

Tiered Rate Methodology Rate Case

**DIRECT TESTIMONY**

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May 2008

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**COST ALLOCATION and COST RECOVERY:**  
Bliven, Homenick, Lee, Lovell

TRM-12-E-BPA-03



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TESTIMONY of  
RAYMOND D. BLIVEN, RONALD J. HOMENICK, CARIE E. LEE, and  
BYRNE E. LOVELL  
Witnesses for Bonneville Power Administration

**SUBJECT: COST ALLOCATION and COST RECOVERY**

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**SUBJECT: COST ALLOCATION and COST RECOVERY**

**Section 1: Introduction and Purpose of Testimony**

*Q. Please state your names and qualifications.*

A. My name is Raymond D. Bliven, and my qualifications are contained in TRM-12-Q-BPA-01.

A. My name is Ronald J. Homenick, and my qualifications are contained in TRM-12-Q-BPA-09.

A. My name is Carie E. Lee, and my qualifications are contained in TRM-12-Q-BPA-11.

A. My name is Byrne E. Lovell, and my qualifications are contained in TRM-12-Q-BPA-12.

*Q. What is the purpose of your testimony?*

A. Our testimony discusses allocation of costs under BPA’s proposed Tiered Rate Methodology (TRM), TRM-12-E-BPA-01. We discuss how costs would be allocated to Cost Pools in Tier 1 and Tier 2 and the use in ratemaking of the proposed Cost Allocation Table, TRM Table 2.1. We also discuss recovery of BPA’s costs under tiered rates, and the proposed treatment of interest earned on the Bonneville Fund. This testimony makes use of defined terms in the TRM; *see* TRM pages v-xvii.

*Q. How is your testimony organized?*

A. Section 1 is this introduction. Section 2 discusses cost allocation and the Cost Allocation Table. Section 3 discusses recovery of BPA’s costs. Section 4 discusses the interest earned on the Bonneville Fund.

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**Section 2: Cost Allocations and the Cost Allocation Table**

*Q. Generally, how would costs be allocated under the TRM?*

A. Under the TRM, BPA would allocate the total Power function revenue requirement for the Rate Period into a number of Cost Pools. The TRM proposes three Cost Pools for costs that would be recovered through Tier 1 Rates and two or more Cost Pools for costs that would be recovered through Tier 2 Rates. See TRM section 2.2.

*Q. What distinguishes the Tier 1 Cost Pools from the Tier 2 Cost Pools?*

A. Almost all of BPA’s current costs would be allocated to the Tier 1 Cost Pools. We propose two exceptions for costs that BPA currently incurs that would be recovered through Tier 2 Rates in the future. The first exception is a provision that would allow BPA to recover a portion of its general and administrative costs through Tier 2 Rates. This would be accomplished with the Overhead Cost Adder, as explained in TRM section 6.3.3. The second exception is for costs associated with providing Resource Support Services (RSS), which are explained in TRM section 8. BPA would use the Federal system to provide RSS, and costs would not be allocated to RSS. Rather, RSS rates would be based on the marginal costs of providing the services, and the revenues from the sales of RSS would be credited to the same Tier 1 Cost Pools to which the costs of the Federal system are allocated.

*Q. What costs would be allocated to Tier 2 Cost Pools?*

A. The TRM proposes that the costs of acquiring new energy resources or additional energy power purchases needed to serve BPA’s customer loads (new resources) would be allocated to the Tier 2 Cost Pools. (The term “new resources” used in this testimony is distinct from the defined TRM term “New Resources,” which refers to a certain class of non-Federal resources.) As mentioned above, an Overhead Cost Adder and RSS charges would also be included in Tier 2 Cost Pools. If there are risks associated with the costs

1 of acquisition of new resources or power purchases, the cost of the risk mitigation would  
2 be included in the associated Tier 2 Cost Pool.

3 *Q. Would the costs of all new resources be allocated to Tier 2 Cost Pools?*

4 A. No, there are some exceptions. BPA could acquire a new resource and allocate its costs  
5 as Tier 1 Augmentation, if the output of the new resource does not cause the limits on  
6 Tier 1 Augmentation to be exceeded. BPA also could acquire new capacity resources  
7 for certain purposes and allocate the costs of the new capacity resource to Tier 1 Cost  
8 Pools.

