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REBUTTAL TESTIMONY OF  
SYDNEY D. BERWAGER, STEPHEN R. OLIVER, AND HARRY W. CLARK  
Witnesses for Bonneville Power Administration

**SUBJECT: Rebuttal Testimony for Service Proposal for Direct Service Industrial Customers**

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5 **SUBJECT: REBUTTAL TESTIMONY FOR SERVICE PROPOSAL FOR DIRECT**  
6 **SERVICE INDUSTRIAL CUSTOMERS**

7 **Section 1. Introduction and Purpose of Testimony**

8 *Q. Please state your names and qualifications.*

9 A. My name is Sydney D. Berwager. My qualifications are contained in WP-02-Q-BPA-03.

10 A. My name is Stephen R. Oliver. My qualifications are contained in WP-02-Q-BPA-54.

11 A. My name is Harry W. Clark. My qualifications are contained in WP-02-Q-BPA-12.

12 *Q. Please state the purpose of your testimony.*

13 A. The purpose of our testimony is to respond to the direct testimony of parties regarding  
14 certain aspects of Bonneville Power Administration's (BPA) proposal for service to its  
15 direct service industrial customers (DSI) that are not directly related to BPA's proposed  
16 Industrial Firm Power (IP) Indexed Rate option. BPA's rebuttal testimony regarding the  
17 proposed Cost-Based Indexed Rate is contained in the testimony of Miller, *et al.*,  
18 WP-02-E-BPA-46.

19 *Q. How is your testimony organized?*

20 A. This testimony consists of three sections including this introductory section. Section 2  
21 responds to portions of the testimony of the Public Power Council (PPC). Section 3  
22 responds to the joint testimony filed by Alcoa and Vanalco regarding the Compromise  
23 Approach and other aspects of BPA's proposal for service to the all DSIs.  
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1 **Section 2. Response to Testimony of the Public Power Council**

2 *Q. PPC states that customers groups other than the DSIs were not involved in the*  
3 *development of the Compromise Approach. Hansen, et al., WP-02-E-PP-06, at 2. Is this*  
4 *correct?*

5 *A. It is true that other customer groups did not attend meetings between BPA and the DSIs*  
6 *where the Compromise Approach was discussed and negotiated. However, the*  
7 *Compromise Approach described what would be in BPA's initial proposal, so it does not*  
8 *represent a final BPA decision on the nature of the service to these DSIs. The 7(i)*  
9 *process is the vehicle for taking comment on this proposal from customers, including*  
10 *those represented by the PPC. These issues will be decided as part of the rate case Final*  
11 *Record of Decision (ROD).*

12 *Q. The PPC states that the Compromise Approach has failed because not all DSIs support*  
13 *it. Hansen, et al., WP-02-E-PP-06, at 4. Please respond.*

14 *A. We disagree. Most of the DSIs support the Compromise Approach. While BPA did*  
15 *consider taking the Compromise Approach off the table in light of the fact that two DSIs*  
16 *elected not to sign the agreement, BPA felt that doing so would defeat its objective of*  
17 *supporting continued DSI operations and employment in the region, consistent with its*  
18 *many other rate case goals. BPA believed also that it would be appropriate to move*  
19 *forward with the proposal on behalf of the DSIs who had said they accepted it as part of*  
20 *the Initial Proposal and would be willing to support it.*

21 *Q. In addition, PPC states that BPA needs to reflect in its proposal for DSI service the fact*  
22 *that Reynolds, a DSI that signed the Compromise Approach and that operates two*  
23 *aluminum smelters served by BPA, will soon be acquired by Alcoa, a DSI that did not*  
24 *sign the Compromise Approach, (Hansen, et al., WP-02-E-PP-06, at 5), and that at a*  
25 *minimum, BPA should reduce the amount of power it proposes to sell under the*  
26

1            *Compromise Approach by the amount currently offered to Reynolds. Id. at 6. Do you*  
2            *agree?*

3            A.    No. Besides the fact that the proposed merger has not occurred and may not until after  
4            rates are approved by the Federal Energy Regulatory Commission (FERC), Reynolds  
5            signed the Compromise Approach agreement and, to the best of our knowledge,  
6            continues to abide by its terms. BPA has no intention of reducing Reynold’s benefits  
7            based on speculation that it will not continue to abide by the terms of the Compromise  
8            Approach agreement. However, if the merger is completed and the merged company  
9            does take actions inconsistent with the Compromise Approach agreement, then BPA  
10           would look at what its options might be at that time.

