cost as provided to KPMG.

Furthermore, this adjustment is inappropriate because it seeks to change the Block/Slice contract. In addition, KPMG’s conclusion challenges BPA’s implementation of the Slice Rate and the Methodology to Calculate Slice Rate and Slice True-Up Adjustment Charge (Methodology). The Methodology is included in the 2002 Supplemental Power Rate Proposal Administrator’s Final Record of Decision (2002 Supplemental ROD) and was approved by the Federal Energy Regulatory Commission (FERC) on July 21, 2003.

#### **Item #12 - PBL Efficiencies Charges**

**Report Conclusion:** [REDACTED] Costs related to PBL Efficiencies projects were new costs since they did not have a separate line item in Exhibit I. [REDACTED]

[REDACTED]

**BPA Response:** BPA disagrees with KPMG's conclusion for the following reasons:

Section 4(b)(5)(A) does not refer [REDACTED] no line item for such costs rather it addresses criteria for including new costs. PBL Efficiencies costs are not new costs, but rather a group of costs that were included in other categories of costs listed in Exhibit I (which is also Table D in the 2002 GRSPs). The fact that BPA chose to delineate these costs separately in the Actual Slice Revenue Requirement for CY 2002 does not make them new costs per the Block/Slice PSA. BPA discussed PBL Efficiencies costs through its Financial Choices process on September 10, 2002 and a handout from this workshop documents that "the Power Business Line Efficiencies Program was created in 1999 to address the need for functional and system changes to respond to a rapidly changing market."

Software introduction or upgrade, repair and efficiency upgrades are all normal operating costs. Since BPA has discussed the fact that it was seeking "*efficiencies*," BPA began showing these costs associated with its Efficiencies Program broken out separately from other operating costs, thus demonstrating BPA implementation of efforts to find efficiencies where it could.

The May 2000 Slice Revenue Requirement (and PBL Revenue Requirement) used expense categories that date back to FY 1999. The FY 1999 expense categories were summarized at a higher level than they are currently. Any PBL Efficiencies costs would have been included in several categories, such as Generation Development and Coordination, Power Scheduling, or Power Marketing. The table in the September 10, 2002 PBL Efficiencies handout shows that actual expenses for the PBL Efficiencies Program were incurred as early as FY 2000 and FY 2001. This shows that these costs are not new and not subject to application of the new cost test criteria.

KPMG requested information to document BPA's PBL Efficiencies expenses for CY 2002. BPA provided KPMG with an accounting system report that contained details for the \$2.841 million charged to the PBL Efficiencies project in CY 2002. In addition, KPMG requested copies (KPMG Fifth Request) of any cost/benefit analyses associated with any of the PBL Efficiencies projects, such as the Transaction Scheduling System (TSS), Columbia Vista, and projects improving load forecasting. BPA did not provide KPMG with any cost/benefit analyses because these studies are associated with management decisions and therefore, outside the scope of this audit.

Even if PBL Efficiencies expenses were determined to be "new costs," the September 10, 2002 handout describes benefits that will accrue to all BPA customers, thereby meeting the new cost criteria for inclusion in the Actual Slice Revenue Requirement.

KPMG's review of this item is within the scope of the audit. However, BPA disagrees with KPMG's conclusion because of the reasons stated in the explanation above.

**Procedural Items**

**Report Conclusion:** [REDACTED] If a cost relates to a line item that is not in Exhibit I, then BPA should identify it as a new cost. [REDACTED]

**BPA Response:** BPA will use the line items provided in Exhibit I (which is also Table D in the 2002 GRSPs). However, to be transparent and consistent with other PBL reporting for Accumulated Net Revenues (ANR), BPA has used line items consistent with tables for ANR reports for the CY 2002 True-Up. For CY 2003, BPA will report the Actual Slice Revenue Requirement, using the line items provided in Exhibit I, but providing a crosswalk from ANR reports, as had been provided in the SN-03 Rate Case.

**Report Conclusion:** [REDACTED] Line items in the Actual Slice Revenue Requirement should match the line items in Exhibit I. [REDACTED]

**BPA Response:** BPA agrees with KPMG's conclusion: BPA will present costs on the same line as established in Exhibit I unless they are new costs. For example, BPA can put the CSRS Pension Expense on its own line.