9 *Q. How do you propose that costs would be allocated to the various Cost Pools under the*  
10 *TRM?*

11 A. The TRM includes a proposed Cost Allocation Table, TRM Table 2.1, that shows how  
12 BPA's current Power function costs would be allocated to the Cost Pools. We fashioned  
13 this table after the current Slice Costing Table, which defined the costs paid by BPA's  
14 Slice customers. We expanded the Cost Allocation Table to accommodate all of BPA's  
15 Power function revenue requirement components and revenue credits. We also  
16 expanded the table by adding the reallocation of costs resulting from BPA's ratemaking  
17 steps. Each cost category on the Power function's pro forma income statement is  
18 specified on the Cost Allocation Table. In addition, some revenue requirement items  
19 that are not on the pro forma statement are added. These additions allow all costs  
20 included in BPA's Power function revenue requirement to be listed on the table.

21 *Q. Why are the ratemaking reallocations included on the Cost Allocation Table?*

22 A. The inclusion of the ratemaking steps would allow the Cost Allocation Table to be used  
23 for the determination of BPA's various rates. In BPA's ratemaking procedures, BPA  
24 would establish a table for each rate pool. Each of the costs would be allocated among  
25 the rate pools by the appropriate allocation factors. The costs then would be totaled by  
26 rate pool before BPA performed the rate design steps of BPA's ratemaking process.

1 With each rate design step, costs are reallocated among rate pools. These lines on the  
2 Cost Allocation Table will show how much is reallocated from a rate pool or to a rate  
3 pool. Then, when all of the rate design steps are complete, all costs and reallocated  
4 costs on the table for each rate pool can be totaled, which would establish the total costs  
5 allocated to each rate pool.

6 *Q. What are the rate pools that BPA currently uses?*

7 A. Currently, BPA has five rate pools. They are Priority Firm Power Preference, Priority  
8 Firm Power Exchange, Industrial Firm, New Resources Firm, and Surplus Power. The  
9 two Priority Firm rate pools are combined until after the section 7(b)(2) rate test is  
10 completed.

11 *Q. Please describe the three proposed Tier 1 Cost Pools.*

12 A. There would be three Tier 1 Cost Pools: Slice, Non-Slice, and Composite. *See* TRM  
13 section 2.2. The Slice Cost Pool would be allocated very specific costs that BPA incurs  
14 for the implementation of the Slice product, as described below. The Non-Slice Cost  
15 Pool would be allocated very specific costs that are excluded from being charged to  
16 Slice customers. All other Tier 1 costs would be allocated to the Composite Cost Pool.

17 *Q. What distinguishes the costs that are allocated to the Non-Slice Cost Pool, and thus  
18 would not be charged to Slice customers?*

19 A. For the most part, they would be costs and revenues from the sale of surplus power sold  
20 on behalf of non-Slice customers. This would include the revenues from BPA sales of  
21 secondary power and any costs associated with those sales, such as wheeling expense.  
22 BPA provides surplus power to Slice customers as part of the Slice product. As a result,  
23 BPA does not incur any additional cost or obtain additional revenue from the surplus  
24 power provided to the Slice customers. Slice customers receive this surplus power by  
25 paying their share of BPA's Composite Cost Pool costs without receiving any credit for  
26 the revenue from BPA's surplus sales.

1           In addition, because the Slice customers pay for their share of Composite Cost  
2 Pool costs, and these costs are subject to being trued up to actual costs, the Slice  
3 customers are not subject to the same risk mitigation measures applicable to rates for  
4 non-Slice products. One such risk mitigation measure is Planned Net Revenues for Risk  
5 (PNRR), which would be added to the Non-Slice Cost Pool as needed. Because Slice  
6 customers are not subject to paying PNRR, any such PNRR would be allocated only to  
7 the Non-Slice Cost Pool. *See Lovell et al., TRM-12-E-BPA-08.*

8 *Q. The proposed Cost Allocation Table, TRM Table 2.1, has a section labeled Allocation*  
9 *Between Composite and Non-Slice Cost Pools (TRM page 109, lines 1-4). What is this?*

10 *A. A small number of line items on the Power function's pro forma income statement may*  
11 *contain costs or credits that combine those that Slice customers should pay or receive*  
12 *credit for and those that Slice customers should not pay or receive credit for. The*  
13 *section of TRM Table 2.1 labeled Allocation Between Composite and Non-Slice Cost*  
14 *Pool shows these line items. The portion of the cost or credit amounts in these line*  
15 *items that the Slice customers should pay or receive credit for would be allocated to the*  
16 *Composite Cost Pool, and the costs or credits the Slice customers should not pay or*  
17 *receive credit for would be allocated to the Non-Slice Cost Pool. Once these*  
18 *preliminary allocations are completed, the costs or credits will be transferred to the*  
19 *respective lines of the Cost Allocation Table.*

