UNITED STATES OF AMERICA
DEPARTMENT OF ENERGY
BEFORE THE
BONNEVILLE POWER ADMINISTRATION

Fiscal Year 2012-2013 Proposed	**)**	**BPA Docket No. BP-12**
Power Rate Adjustments Public	**)**	
Hearing and Opportunities for	**)**	
Public Review and Comment	**)**	

DIRECT TESTIMONY OF:

PUBLIC POWER COUNCIL,

INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES,

NORTHWEST REQUIREMENTS UTILITIES, AND

PACIFIC NORTHWEST GENERATING COOPERATIVE (for both itself and the PNGC Members)

SUBJECT:

DSI SERVICE ASSUMPTIONS AND RATES

WITNESSES:
Michael Deen
Kevin O'Meara
Lincoln Wolverton
Geoffrey Carr
Douglas Brawley

January 20, 2011

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TESTIMONY OF:

Michael Deen
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SUBJECT: DSI Service Assumptions and Rates

Section 1: Introduction and Purpose of Testimony

Q: Please state your names and qualifications.

A: My name is Michael Deen. My qualifications are shown at BP-12-Q-PP-02.

A: My name is Kevin O'MearA: My qualifications are shown at BP-12-Q-PP-03.

A: My name is Lincoln Wolverton. My qualifications are shown in BP-12-Q-IN-01.

A: My name is Geoff Carr. My qualifications are shown in BP-12-Q-NR-01-E01.

A: My name is Douglas Brawley. My qualifications are shown in BP-12-Q-PN-02.

Q: What is the purpose of your testimony?

A: The purpose of this testimony is to address issues related to service of Direct Service Industry customers during the WP-12 Rate Period. Firstly we will address BPA's assumptions regarding the level, duration, and character of DSI load to be served during FY 2012-2013. Secondly we will address issues in how BPA has set the IP rate, including costs allocated to the IP rate through the melded PFp rate, the level of the Value of Reserves Credit, and also the calculation of the Section 7(c)(2) Industrial Margin.

Q: Has PPC and other public power entities provided commentary to BPA on its policies towards DSI service in other processes or venues?

A: Yes. PPC and other entities have provided extensive commentary on DSI service issues both to BPA and also in legal proceedings. It is the position of PPC and many other groups that BPA is not under any obligation to provide service to DSI customers, and by doing so at the expense of preference customers BPA is violating both the law and sound business principles.

Section 2: Assumed DSI Service Level for FY 2012-2013

Q: What are BPA's assumptions for the level of DSI load to be served at the IP rate during the rate period?

A: BPA is assuming approximately 340 aMW of service to Alcoa's Intalco smelter and Port Townsend Paper Company at the IP rate for the entire FY 2012-2013 period.

Q: Have you quantified the cost to preference customers of BPA's proposed level of DSI service for the rate period?

A: BPA staff performed this calculation in response to data request NR-BPA-1 (Attachment 1). On the basis of differences between augmentation costs and DSI revenues, BPA estimated the cost to preference customers of DSI service at 340 aMW to be $55.6 million over the two year rate period, or an average of $27.8 million per year.

Q: Are BPA's DSI service assumptions appropriate?

A: No. Even under BPA's current agreements, which are under litigation, BPA has only made the determination to supply power to the current DSI customers through May of 2012. BPA should not assume any further DSI service after that time.

Q: Why should BPA adopt this alternate assumption?

A: It is our understanding that in response to the *PNGC II* court opinion, BPA instituted the "Equivalent Benefits Test" methodology to establish whether sales to DSI customers meet sound business principles. BPA conducted such an analysis in October 2010 to justify the current sales to DSI customers extending through May 2012. Although we do not endorse the validity of the Equivalent Benefits Test as a means of establishing whether BPA is following sound business principles in serving DSI customers, in this proceeding BPA has not provided any forecast or reasoning to support why sales to the DSI customers at the proposed levels past May 2012 will meet even that standard.

Q: Are there reasons to believe that sales to DSI customers past May 2012 would not pass even BPA's Equivalent Benefits methodology?

A: Yes. A number of facts are forecast to be different after May of 2012 than for the last period BPA conducted an Equivalent Benefits Test analysis. Specifically, in its most recent Equivalent Benefits analysis, BPA assumed lower market prices than it is now forecasting will prevail after May of 2012.

Using the same reasoning as BPA in its response to Data Request NR-BPA-01, the cost to preference customers of DSI service over the 19 month period from June 2012 through September 2013 would be approximately $41.1 million, or nearly $2.2 million per month.