**Report Conclusion:** [REDACTED] Line items in nVision reports should match the direct queries performed in the PeopleSoft accounting system. [REDACTED]

**BPA Response:** BPA disagrees with KPMG's conclusion for the following reasons: The nVision report used to report the Annual True-Up differs from direct queries, and is only relevant to reconciling the PBL income statement expenses to the expenses in the Annual True-Up. A reconciliation between each line of the income statement to the Annual True-Up was provided to the Auditors. The reconciliation is needed because, as noted in the referenced example (i.e., line #60), by design the income statement summarizes data to a greater level than does the Annual True-Up Adjustment. The greater detail requires that specific costs are pulled out of summarized numbers in the income statement, and displayed in the Annual True-Up separate from the summarized number.

## **Final Conclusion and Decision**

BPA has reviewed and analyzed the requested cost adjustments proposed by the Slice Customers Final Audit Report for Contract Year 2002 and will make the adjustments as noted in the body of this report. This report is the final decision on the part of BPA regarding the matters raised by the KPMG audit report. The decisions contained herein are a final action under section 9(e)(1)(G) of the Northwest Power Act.

**Miller, Thomas D - LP-7**

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**From:** Miller, Thomas D - LP-7  
**Sent:** Tuesday, September 09, 2003 4:13 PM  
**To:** Roach, Randy A - L-7; Van Buren, Marybeth - LP-7; Adler, David J - LP-7  
**Subject:** Slice Audit/Benton County case

I called Sue and left a message - she was out - suggesting that we update each other on the slice audit, and the litigation situation. I'll let you all know when I here back from her.

## Adler, David J - LP-7

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**From:** Van Buren, Marybeth - LP-7  
**Sent:** Tuesday, October 14, 2003 2:38 PM  
**To:** Adler, David J - LP-7; Miller, Thomas D - LP-7; Roach, Randy A - L-7  
**Subject:** FW: Slice materials

Let's have David coordinate with Sue since Tom and Randy are still in settlement discussions. Please send David your comments and/or suggestions. Thanks, MVB

-----Original Message-----

**From:** Susan K. Ackerman [mailto:susan.k.ackerman@comcast.net]  
**Sent:** Tuesday, October 14, 2003 2:31 PM  
**To:** Marybeth Van Buren  
**Subject:** Slice materials

MB, attached is NRU's petition on the Slice audit. We aren't challenging the method, just the implementation, but John has nevertheless said to go ahead and file by the October 20 date. Any comments/suggestions/edits? I'd love any that the BPA lawyers have. Highlighting just indicates where I need to check citations.

Also, could you forward to Tom Miller or others in OGC that need to look at this? I don't have all the email addresses.

We need to put the mailing together on Thursday, so I'd appreciate any comments before then. Thanks!

Susan Ackerman  
503-297-2392

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NORTHWEST REQUIREMENTS )  
UTILITIES, for both itself and its members, ) No.  
CITY OF ASHLAND (OREGON), )  
BENTON RURAL ELECTRIC ASSOCIATION, )  
(WASHINGTON), BIG BEN ELECTRIC CO- )  
OPERATIVE (WASHINGTON), CITY OF ) **PETITION FOR REVIEW OF**  
BONNERS FERRY (IDAHO), CANBY UTILITY ) **IMPLEMENTATION OF**  
BOARD (OREGON), CITY OF CASCADE ) **SLICE RATE**  
LOCKS (OREGON), CENTRAL LINCON )  
PEOPLES UTILITY DISTRICT (OREGON), )  
CITY OF CHENEY (WASHINGTON), )  
COLUMBIA BASIN ELECTRIC COOPERATIVE ) **RELATED MATTER:**  
(OREGON), COLUMBIA POWER COOPERA- ) **No. 03-71471**  
TIVE (OREGON), COLUMBIA RURAL )  
ELECTRIC ASSOCIATION (WASHINGTON), )  
EAST END MUTAL ELECTRIC COMPANY )  
(IDAHO), FERRY COUNTY PUBLIC UTILITY )  
DISTRICT NO. 1 (WASHINGTON), )  
FLATHEAD ELECTRIC COOPERATIVE )  
(MONTANA), CITY OF FOREST GROVE )  
(OREGON), GLACIER ELECTRIC CO- )  
OPERATIVE (MONTANA), HARNEY )  
ELECTRIC COOPERATIVE (OREGON), HOOD )  
RIVER ELECTRIC COOPERATIVE (OREGON), )  
IDAHO COUNTY LIGHT AND POWER )  
(IDAHO), INLAND POWER & LIGHT (WASH- )  
INTON), KLUCKITAT COUNTY PUD (WASH- )  
INTON), KOOTENAI ELECTRIC COOPERA- )  
TIVE (IDAHO), LINCOLN ELECTRIC COOP- )  
ERATIVE, INC. (MONTANA), LOWER VALLEY )  
ELECTRIC (WYOMING), MIDSTATE )  
ELECTRIC COOPERATIVE (OREGON), )  
MISSION VALLEY POWER (MONTANA), )  
MODERN ELECTRIC WATER COMPANY )  
(WASHINGTON), CITY OF MONMOUTH )  
(OREGON), NESPELEM VALLEY COOP- )  
ERATIVE (WASHINGTON), NORTHERN )  
WASCO COUNTY PUBLIC UTILITY DISTRICT )  
(OREGON), NORTHWEST IRRIGATION )  
UTILITIES (IDAHO), ORCAS POWER & )  
LIGHT COOPERATIVE (WASHINGTON), )