20 *Q. What are the types of costs that would be included in the Allocation Between Composite*  
21 *and Non-Slice Cost Pools?*

22 *A. The first, Transmission & Ancillary Services, contains the costs of wheeling and*  
23 *accompanying services for deliveries of certain sales and obligations. Some of these*  
24 *costs are for the deliveries of designated BPA obligations such as the Canadian*  
25 *Entitlement Return. These are designated BPA obligations for which Slice customers*  
26 *are responsible for paying their share. These costs would be allocated to the Composite*

1 Cost Pool. Also included in this line are costs incurred to wheel BPA's surplus sales.  
2 Slice customers are not responsible for these costs, so these costs would be allocated to  
3 the Non-Slice Cost Pool.

4 The next line is Bad Debt. Slice customers are responsible for paying a share of  
5 certain bad debt, and these costs, if incurred, would be allocated to the Composite Cost  
6 Pool. Slice customers are not responsible for certain bad debt. This bad debt, if  
7 incurred, would be allocated to the Non-Slice Cost Pool. Generally, the distinction is  
8 that any bad debt associated with BPA's surplus marketing will not be the responsibility  
9 of the Slice customers. However, this is a general statement; the actual distinction will  
10 be established in the relevant rate case.

11 The next line is Depreciation. This is included because there may be  
12 depreciation of specific assets associated with BPA's surplus marketing. In the past,  
13 BPA's trade management system was such an item. Should such items occur in the  
14 future, the depreciation associated with the specified asset would be allocated to the  
15 Non-Slice Cost Pool. The remaining depreciation would be allocated to the Composite  
16 Cost Pool.

17 The last line is Interest Earned on BPA Fund for Power. This line is included to  
18 accomplish the proposed division of the interest credit described in section 4 of this  
19 testimony and TRM section 2.4.

20 *Q. Are these the only line items that could be included in this section of the Cost Allocation*  
21 *Table?*

22 *A. No. Should cost or credit items arise in the future that are not the responsibility of Slice*  
23 *customers, the cost or credit lines that include these costs would be added to this section*  
24 *of the table.*

25 *Q. There are some lines blacked out on the Cost Allocation Table, such as lines 23 and 24.*  
26 *Why are they blacked out?*

1 A. Costs on the table are included on BPA's pro forma income statement for the Power  
2 function in the order that they appear on the statement. The blacked out lines indicate  
3 the items on the pro forma statement that are entirely allocated to either the Slice Cost  
4 Pool or the Non-Slice Cost Pool.

5 *Q. Some cells of the Cost Allocation Table are grayed. Why is this?*

6 A. The Cost Allocation Table shown as TRM Table 2.1 is designed to double as the table  
7 that would be used in the Slice True-Up. The grayed cells indicate those line items that  
8 would not be subject to the Slice True-Up. In each rate case, the table would be  
9 prepared for the Slice True-Up by placing the total costs that Slice customers pay into  
10 the "forecast" columns, Columns B and D. These same forecast numbers would be  
11 placed into the grayed cells of the "actual" columns, Columns C and E. Then, when the  
12 True-Up is performed, actual costs would be placed into the appropriate cells in Column  
13 C or E.

14 *Q. Where would BPA allocate the costs related to developing and maintaining the necessary  
15 systems and processes required to manage, schedule, and deliver power sold under the  
16 CHWM Contracts?*

17 A. Except for some specific exceptions, BPA would allocate the staffing and  
18 information technology costs necessary to develop and maintain the automated  
19 and manual systems required to manage, schedule, and deliver power for the Load  
20 Following, Block, and Slice/Block products to the Composite Cost Pool.