11           **Section 3.      Response to Testimony of Alcoa and Vanalco**

12           *Q.    Alcoa and Vanalco claim in their testimony that BPA proposed a more onerous service*  
13           *arrangement for them because they refused to accede to the Administrator’s demand that*  
14           *they relinquish their right to fully participate in the section 7(i) process. Speer, et al.,*  
15           *WP-02-E-AL/VN/EG-01, at 4. Please respond*

16           A.    First, we disagree with Alcoa’s and Vanalco’s characterization of BPA’s proposal for  
17           service to them as “onerous.” BPA is offering to sell Alcoa and Vanalco more than half  
18           of the power they are currently purchasing from BPA at a price of 25 mills/kilowatthour  
19           (kWh), well below projected market power prices. *See Oliver, et al., WP-02-E-BPA-45.*  
20           Second, Alcoa and Vanalco represented to BPA in negotiations that they were not  
21           interested in BPA power at either 23.5 or 25 mills/kWh, with or without the conditions  
22           under the Compromise Approach, so it is unclear how the one proposal is “onerous”  
23           compared to the other. Third, when Alcoa and Vanalco refused to join the other DSIs in  
24           signing the Compromise Approach, BPA could have opted to offer nothing to those two  
25           companies, or leave the original offer of their share of 1,200 average megawatts (aMW)  
26           at 25 mills/kWh on the table. In an attempt to demonstrate that there was no intent to

1 unduly disadvantage Alcoa and Vanalco for their decision, BPA decided to carry the  
2 earlier below-market proposal to them into the initial proposal, so again we do not agree  
3 that proposing to make available to these two companies the original offer is “onerous”  
4 compared with the alternative.

5 In addition, we do not believe BPA could justifiably propose in the rate case to  
6 offer Alcoa and Vanalco the same terms of service as those offered to DSI customers that  
7 bargained with BPA for a deal that, we believe, enhances the quality and sustainability of  
8 BPA’s overall rate proposal.

9 A secondary consideration in allocating a smaller amount of power to Alcoa and  
10 Vanalco is the risk and cost associated with BPA making augmentation purchases to meet  
11 loads of companies that were indicating, by their refusal to sign the Compromise  
12 Approach, that there was a real question whether they would be purchasing power from  
13 BPA. One approach to managing this uncertainty, and the resulting risks, is to reduce the  
14 amount of discretionary sales that fall into this category.

15 *Q. Vanalco and Alcoa state that BPA proposed a lesser allocation of power for them solely*  
16 *because they refused to sign the Compromise Agreement. Speer, et al.,*  
17 *WP-02-E-AL/VN/EG-01, at 5. Please respond.*

18 *A.* We presume that the lesser allocation they are referring to is the proposal to base their  
19 allocation on a 1,200 aMW DSI class total as opposed to the 1,500 aMW class total that  
20 was used for the DSIs that signed the Compromise Approach, and not the proposal to  
21 allocate power to the individual companies based on their purchases from BPA during the  
22 current rate period under the Industrial Power (IP-96) rate schedule. The decision to  
23 allocate to individual companies based on IP-96 purchases was not a focal point of the  
24 Compromise Approach agreement negotiations. There were a number of reasons that  
25 BPA offered Alcoa and Vanalco their share of a 1,200 aMW class total. First, it was the  
26 offer that had been on the table prior to the Compromise Approach discussions and BPA

1 concluded it would be inappropriate to withdraw that offer from Alcoa and Vanalco. The  
2 subsequent offer to increase the amount for those who agreed to the Compromise  
3 Approach was additional value that BPA had offered to any DSI who agreed to accept  
4 and support the Compromise Approach. Second, as noted above, BPA must make some  
5 projections regarding loads, and consequently make some decisions regarding system  
6 augmentation between now and the time contracts are actually executed with customers.  
7 The conclusion of Alcoa and Vanalco that the Compromise Approach was not acceptable  
8 to them makes BPA less confident that they will actually place load on BPA. There is a  
9 rationale for allocating a greater amount of power to the companies that, by agreeing to  
10 the Compromise Approach, indicated greater interest in buying from BPA. This logic  
11 does not apply in the case of the DSIs that supported neither the original Targeted  
12 Augmentation offer nor the Compromise Approach.