2003. Pursuant to Federal Rules of Appellate Procedure 15 (c) and Ninth Circuit Rule 15-2, Petitioners have served a copy of this Petition and the Civil Appeals Docketing Statement on all parties to BPA's 2002 Wholesale Power Rate Case.

1. BPA developed a firm power product called the Slice product as part of its Priority Firm Rate offerings. Rate design aspects of the Slice product were developed in the context of BPA's 2000 Power Rate Case and 2002 Supplemental Rate Case hearings, pursuant to section 7(i) of the Northwest Power Act, 16 U.S.C. § 839e(i). The Slice Rate actually consists of a number of components which include the Slice Rate, the Actual Slice Revenue Requirement, the Annual True-Up for Actual Costs, Slice Implementation Costs, and Total Individual charges (collectively referred to as the "Slice Rate"). Collectively, BPA uses these components each year to recalculate the price paid by Slice Customers for the Slice product. The Slice Rate was adopted by BPA in its May 2000 Record of Decision, WP-02-A-02, Part 3 of 3; WP-02-A-02, Attachment A-1. Revisions were made to the Slice Rate in BPA's 2002 Supplemental Record of Decision, WP-02-A-09, Attachment, at 8-A-1 through 8-A-6. BPA's 2002 Wholesale Power Rates, including the Slice Rate, were given final approved by the Federal Energy Regulatory Commission (FERC) on July 21, 2003. 104 F.E.R.C. ¶ 61,093 (July 21, 2003).

2. The Slice Rate is a formula rate that requires an annual accounting and true up pursuant to the cost categories, methods and formulas developed in the rate case. In January 2003, BPA performed this annual accounting and true up of the Slice Rate for the 2002 contract year. Slice customers retained an auditing firm to audit BPA's accounting and true up. The audit raised a number of issues regarding BPA's implementation of the accounting and true up provisions of the Slice Rate. BPA

responded to the audit on August 18, 2003 (*see*, Exhibit B). BPA's response agreed with the auditor's conclusions on some items, and disagreed with others. To the extent that BPA has agreed with some of the auditor's conclusions, the financial consequences of those decisions will be borne by Non-Slice Customers through their BPA rates.

3. The great majority of the issues raised in the audit are challenges to BPA's Slice Rate or to BPA decisions implementing the Slice Rate. Based on information received, Non-Slice Customers believe that Slice Customers may attempt to resolve issues raised by the audit in binding arbitration. Non-Slice Customers would not be able to participate in binding arbitration proceedings, although they would bear any costs that are not borne by Slice Customers as a result of any resolution of accounting and true up issues.

4. Slice Customers' issues regarding the Slice rate accounting and true up involve challenges to a final rate or final decision on rate implementation and therefore are subject to this Court's exclusive jurisdiction. *See, Puget Sound Energy, Inc., v. Bonneville Power Administration*, 310 F.3<sup>rd</sup> 613, 617 (9<sup>th</sup> Cir. 2002); Public Utilities Commission of State of Cal. v. P.E.R.C., 814 F.2d 560 (9<sup>th</sup> Cir. 1987); Central Lincoln Peoples Utility District v. Johnson, 751 F.2d 1101, 1108-10 (9<sup>th</sup> Cir. 1984). This Court has previously ruled that BPA decisions regarding rate true up provisions are rate implementation matters within the exclusive jurisdiction of the Ninth Circuit. Puget Sound, *supra*, 310 F.3<sup>rd</sup> at 622. Because rate and rate implementation matters are within the exclusive jurisdiction of this Court, they are not arbitrable. Kaiser Aluminum & Chemical Corporation v. Bonneville Power Administration, 261 F.3<sup>rd</sup> 843, 852 (9<sup>th</sup> Cir. 2001).