21 *Q. There are a number of line items in the Non-Slice Cost Pool on the Cost Allocation Table  
22 (TRM page 113, beginning on line 159). Please describe each of these costs.*

23 A. As introduced above, there are two basic categories of costs that are excluded from  
24 being charged to Slice customers. The first is associated with BPA's surplus marketing.  
25 Therefore, the lines associated with surplus marketing are listed under the Non-Slice  
26 Costs. These are Other Power Purchases (Balancing); Hedging/Mitigation;

1 Transmission & Ancillary Services (non-Slice portion); Third Party Transmission &  
2 Ancillary Services; Bad Debt Expense (non-Slice portion); Depreciation (non-Slice  
3 portion); Interest Earned on BPA Fund for Power (non-Slice portion); Reserve Services  
4 revenue credit; and Secondary Revenue credit.

5 The second basic category is risk mitigation. The line items in this category are  
6 Planned Net Revenues for Risk and Accrual Revenues.

7 *Q. What other line items are there in the Non-Slice Cost Pool on the Cost Allocation*  
8 *Table?*

9 A. Another line is Other Power Purchases (Capacity). This is included to allocate the costs  
10 associated with the acquisition of capacity for meeting the loads of Load Following and  
11 Block customers.

12 The final two line items are credits for the forecast revenues from the Demand  
13 and Load Shaping Charges. These two charges are limited to non-Slice customers. The  
14 costs of meeting these loads would be included in the Non-Slice Cost Pool, primarily  
15 through balancing purchases or capacity costs. The credit of the revenues offsets the  
16 costs allocated to the Non-Slice Cost Pool.

17 *Q. How might the Cost Allocation Table change in the future?*

18 A. We have described some conditions for change above. If new costs or credits that are  
19 not the responsibility of Slice customers are incorporated into an existing line item with  
20 costs or credits that are the responsibility of Slice customers, this line would be added to  
21 the first section of the Cost Allocation Table to separate the Composite from non-Slice  
22 costs. If BPA revises its pro forma income statement for the Power function, the Cost  
23 Allocation Table would also be revised to conform to the pro forma income statement,  
24 including adding a new line(s), as needed. If an existing cost allocation is challenged in  
25 a Slice verification process or in a rate case and it was decided in a rate case that Slice  
26 customers were not responsible for that cost, or that they were entirely responsible for

1 that cost, the Cost Allocation Table would be revised to reflect the decision. Finally,  
2 Cost Pools for new Tier 2 Rate Alternatives would be added as the alternatives are  
3 developed.

4 *Q. If BPA revises the pro forma income statement for the Power function, would the*  
5 *allocations of the costs change?*

6 *A.* No. BPA would demonstrate that the cost allocations before the pro forma revision are  
7 the same as after the revision. Although the Cost Allocation Table might change, the  
8 underlying theory behind cost allocations will not.

9 *Q. What are the two Tier 2 Cost Pools you referred to above?*

10 *A.* At the outset of implementation of tiered rates, we expect that there would be at least  
11 two Tier 2 Cost Pools. For customers electing the proposed Tier 2 Load Growth rate, a  
12 Cost Pool would be established that would contain the costs allocated to serve specified  
13 amounts of the load of these customers. The other Tier 2 Cost Pool would be the  
14 proposed Tier 2 Short-Term Cost Pool. This Cost Pool would contain costs allocated to  
15 serve specified amount of loads of customers electing the Tier 2 Short-Term rate.

16 *Q. What distinguishes these Cost Pools?*

17 *A.* Consistent with the descriptions of the rate schedules and contract provisions, the Tier 2  
18 Load Growth rate would be established for customers electing BPA to serve their above-  
19 RHWM load throughout the term of the CHWM Contracts. As BPA acquired resources  
20 to serve customer loads, the costs of these resource acquisitions would be allocated to  
21 the Cost Pool for the Load Growth rate. To the extent that the total above-RHWM loads  
22 of customers electing this Tier 2 Rate Alternative are greater than the output of the  
23 resources acquired, we expect that the costs of power purchases to serve the remaining  
24 portion of the customers' above-RHWM load would be allocated to this Load Growth  
25 Cost Pool. Similarly, the costs of power purchases to serve loads of customers electing  
26 the Tier 2 Short-Term rate would be allocated to the Cost Pool for the Short-Term rate.

1 Q. *How would new Tier 2 Cost Pools be determined?*

2 A. As new Tier 2 Rate Alternatives are developed, Cost Pools for those new rate  
3 alternatives would also be developed. At this time, we expect that the new Tier 2 Rate  
4 Alternatives would be vintaged rates; that is, rate alternatives developed for customers  
5 electing to purchase service for a portion of their above-RHWM load based on the costs  
6 of a particular new resource acquisition by BPA. In this event, BPA would establish a  
7 Cost Pool so that the costs of that new resource acquisition could be allocated to the  
8 Cost Pool.