13 *Q. The testimony discusses the increased closure risk to Alcoa and Vanalco by virtue of*  
14 *BPA's proposal. Speer, et al., WP-02-E-AL/VN/EG-01, at 5. They conclude that BPA*  
15 *forced them to choose between the Compromise Approach and a greater risk of survival.*  
16 *Id. at 6. Please respond.*

17 *A.* As noted previously, the proposal to base the allocation to individual companies on their  
18 fiscal year (FY) 1997-2001 purchases was arrived at independently of the Compromise  
19 Approach, and is not related to whether any company signed the Compromise Approach.  
20 BPA has offered to sell power to Alcoa and Vanalco at below-market prices even though  
21 BPA has no obligation to do so under the Northwest Power Act. So, BPA has used its  
22 discretion in offering Alcoa and Vanalco service that should improve their survivability  
23 compared to the case without BPA's proposal. Their unwillingness to agree to the  
24 Compromise Approach did have consequences in terms of the Initial Proposal service  
25 offered to them. Those DSIs that agreed to the Compromise Approach did so partly on  
26 the basis that the service offered was an acceptable improvement, both in terms of price

1 and amount, over what BPA had stated it was willing to offer them absent their  
2 agreement. Unlike the other DSIs, both Alcoa and Vanalco chose not to accept the  
3 Compromise Approach.

4 *Q. Alcoa and Vanalco conclude that there is no cost-of-service basis for treating them*  
5 *differently. Speer, et al., WP-02-E-AL/VN/EG-01, at 6-7. Please respond.*

6 A. As explained above, BPA believes that there is an additional, though perhaps not easily  
7 quantifiable, cost and risk associated with planning to serve Alcoa and Vanalco, given the  
8 uncertainty about whether they would purchase from BPA even at 23.5 mills/kWh.  
9 While not the primary reason that BPA decided to make an offer to Alcoa and Vanalco  
10 which is different from the offer to the DSIs that accepted the Compromise Approach,  
11 BPA believes it is appropriate to reflect this difference in the service being offered.

12 *Q. How much revenue would BPA forgo if the Administrator decides in the Final ROD to*  
13 *offer Alcoa and Vanalco their allocation of power at 23.5 mills/kWh instead of*  
14 *25 mills/kWh?*

15 A. Assuming that BPA adopts its proposed allocation methodologies for the DSIs, and that  
16 both Alcoa and Vanalco purchase all the power allocated to them, then BPA would lose  
17 approximately \$3 million per year in revenues if BPA charged these companies  
18 23.5 mills/kWh, instead of 25.0 mills/kWh, for the same amount of power.

19 *Q. Alcoa and Vanalco state that the Compromise Approach would preclude them from*  
20 *arguing for a different allocation method from the method proposed by BPA. Speer,*  
21 *et al., WP-02-E-AL/VN/EG-01, at 8. Is this correct?*

22 A. The Compromise Approach agreement does state that the proposed allocation of power  
23 among the DSIs would be based on the relative amounts of Industrial Power (IP)  
24 purchased in the FY 1997-2001 time period. However, as noted elsewhere in this  
25 testimony, BPA's proposed allocation methodology was not decided as part of the  
26 Compromise Approach negotiations, nor was the allocation methodology a point that

1 received much discussion at those negotiations. BPA's primary concern centered on  
2 those elements of the Compromise Approach that created costs and risks for other  
3 customers.

4 *Q. Alcoa and Vanalco state several points for the assertion that BPA has already made a*  
5 *final decision regarding rates for service to the DSIs. Speer, et al.,*  
6 *WP-02-E-AL/VN/EG-01, at 9. Please respond.*

7 *A.* This is incorrect. BPA has made no final decisions regarding service to the DSIs,  
8 including Vanalco or Alcoa. BPA's rate proceeding is an ongoing administrative  
9 process, and every aspect of BPA's Initial Proposal in the ongoing rate proceeding  
10 remains subject to change and modification.