5. As required by 16 U.S.C. § 839f(e), this Petition has been submitted within 90 days of BPA's final decision on the Slice Rate accounting and true up audit.

**WHEREFORE**, Non-Slice Customers respectfully request that the Court (i) determine that it has exclusive jurisdiction to review BPA's final decision regarding the audit of its Slice Rate accounting and true up, and (ii) review on the merits BPA's final decision on the accounting and true up audit.

**DATED** this 17<sup>th</sup> day of October, 2003.

SUSAN K. ACKERMAN

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Susan K. Ackerman, OSB #83138  
P.O. Box 10207  
Portland, Oregon 97296

Attorney for Non-Slice Customers

**Adler, David J - LP-7**

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**From:** Adler, David J - LP-7  
**Sent:** Wednesday, October 15, 2003 2:00 PM  
**To:** 'Susan K. Ackerman'  
**Subject:** RE:

Great. Thanks much.

-----Original Message-----

**From:** Susan K. Ackerman [mailto:[susan.k.ackerman@comcast.net](mailto:susan.k.ackerman@comcast.net)]  
**Sent:** Wednesday, October 15, 2003 1:56 PM  
**To:** David Adler  
**Subject:**

Most recent version. Thanks, Dave.

Susan Ackerman  
503-297-2392

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NORTHWEST REQUIREMENTS )  
UTILITIES, for both itself and its members, ) No.  
CITY OF ASHLAND (OREGON), )  
BENTON RURAL ELECTRIC ASSOCIATION, )  
(WASHINGTON), BIG BEND ELECTRIC CO- )  
OPERATIVE, INC. (WASHINGTON), CITY OF ) PETITION FOR REVIEW OF  
BONNERS FERRY (IDAHO), CANBY UTILITY ) SLICE RATE  
OREGON), CITY OF CASCADE LOCKS ) IMPLEMENTATION  
(OREGON), CENTRAL LINCON PEOPLE'S )  
UTILITY DISTRICT (OREGON), CITY OF )  
CHENEY (WASHINGTON),COLUMBIA BASIN )  
ELECTRIC COOPERATIVE, INC. (OREGON), ) RELATED MATTER:  
COLUMBIA POWER COOPERATIVE ASSO- ) No. 03-71471  
CIATION (OREGON), COLUMBIA RURAL )  
ELECTRIC ASSOCIATION, INC. (WASHING- )  
TON), EAST END MUTAL ELECTRIC )  
COMPANY, LTD (IDAHO), FERRY COUNTY )  
PUBLIC UTILITY DISTRICT (WASHINGTON), )  
FLATHEAD ELECTRIC COOPERATIVE, INC. )  
(MONTANA), CITY OF FOREST GROVE )  
(OREGON), GLACIER ELECTRIC CO- )  
OPERATIVE, INC. (MONTANA), HARNEY )  
ELECTRIC COOPERATIVE, INC. (OREGON), )  
HOOD RIVER ELECTRIC COOPERATIVE )  
(OREGON), IDAHO COUNTY LIGHT AND )  
POWER (IDAHO), INLAND POWER & LIGHT )  
COMPANY (WASHINTON), PUD NO. 1 OF )  
KLUCKITAT COUNTY (WASHINGTON), )  
KOOTENAI ELECTRIC COOPERATIVE )  
(IDAHO), LINCOLN ELECTRIC CO- )  
OPERATIVE, INC. (MONTANA), LOWER )  
VALLEY ENERGY (WYOMING), MIDSTATE )  
ELECTRIC COOPERATIVE, INC, (OREGON), )  
MISSION VALLEY POWER (MONTANA), )  
MODERN ELECTRIC WATER COMPANY )  
(WASHINGTON), CITY OF MONMOUTH )  
(OREGON), NESPELEM VALLEY COOP- )  
ERATIVE, INC, (WASHINGTON), NORTHERN )  
WASCO COUNTY PEOPLE'S UTILITY )  
DISTRICT (OREGON), ORCAS POWER & )  
LIGHT COOPERATIVE (WASHINGTON), )



BPA's 2000 and 2002 Wholesale Power Rates. A copy of BPA's final decision respecting the audit, dated August 18, 2003<sup>1</sup>, is attached to the Civil Appeals Docketing Statement filed with this petition. A related petition for review is pending in No. 03-71471 in this Court, although a Motion to Dismiss for Lack of Jurisdiction was filed by Petitioners in that matter on October 3, 2003. Pursuant to Federal Rules of Appellate Procedure 15 (c) and Ninth Circuit Rule 15-2, Petitioners have served a copy of this Petition and the Civil Appeals Docketing Statement on all parties to BPA's 2002 Wholesale Power Rate Case.

