ASC METHODOLOGY

INVESTOR-OWNED UTILITY SUPPLEMENTAL RESPONSE

10/30/2007

The supplemental response provided below addresses materials and comments presented by various parties at the October 22, 2007, Residential Exchange Workshop and supplements the "ASC Methodology – Investor Owned Utility Preliminary Response," which was also submitted October 22, 2007.[1]

1. What construct should BPA use to determine a utility's ASC?

SUPPLEMENTAL RESPONSE:

a. Review and Comment

BPA's ASC Process contemplates that an exchanging utility's proposed ASC would be reviewed at BPA. This review would include the participation of interested parties, such as the exchanging utility, customers, and other stakeholders. Among other things, interested parties may: i) obtain any supporting ASC documentation prepared by BPA; ii) submit written comments to BPA; iii) submit data requests to exchanging utilities through BPA; and iv) challenge BPA's ASC proposal. BPA proposes that it will post to its website any responses to comments and rationales used in support of various ASC issues. BPA will prepare an ASC report for each exchanging utility setting forth BPA's ASC determination. Pursuant to section 205 of the Federal Power Act ("FPA") and section 35.31 of the Code of Federal Regulations ("CFR"), exchanging utilities must also file ASCs with FERC.

BPA's current straw man proposal for review of proposed ASCs would duplicate procedures already provided at the Federal Energy Regulatory Commission ("FERC") for review of investor-owned utility rates under section 205 of the Federal Power Act. This would essentially allow parties "two bites at the apple" with respect to their ability to challenge an exchanging utility's ASC. Pursuant to section 205 of the FPA and 18 CFR

[1] On October 29, 2007, public power submitted preliminary responses to BPA's request for Feedback on 7(b)(2) and ASC methodology issues ("Public Power Comments"). The Public Power Comments were not distributed until the day before the investor-owned utilities' supplemental response was to be submitted. As a result, the investor-owned utilities have not yet had an opportunity to fully respond to the Public Power Comments. The investor-owned utilities reserve the right to submit additional comments at a later time in response to the Public Power Comments. In that regard, silence regarding any argument or factual misstatement in the Public Power Comments does not indicate or imply agreement therewith or any undertaking to correct any or all such factual misstatements or respond to any and all such arguments.

35.31, exchanging utilities are required to file ASCs with FERC and any interested stakeholder may participate in FERC review of the filed ASCs under FERC's procedures. 18 CFR 35.31(b) provides that FERC will determine whether the ASC set by BPA for the applicable exchange period was determined in accordance with the ASC methodology.

The process provided at FERC for review of ASCs is sufficient. The investor-owned utility proposal for ASC determination as set forth in the “ASC Methodology – Investor Owned Utility Preliminary Response” provides for meaningful participation by interested parties without duplicating the procedures already afforded under federal law. For example, the investor-owned utility proposal includes the ability of interested stakeholders to provide comments to BPA on draft ASC determinations posted to BPA’s website. Under this proposal, BPA reviews and responds to the comments and determines the ASCs, posting the comments and BPA responses on BPA's website.

In any event, any requests in connection with review at BPA of proposed ASCs should only be data requests that BPA determines are necessary and appropriate. This will avoid or mitigate the possibility of unnecessary, unduly burdensome, and duplicative data requests. Under this approach, interested parties could propose data requests to BPA. BPA would issues such data requests if it determines they are necessary, appropriate, and do not duplicate data requests previously issued by BPA.

b. New Utility Plant Additions

With respect to inclusion in a utility’s ASC of the cost of new resources projected to come on line by the end of the period for which ASC is being determined, BPA's straw man proposal is to make two ASC determinations: (1) assuming that that loads are served with market purchases rather than with such new resources, and (2) assuming that the costs of such new resources are included in ASCs. Actual REP benefits paid would be based on ASC determination (1) above (*i.e.*, without such new resource additions) until such time as the exchanging utility files a notice that the resource(s) has been added to plant in service accompanied by a commission rate order affirming that the resource(s) has been added to rate base. Upon receipt of this additional documentation, the ASC determination with resource additions would be used to calculate REP benefits.

BPA's proposal for reflecting the cost of new resources projected to come on line by the end of the period for which ASC is being determined is a helpful improvement in the “non-trueup” model. However, the shift to include the cost of such new resources should be tied to the exchanging utility's filing of a notice with BPA that that the investment in the plant has been moved from Construction Work In Progress to a Rate Base account.

The alternative of requiring a commission rate order including the cost of the investment in the resource in retail rates is problematic. First, it leads to a different treatment between historic plant data taken from the FERC Form 1 and forecasted resource addition, because the utility typically records amounts in FERC accounts prior to commission inclusion in rates. Second, regulatory lag between the new utility plant in-service date and a commission order could be significant and thus not reflect the actual utility resource costs. Third, this alternative would disadvantage utilities operating in jurisdictions that allow the use of alternative cost adjustment mechanisms to recover the costs of new resources as an alternative to adding the costs to rate base. Fourth, it is not clear how the concept of requiring a commission rate order affirming that the resource(s) has been added to rate base in the determination of retail rates would work for multi-state utilities.

2. Should return on equity be included as a resource cost?

SUPPLEMENTAL RESPONSE:

The appropriate cost of capital to be used in determining a utility's ASC should be the Weighted Average Cost of Capital (WACC)[2] as allowed or approved by the appropriate state regulatory body in the utility's most recent general rate case. The WACC includes capital structure (*i.e.*, debt to equity ratio), cost of debt and cost of equity (*i.e.*, return on equity or ROE) for the utility. Therefore, WACC appropriately takes into account the cost to the utility of financing resource additions, since both debt and equity are used to finance resource additions. If a utility is rate regulated by multiple commissions, its WACC should be the sum of the individual WACCs multiplied by the appropriate allocation factor.

[2] The WACC is also known as the Rate of Return.