11 *Q. Alcoa and Vanalco argue that the rate case process is inherently flawed because the*  
12 *Administrator is the decisionmaker. Speer, et al., WP-02-E-AL/VN/EG-01, at 9. Please*  
13 *respond.*

14 *A.* It is a little difficult to know how to respond to this argument other than to refer these  
15 companies to BPA's enabling statutes, and most importantly the Northwest Power Act,  
16 where Congress created the rate setting process they feel is inherently flawed. Clearly,  
17 the role of the Administrator is not that of an impartial third party like a judge. Rather,  
18 the Administrator is charged with the duty of formulating a proposal for the sale of  
19 Federal power, and also with maintaining an open mind with respect to that proposal  
20 through the formal rate setting process. To our knowledge this is the first time either of  
21 these parties, both involved in many prior BPA rate cases, have taken the position, at  
22 least publicly, that BPA's ratemaking process is inherently flawed.

23 *Q. Next they argue that the fact that the Administrator was personally involved in fashioning*  
24 *the Compromise Approach is evidence that she has made a final decision on service to*  
25 *the DSIs. Speer, et al., WP-02-E-AL/VN/EG-01, at 9. Please respond.*

1 A. The Compromise Approach is an agreement by BPA to propose and support an Initial  
2 Proposal consistent with the Compromise Approach, but the proposal is subject to change  
3 in the rate case. BPA often fashions both the outlines and the details of rate case  
4 proposals with its customers prior to the commencement of a rate case, for example  
5 through its rate case workshops. This is not unusual and in fact is appropriate. BPA tries  
6 to formulate rate proposals that it believes will be largely acceptable to its customers, and  
7 such proposals can only be formulated through negotiation and compromise with its  
8 various classes of customers.

9 *Q. Alcoa and Vanalco also argue that the Industrial Power Targeted Adjustment Charge (IP*  
10 *TAC) rate is arbitrary. Speer, et al., WP-02-E-AL/VN/EG-01, at 9. Please respond.*

11 A. Alcoa and Vanalco argue that the IP TAC constitutes an arbitrary mix of cost-based and  
12 market-priced power. It is true that BPA “mixed” the two types of power in a way that  
13 would result in the rates contained in the Compromise Approach, but that does not make  
14 this an arbitrary action. BPA’s policy objective with respect to DSI service in the next  
15 rate period--driven in particular by the goal of enhancing aluminum smelter  
16 survivability--is to serve the DSIs with as much low cost power as it can without raising  
17 the rates of its other customers. The IP TAC rate of 23.5 mills/kWh is a rate BPA  
18 believes accomplishes these competing objectives. In this context, working backward  
19 from the rate that balances these goals as best as possible is not arbitrary. In addition, as  
20 the Compromise Approach and the Initial Proposal make clear, the level of the IP TAC  
21 rates can move if certain determinants of it move during the course of the rate case.

22 *Q. Alcoa and Vanalco argue that the DSIs are foreclosed by the Compromise Approach*  
23 *from further discussion of DSI rates, and that BPA is bound by the Compromise*  
24 *Approach to some further conduct beyond the Initial Proposal. Speer, et al.,*  
25 *WP-02-E-AL/VN/EG-01, at 9-10. Please respond.*  
26

1 A. It is not true that the DSIs are foreclosed by the Compromise Agreement from further  
2 discussion of DSI issues. This should be abundantly clear from the volume of testimony  
3 on DSI issues filed by the DSIs that did sign the Compromise Approach agreement. It is  
4 true that if all the DSIs had signed the Compromise Approach that there would be no  
5 DSIs filing testimony on the few issues they agreed not to contest. But that is not the  
6 same thing as “imposing a penalty” on the companies, but is rather the result of a  
7 negotiation between two business partners dealing at arms length.

8 Finally, we do not know what Alcoa and Vanalco are referring to when they state  
9 that certain conduct by the DSIs that signed the Compromise Approach indicates that  
10 BPA is obligated under the Compromise Approach to take further action beyond the  
11 initial proposal. BPA made no commitments to the DSIs beyond what is provided for in  
12 the Compromise Approach.