9 Q. *Do you expect the match between resource acquisition costs and Cost Pools to change  
10 through time?*

11 A. No, with a limited exception. We propose that once BPA establishes that a particular  
12 resource acquisition is allocated to a particular Cost Pool, whether that cost pool is a  
13 Tier 2 or a Tier 1 Cost Pool, the costs of that resource would continue to be allocated to  
14 that Cost Pool for the duration of the TRM. However, the TRM proposes an exception  
15 that would allow temporary cost assignments to other Cost Pools under certain  
16 conditions.

17 Q. *Under what conditions would BPA temporarily assign a particular cost to another cost  
18 pool?*

19 A. If BPA acquired a resource with the expectation that the resource would be used for  
20 future load growth, then its costs could be temporarily allocated to other Cost Pools. For  
21 example, if the total above-RHWM loads of those customers electing the Tier 2 Load  
22 Growth rate are 20 aMW, and the above-RHWM loads of these customers are expected  
23 to grow to 30 aMW over the next few years, BPA might acquire a resource with the  
24 expected output of 30 aMW. In this case, when the total above-RHWM load is  
25 20 aMW, two-thirds of the costs of the resource acquisition would be allocated to the  
26 Cost Pool for the Load Growth rate, and one-third of the costs would be allocated to

1 another Cost Pool on a temporary basis. Which Cost Pool that might be would be  
2 determined in the relevant rate case.

3 Continuing the example, the other Cost Pool might be the Cost Pool for the  
4 Tier 2 Short-Term rate or the Tier 1 Composite Cost Pool as an Augmentation cost.  
5 Then, as the above-RHWM loads of the customers electing the Tier 2 Load Growth rate  
6 grow, the costs of that acquired resource would be reallocated to the Cost Pool for the  
7 Load Growth rate. Thus, if the above-RHWM loads grow to 25 aMW, then five-sixths  
8 of the resource acquisition costs would be allocated to the Cost Pool for the Load  
9 Growth rate and one-sixth to the other Cost Pool.

10 *Q. Must the costs of a particular resource acquisition be confined to a single Cost Pool?*

11 *A.* No. The costs of particular resources could be allocated to multiple Cost Pools. For  
12 example, if the total above-RHWM loads of those customers electing the Tier 2 Vintage  
13 rate are 20 aMW, and those customers structure their elections such that the 20 aMW  
14 commitment is fixed, BPA might acquire a resource with the expected output of 30  
15 aMW. In this case, two-thirds of the costs of the resource acquisition would be allocated  
16 to the specific Vintage Cost Pool, and one-third of the costs would be allocated to  
17 another Cost Pool on a permanent basis. Whichever Cost Pool that might be would be  
18 determined in the relevant rate case.

19 *Q. Will Tier 2 Cost Pools be eliminated?*

20 *A.* There may be a circumstance when a Tier 2 Cost Pool would be eliminated, but this  
21 would occur only if the customer elections to the associated Tier 2 Rate Alternative  
22 expire. If there are no above-RHWM loads associated with a particular Tier 2 Rate  
23 Alternative, the Cost Pool would be eliminated.

1 Q. *What would happen to the costs that had been allocated to the Cost Pool that was*  
2 *eliminated?*

3 A. There should not be any remaining costs in the Cost Pool. BPA would tie the term of  
4 resource acquisitions and associated cost commitments to the commitment term of the  
5 customers electing the Tier 2 Rate Alternative. Therefore, the costs of the resource  
6 acquisition would go away as the term of the customer election expires.

7 For example, if BPA acquired a 10-year output contract of a particular resource,  
8 and customers elected a Tier 2 Rate Alternative based on the costs of that acquisition,  
9 then the customers would be electing to purchase service for a specified portion of their  
10 above-RHWM loads at the Tier 2 Rate for 10 years. After 10 years, the elections would  
11 expire, as would the resource acquisition and all associated costs of the acquisition.