1. BPA developed a firm power product called the Slice product as part of its Priority Firm Rate offerings. Rate design aspects of the Slice product were developed in the context of BPA's 2000 Power Rate Case and 2002 Supplemental Rate Case hearings, pursuant to section 7(i) of the Northwest Power Act, 16 U.S.C. § 839e(i). The Slice Rate actually consists of a number of components which include the Slice Rate, the Actual Slice Revenue Requirement, the Annual True-Up for Actual Costs, Slice Implementation Costs, and Total Individual charges, among others (collectively referred to as the "Slice Rate"). Collectively, BPA uses these components each year to recalculate the price paid by Slice Customers for the Slice product. The Slice Rate was adopted by BPA in its May 2000 Record of Decision, WP-02-A-02, Part 3 of 3; WP-02-A-02, Attachment A-1. Revisions were made to the Slice Rate in BPA's 2002 Supplemental Record of Decision, WP-02-A-09, Attachment, at 8-A-1 through 8-A-6. BPA's 2002 Wholesale Power Rates, including the Slice Rate as revised, were approved by the Federal Energy Regulatory

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<sup>1</sup> The full title of BPA's response is "Block and Slice Power Sales Agreement Independent Audit by Slice Purchasers Pursuant to 4(b)(6)(D) of the Slice Agreement Bonneville Power Administration Response to the Final Report August 18, 2003."

Commission (FERC) on a final basis on July 21, 2003. 104 F.E.R.C. ¶ 61,093 (July 21, 2003).

2. The Slice Rate is a formula rate that requires an annual accounting and true up pursuant to the cost categories, methods and formulas developed in the rate case. In January 2003, BPA performed this annual accounting and true up of the Slice Rate for the 2002 contract year. Slice customers retained an auditing firm to audit BPA's accounting and true up. The audit raised a number of issues regarding BPA's implementation of the accounting and true up provisions of the Slice Rate. BPA responded to the audit on August 18, 2003. BPA's response agreed with the auditor's conclusions on some items, and disagreed with others. To the extent that BPA has agreed or disagreed with the auditor's conclusions, the financial consequences of those decisions will be borne by Petitioners and other non-Slice customers through their BPA rates.

3. The great majority of the issues raised in the audit are challenges to BPA's Slice Rate or to BPA decisions implementing the Slice Rate. Based on information received, Petitioners believe that Slice Customers may attempt to resolve issues raised by the audit in binding arbitration. Petitioners and other non-Slice customers would not be able to participate in binding arbitration proceedings, although they would bear any costs that are not borne by Slice Customers as a result of any resolution of accounting and true up issues.

4. Slice Customers' issues regarding the Slice rate accounting and true up involve challenges to a final rate or final decision on rate implementation and therefore are subject to this Court's exclusive jurisdiction. *See, Northwest Power Act*, 16 U.S.C. § 839f(e)(5); *Puget Sound Energy, Inc., v. Bonneville Power Administration*, 310 F.3<sup>rd</sup> 613,

617 (9<sup>th</sup> Cir. 2002). This Court has previously ruled that BPA decisions regarding rate true up provisions are rate implementation matters within the exclusive jurisdiction of the Ninth Circuit. *Puget Sound, supra*, 310 F.3<sup>rd</sup> at 622. Because rate and rate implementation matters are within the exclusive jurisdiction of this Court, they are not arbitrable. *Kaiser Aluminum & Chemical Corporation v. Bonneville Power Administration*, 261 F.3<sup>rd</sup> 843, 852 (9<sup>th</sup> Cir. 2001).

5. As required by 16 U.S.C. § 839f(e), this Petition has been submitted within 90 days of BPA's final decision on the Slice Rate accounting and true up audit.

**WHEREFORE**, Petitioners respectfully request that the Court (i) determine that it has exclusive jurisdiction to review BPA's final decision regarding the audit of its Slice Rate accounting and true up, and (ii) review on the merits BPA's final decision on the accounting and true up audit.

**DATED** this \_\_\_\_<sup>th</sup> day of October, 2003.

SUSAN K. ACKERMAN

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Susan K. Ackerman, OSB #83138  
P.O. Box 10207  
Portland, Oregon 97296

Attorney for Petitioners