13 Q. *Beginning at page 11, line 21, Alcoa and Vanalco state that the economic value in the*  
14 *Compromise Approach is in the cost-based portion of the deal, and that the market-based*  
15 *portion of the deal provides no additional economic value. Speer, et al.,*  
16 *WP-02-E-AL/VN/EG-01, at 11. Is this correct?*

17 A. As we indicated in our direct case, the evidence suggests that making additional  
18 augmentation purchases for the DSIs, even if the DSIs are required to pay the full costs of  
19 those additional purchases, and melding those purchases with power priced under  
20 Section 7(c)(2), does materially aid DSI survivability by encouraging the broad use of  
21 these benefits over a larger DSI load than would be the case if the amount were only the  
22 cost-based portion.

23 Q. *Alcoa and Vanalco suggest that BPA is acting in a predatory fashion by combining the*  
24 *cost-based portion of the deal with the market-based portion, and not offering only the*  
25 *cost-based portion. Speer, et al., WP-02-E-AL/VN/EG-01, at 12. Is this correct?*  
26

1 A. No. Alcoa and Vanalco dispute BPA's forecast of power market prices, and seem to be  
2 asserting that BPA is linking the market-purchased power to the cost-based power only to  
3 reap some kind of windfall from the sale of the market-based portion, which they assert is  
4 going to cost BPA less to purchase than BPA is projecting. First, we disagree with Alcoa  
5 and Vanalco's conclusion that BPA is overestimating the purchase price for augmenting  
6 the Federal Base System with five-year flat-block purchases. *See Oliver, et al.,*  
7 *WP-02-E-BPA-45.* In addition, BPA is not linking the two components of power  
8 together in order to make a profit from the sales of the market-based portion to the DSIs,  
9 as Alcoa and Vanalco imply. On the contrary, if BPA was solely interested in  
10 maximizing its revenues, and not attempting to fashion a proposal for DSI service that  
11 enhances DSI smelter survivability, it simply would not be making any service proposal  
12 to the DSIs. BPA is proposing in this rate case that its other customers forgo the  
13 possibility of lower rates for themselves in order to make this proposal available to the  
14 DSIs, and BPA is taking on other risks related to its DSI service proposal. *See Burns,*  
15 *et al., WP-02-E-BPA-36.* Therefore, to suggest that BPA is acting in a predatory manner  
16 with respect to any part of this proposal is far-fetched.

17 *Q. Alcoa and Vanalco suggest that BPA abandon the Compromise Approach and offer*  
18 *cost-based power to the DSIs at the section 7(c)(2) equitable rate. Speer, et al.,*  
19 *WP-02-E-AL/VN/EG-01, at 12. Please respond.*

20 A. BPA believes that its ability to achieve the goal of enhancing the prospects of DSI  
21 survivability, while meeting its other rate objectives, is best achieved through the  
22 proposal to offer more power than would be available to them at the cost-based rate by  
23 making additional market-based purchases, and melding the costs together.

24 *Q. Alcoa and Vanalco state that BPA's proposal to allocate power to the DSIs based on IP*  
25 *purchases under the Block Sale Contracts is not consistent with the idea of aligning*  
26 *pre-2001 risks with post-2001 benefits. In particular, they argue that the above-market*

1 *purchases under those contracts acquired for the companies that signed them express*  
2 *targeted stranded cost protection post-2001, not more favorable treatment with regard to*  
3 *a follow-on contract. Speer, et al., WP-02-E-AL/VN/EG-01, at 13-1. Please respond.*

4 A. The primary benefit BPA received for the DSIs who purchased from BPA during this  
5 period was a high degree of certainty that BPA would be able to cover its costs during the  
6 1997-2001 period, a period that in 1995 it was believed that BPA's cost-based rates  
7 would be above market prices. The greater the 1997-2001 load placed on BPA by a DSI,  
8 the more of this benefit that BPA received from that DSI. BPA considers it entirely  
9 appropriate to reflect this benefit in how it will allocate power to the DSIs when it enters  
10 into the discretionary post-2001 sales. There were other benefits for both parties in the  
11 contracts. For instance, the DSIs who signed them did receive some stranded-cost  
12 protection; on the other hand, BPA benefited by having a substantial amount of take-or-  
13 pay firm sales at favorable rates during the five-year term of the contracts.