12 Therefore, there should be no remaining costs in the Cost Pool being eliminated.

13  
14 **Section 3: Cost Recovery Demonstration**

15 Q. *Will tiering BPA's Priority Firm Power (PF) rate change the manner in which BPA*  
16 *demonstrates cost recovery in its Power rate filings?*

17 A. No. As specified in Department of Energy Order RA 6120.2, BPA first tests the  
18 adequacy of revenues from current rates to recover both the Rate Period revenue  
19 requirement and the repayment schedule over the ensuing 50-year repayment period. If  
20 current rates are inadequate or other circumstances warrant changing rates, new rates are  
21 established. BPA then tests the adequacy of the proposed rates at the end of the  
22 ratesetting process. The revised revenue test compares the revenues from proposed rates  
23 to the revenue requirement for the Rate Period. The revenues must be equal to or greater  
24 than the annual revenue requirements for the Rate Period; otherwise, the revised revenue  
25 test fails. Planned amortization may be shifted within the Rate Period to accommodate  
26 the cash flows from the expected annual revenues. If that also fails to meet the

1 repayment requirement in the Rate Period, rates must be adjusted upward. The  
2 repayment period demonstration shows that the revenues from proposed rates also are  
3 adequate to ensure recovery of the Federal investment within the established 50-year  
4 repayment period. If the repayable obligations (Treasury bonds, Congressional  
5 appropriations, and irrigation assistance) are not fully repaid within the 50 years, the  
6 demonstration fails and adjustments must be made to the rates.

7 *Q. Will tiering BPA's PF rate affect the statement of BPA's total Power function costs?*

8 A. No. Tiering BPA's PF rate would be solely a matter of rate design. Tiering would affect  
9 the allocation of costs and the rates to recover all costs allocated to the PF rate pools. It  
10 would not change the statement of BPA's total Power function costs. All of  
11 BPA's Power function revenue requirement would continue to be included in the  
12 ratesetting process and would be allocated among the Cost Pools. There would be no  
13 cost without a Cost Pool. In fact, the pro forma income statement upon which the Cost  
14 Allocation Table, TRM Table 2.1, is modeled on what is used today to develop the Cost  
15 of Service Analysis that forms the basis for today's rates. Rates under the TRM would be  
16 designed to recover all costs, just as today. Therefore, although there would be a  
17 different set of rates under the TRM than there is today, the revenues resulting from all of  
18 the rates would recover the same amount of revenues. Both cost recovery tests—the  
19 revised revenue test and the repayment period demonstration—should be unchanged from  
20 today.

21  
22 **Section 4: Interest Earned on the Bonneville Fund**

23 *Q. What are you proposing for treatment of interest earned on the Bonneville Fund for the*  
24 *Slice product in the TRM period?*

25 A. We propose to limit the amount of interest earned on the Bonneville Fund included in  
26 the Composite Cost Pool. The Composite Cost Pool is the basis for the Composite

1 Customer Rate, which would be applicable to all customers who purchase at Tier 1  
2 Rates, including both Slice and non-Slice products.

3 *Q. Would all customers be affected by this limit on the amount of interest earned on the*  
4 *Bonneville Fund?*

5 A. All customers would be initially affected by this limit. The Non-Slice Customer Rate  
6 would include an adjustment in the Non-Slice Cost Pool equal to the “total anticipated  
7 credit earned on the Bonneville Fund balances attributed to the Power function less the  
8 amount of interest credit included in the Composite Cost Pool.” *See* TRM section 2.4.  
9 This adjustment could be positive or negative.

10 *Q. How could this adjustment be negative?*

11 A. This adjustment could be negative if forecasts of the Bonneville Fund levels decline  
12 below specified levels. The specified level of the Bonneville Fund is described below.

13 *Q. How do you propose to limit the amount of interest earned on the Bonneville Fund for*  
14 *inclusion in the Composite Cost Pool?*

15 A. We propose to start with the level of BPA’s financial reserves attributed to the Power  
16 function on the first day of the Slice contract, October 1, 2001. This amount was  
17 \$495.6 million. BPA would forecast interest earned on this amount and include this  
18 credit in the Composite Cost Pool.

19 *Q. Why do you propose to limit the amount of interest earned on the Bonneville Fund for*  
20 *inclusion in the Composite Cost Pool?*

21 A. The \$495.6 million attributable to BPA’s Power function on October 1, 2001, represents  
22 the reserves BPA accumulated from selling traditional requirements products to its  
23 customers prior to the inception of the Slice product.