14 Q. *Alcoa and Vanalco propose that BPA should allocate power to the DSIs based on their*  
15 *"ability to take." Speer, et al., WP-02-E-AL/VN/EG-01, at 15. Do you agree?*

16 A. No. As explained above, BPA believes it is appropriate to allocate the benefits among  
17 those who provided BPA revenue certainty during the 1997-2001 period.

18 Q. *Alcoa and Vanalco state that 990 aMW of the power that BPA is proposing to make*  
19 *available to the DSIs is cost-based power that BPA should make available to the DSIs at*  
20 *the section 7(c)(2) rate. Speer, et al., WP-02-E-AL/VN/EG-02, at 18. Please respond.*

21 A. As we testified in our direct case, BPA has designed a DSI service package reflecting  
22 both a price and a quantity which are inextricably linked because the amount of service is  
23 important and allows a DSI to buy up to approximately 75 percent of its current IP  
24 purchases. But the price is also important, and is proposed to be at rates significantly  
25 below BPA's market price projections. BPA believes that this amount and price  
26 combination offers more than the sum total of its individual parts and will substantially

1 assist in the DSIs' ability to continue to operate in the Pacific Northwest. Another benefit  
2 that BPA receives from blending the two types of power into a single-amount offer is that  
3 the entire amount will be subject to the power Cost Recovery Adjustment Clause which  
4 provides BPA and its other customers a higher level of risk protection during the  
5 FY 2002-2006 than would be the case if the amount was simply 990 aMW. *See*  
6 *Berwager, et al., WP-02-E-BPA-09.*

7 *Q. Alcoa and Vanalco note that the direct assignment of augmentation purchases to*  
8 *particular customer classes is a significant departure from past practices. Speer, et al.,*  
9 *WP-02-E-AL/VN/EG-02, at 18. Please respond.*

10 *A. Yes it is, but BPA is attempting to address circumstances that are different than in the*  
11 *past. One such circumstance is that, according to BPA counsel, offers of new power*  
12 *sales contracts to the DSIs under section 5 of the Northwest Power Act for the period*  
13 *after 2001 are discretionary. The Administrator is proposing to use that discretion to*  
14 *make such sales to the DSIs, but only in the context of BPA's other rate case goals.*  
15 *Therefore, BPA is willing to spread net costs associated with the purchase of the*  
16 *990 aMW across its broad customer base, because it can do so and still meet its other rate*  
17 *objectives. However, the costs of BPA augmentation above that threshold level is*  
18 *appropriately the responsibility of the DSIs on whose behalf BPA is using its*  
19 *discretionary ability to serve.*

20 *Q. Alcoa and Vanalco allege that BPA's proposal to link the 450 aMW of market-priced*  
21 *power with the 990 aMW of cost-based power is a "tying arrangement," and that BPA is*  
22 *attempting to extract additional revenue from the DSIs and running "an unregulated*  
23 *business for profit." Speer, et al., WP-02-E-AL/VN/EG-02, at 20. They recommend that*  
24 *purchases made to augment the Federal Base System (FBS) should be treated as FBS*  
25 *resources. Id. Is their description accurate, and should BPA allocate all augmentation*  
26 *purchases to the FBS?*

1 A. Alcoa and Vanalco's assertions are absurd. BPA is taking risk in taking on the  
2 responsibility of serving this load, even though the expected costs of the 450 aMW of  
3 augmentation are projected in the rate case to be recovered fully from the DSIs. There is  
4 some risk that the cost of obtaining the power will be higher than forecast in the rate case,  
5 if BPA waits to purchase until the sales amount is known, or that the loads will not  
6 materialize once BPA has purchased the power, if it locks in the purchases before the  
7 sales amount is known.

8 For the reasons mentioned in the immediately preceding question, BPA is not  
9 proposing to treat the 450 aMW of purchases as FBS resources and spread those costs  
10 among all of BPA's requirements customers. In order for BPA to achieve its rates  
11 objectives, these costs should be borne by the DSIs on behalf of whom BPA is making  
12 the purchases.

13 Q. *Does this conclude your testimony?*

14 A. Yes.

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