24 *Q. Why does the inception of the Slice product matter in this determination?*

25 A. The inception of the Slice product is a significant milestone in that it marks the time  
26 from which Slice customers assumed BPA’s financial risks directly, compared to the

1 manner that the customers of BPA's other Subscription products assumed BPA's  
2 financial risk. *See Mesa et al.*, WP-02-E-BPA-32, at 16-17. Theoretically, the Slice  
3 product sales did not contribute to financial reserves beginning October 1, 2001, and  
4 thereafter.

5 *Q. How did Slice customers assume financial risk beginning October 1, 2001, and*  
6 *thereafter, compared to customers of BPA's other Subscription products?*

7 *A.* The Slice product addressed BPA's financial risks by first shifting the power supply and  
8 market price risks directly to the Slice customer and then incorporating an annual true-  
9 up adjustment charge for differences between planned and actual costs (and credits) of  
10 the Slice Revenue Requirement. *See Mesa et al.*, WP-02-E-BPA-32, at 17.

11 In contrast, BPA's other Subscription products included two general mechanisms  
12 for dealing with BPA's risk of not meeting its financial obligations. The first, Planned  
13 Net Revenues for Risk, was incorporated into the Power function revenue requirement.  
14 The other, the Cost Recovery Adjustment Clause (CRAC), allowed the rates applied to  
15 sales of general requirements power to be raised if certain financial targets were not  
16 achieved. *Id.* at 16. Essentially, BPA collected money ahead of time from non-Slice  
17 customers to build reserves to handle financial volatility.

18 In addition, BPA earned revenues from its sales of secondary energy and used  
19 these revenues to build up its financial reserves. The Slice rate does not include a  
20 secondary revenue credit based upon the sale of secondary energy. The Slice customer  
21 received its Slice Percentage share of secondary energy directly and had to realize the  
22 revenues from the sale of secondary energy on its own. In theory, Slice customers built  
23 up their own financial reserves in order to cover their share of BPA's financial risks that  
24 they could face in the form of Slice True-Up Adjustment charges.

25 *Q. Would the amount of this interest earned on the Bonneville Fund be subject to the Slice*  
26 *True-Up?*

1 A. Yes. BPA would determine what the appropriate amount of financial reserves would be  
2 for the applicable Fiscal Year and then forecast the interest earned on this amount using  
3 the weighted-average forecast interest rate for the applicable Fiscal Year. For Slice  
4 True-Up purposes, BPA would include this calculation of interest earned for use in the  
5 actual Composite Cost Pool costs. The actual interest earned amount could differ from  
6 the forecast interest earned amount in the Composite Cost Pool if the actual interest rate  
7 differs from the forecast interest rate. The actual interest earned amount also could  
8 differ from the forecast interest earned amount in the Composite Cost Pool if the actual  
9 Power function financial reserves level (as of October 1, 2001) has been adjusted (for  
10 any reason) since the financial reserves level that was initially assumed in the applicable  
11 Rate Period. Slice customers would receive their Slice Percentage share of the actual  
12 interest earned for the applicable Fiscal Year, reflected in their Slice True-Up  
13 Adjustment charge.

14 *Q. How would applicable interest rates differ from what would be initially assumed for the*  
15 *applicable Rate Period?*

16 A. Forecasts of interest earnings typically have used the actual rate in effect at the end of  
17 the previous Fiscal Year. Currently, the rate, which is based on the weighted-average  
18 interest rate of outstanding Treasury bonds, changes during the year whenever there are  
19 new bonds issued or existing bonds are repaid. These interest earnings are known as  
20 Interest Offset Credits (IOCs).

21 BPA recently signed an agreement with the Treasury that will gradually replace  
22 the existing IOC interest-earning rate formula with a market-based investing approach.  
23 Starting October 1, 2008, \$100 million of deposits in the Bonneville Fund will be  
24 invested in Treasury investment securities and will no longer earn interest at the  
25 weighted-average interest rate of BPA's outstanding Treasury bond debt. In each year  
26 thereafter for up to 10 years, an additional \$100 million of BPA funds on deposit will be

1 invested in Treasury investment securities in lieu of earning IOCs. The phase-out will  
2 end when the amount in the Bonneville Fund is fully invested in Treasury securities or  
3 in 10 years (September 30, 2018), whichever is sooner.

4 *Q. How would the amount of financial reserves upon which interest is calculated to be*  
5 *credited to all customers change over time?*

6 A. The amount of financial reserves upon which interest is calculated to be credited to all  
7 customers could change over time for reasons related to recovery of outstanding  
8 receivables or liabilities incurred for the pre-FY 2002 period. This is described in TRM  
9 section 2.4.

10 *Q. TRM section 2.4 states that “future circumstances will occur that make it reasonable*  
11 *and fair to make additional adjustments to the size of the ‘base amount’ on which*  
12 *interest credit is calculated for ratemaking purposes for crediting to the Composite Cost*  
13 *Pool.” What kinds of circumstances might lead BPA to make such additional*  
14 *adjustments?*

15 A. An example of such a circumstance would be when BPA’s cash requirements (generally,  
16 Federal amortization and irrigation assistance payments to the U.S. Treasury) are less  
17 than its non-cash expenses (primarily depreciation and amortization). Under those  
18 conditions, the Minimum Required Net Revenue (MRNR) component in the Composite  
19 Cost Pool is zero, and BPA essentially collects additional cash that would add to  
20 reserves through rates for all customers by the amount that the non-cash expenses  
21 exceed BPA’s cash requirements. BPA is considering various implications of this  
22 condition in future Rate Periods in the Cost Recovery Policy component of its update to  
23 the Financial Plan. Any implications for MRNR treatment resulting from such Cost  
24 Recovery Policy discussions will be identified and proposed by BPA in a Power rate  
25 case.

1 *Q. Does the situation of forecast cash accumulation affect customers purchasing non-Slice*  
2 *products as well as customers purchasing the Slice product?*

3 A. Yes. This situation is one that affects both customers purchasing the Slice product and  
4 customers purchasing non-Slice products, because the Composite Customer Rates for  
5 both these types of products would be based on the Composite Cost Pool. The  
6 Composite Cost Pool would contain the MRNR component.

7 *Q. When will BPA decide how to address this issue?*

8 A. As stated above, BPA is considering various aspects of forecast cash accumulation in the  
9 Cost Recovery Policy component of its update to the Financial Plan. BPA intends to  
10 work with customers in the future to explore possible outcomes. This issue will not be  
11 resolved before the completion of the TRM rate case. Any implications for MRNR  
12 treatment resulting from such Cost Recovery Policy discussions will be identified and  
13 proposed by BPA in a power rate case. In the absence of any changes to treatment of  
14 MRNR, if cash from operations exceeds cash requirements in the MRNR component of  
15 the Composite Cost Pool, BPA would assume that MRNR is equal to zero for ratesetting  
16 purposes.

17 *Q. What amount of interest earned on the Bonneville Fund is credited to rates for non-Slice*  
18 *products?*

19 A. Rates for non-Slice products would benefit from any amount of interest earned on the  
20 Bonneville Fund accrued for the applicable Fiscal Year by virtue of financial reserve  
21 levels reflecting this amount of interest earned. The Non-Slice Cost Pool would reflect  
22 any additions to or subtractions from this amount.

1 Q. *What would happen to the amount of interest earned on the Bonneville Fund for*  
2 *inclusion in the Composite Cost Pool if the actual level of financial reserves is lower*  
3 *than \$495.6 million, or whatever the amount is determined to be?*

4 A. In this situation, the actual total amount of interest earned on the Bonneville Fund  
5 accrued in the Power function's financial statements could be less than the interest  
6 forecast to be earned on the \$495.6 million (or whatever the amount is determined to  
7 be). If this occurs, the actual Composite Cost Pool costs would not reflect that lower  
8 interest amount for Slice True-Up calculation purposes. The actual Composite Cost  
9 Pool costs would reflect only the change in the interest earned due to either a change in  
10 the applicable interest rate or a change in the \$495.6 million base financial reserve  
11 amount.

12 Q. *Conversely, what happens to the interest credit if the actual financial reserves amount is*  
13 *higher than \$495.6 million, or whatever the actual threshold amount is determined to*  
14 *be?*

15 A. In this situation, the actual total amount of interest earned on the Bonneville Fund  
16 accrued in the Power function's financial statements could be greater than the interest  
17 forecast to be earned on the \$495.6 million (or whatever the amount is determined to  
18 be). If this occurs, the actual Composite Cost Pool costs would not reflect that higher  
19 interest amount for Slice true-up calculation purposes. The actual Composite Cost Pool  
20 costs would reflect only the change in the interest earned due to either a change in the  
21 applicable interest rate or a change in the \$495.6 million base financial reserve amount.

22 Q. *Does this conclude your testimony?*

23 A. Yes.  
24  
25