In BPA's October 29th, 2010 Record of Decision Granting Alcoa's Request to Extend the Initial Period of Alcoa's Power Sales Agreement (Attachment 2), BPA calculated a total value of "tangible" financial benefits of selling power to Alcoa of approximately $10.4 million for sales made during the Extended Initial Period from May 27th, 2011 through May 26th, 2012. This yields a per month value of approximately $866,000 in "tangible" financial benefits to offset power sales costs as a result of DSI service.

As can be seen from this exercise, based on the evidence available to date in this rate proceeding, "tangible" financial benefits from DSI sales would have to increase by 250% from BPA's last R.O.D. on the topic to justify DSI service beyond May 2012 in the upcoming rate period.

Q: Would it be unduly burdensome for BPA to perform an analysis to forecast whether it is likely that DSI service will be justified after May 2012 under the Equivalent Benefits Test?

A: No it would not. BPA has all the substantial information it would need to perform such a forecast analysis already in the record for this proceeding, most notably in the form of market price forecasts and loads and resource studies. By not performing some type of Equivalent Benefits Test forecast BPA is effectively pre-judging the outcome of that process at the expense of preference customers during an extremely adverse economic time.

We fully understand that ratemaking is by nature an uncertain process and must be based on forecasts and further that the Equivalent Benefits Test and levels of DSI service are outside the scope of this proceeding. However, by including DSI service as an input in this proceeding after May of 2012 BPA has made an implicit but clear assumption that that service will at that time pass the Equivalent Benefits Test. They have not, however, provided any analysis to show that this outcome is likely. On the contrary, it appears that the record to date in this proceeding would support the assumption that DSI service will not continue past May of 2012 based on the Equivalent Benefits standard as currently implemented by BPA:

Q: Are there other issues related to the level of assumed DSI service during the rate period that you would like to raise?

A: Yes. We would like to address the possibility of service to additional DSI load during the rate period.

Q: What has BPA said with regard to service to additional DSI load?

A: In the Policy Testimony, BPA states that "During the week of November 8, 2010, BPA received a call from Columbia Falls Aluminum Company (CFAC) inquiring about a possible power sales contract; however, such a sale is not certain enough to be included in the forecast amount of service to DSIs for FY 2012-2013." (BP-12-E-BPA-11, Page 19, lines 7 to 10). BPA then tested the TPP effects of levels of service to DSI loads from 340 aMW up to the "maximum permissible" of 480 aMW and found the TPP was still 95%. (BP-12-E-BPA-15, Page 66, lines 3 to 7.)

Q: What are your concerns about this additional service to the DSIs?

A: As described above, service to the DSIs at the proposed level of 340 aMW is costly to BPA's public power customers. Additional service would be even more costly. Also, this implied potential for service to additional DSI load is inconsistent with the way in which unanticipated load is addressed for preference customers. Additional service to unanticipated preference load is dealt with through the Unanticipated Load Service rate.

Q: What is BPA's definition of Unanticipated Load?

A: BPA provides the following definition: " Unanticipated load is any request by a customer for firm power requirements service received by BPA after February 1, 2011, that results in an increase in the customer's load placed on BPA during the FY 2012-2013 rate period that was not requested and thus not forecast when setting the rates for that rate period." (BP-12-E-BPA-21, Page 16, lines 16 to 19).

Q: What pricing principles does BPA apply to unanticipated public power load?

A: BPA proposes that: "the energy rate be the greater of the posted rate or the forecast market price to ensure that BPA recovers its cost for purchased power, if any, and does not absorb the cost of purchasing power to meet unanticipated load that is at a higher price than the rate that would otherwise be applied to unanticipated load". (BP-12-E-BPA-21, Page 20, lines 13 to 16).

Q: What is your proposal with regard to Unanticipated DSI load?

A: We propose that BPA use the same pricing principles for the power portion of the costs of unanticipated DSI load that it is using for unanticipated preference customer load. That is, BPA should apply a rate to this load that recovers its cost of purchased power to serve this load. To this estimate would be added the industrial margin and any Section 7(b)(3) surcharges less an amount for value of reserves provided, if any such value is demonstrated. Any unanticipated DSI load should be served at the greater of the posted IP rate as adjusted by this testimony or the actual market price for the power used to serve this load. Actual market is proposed here in order to ensure that BPA's other customers do not absorb the cost of serving this load.

Section 3: IP Rate Issues

Q: Has BPA allocated a proper share of all appropriate costs to the IP rate?

A: No. In sections 2.1.3.3 and 2.1.3.4 of WP-12-E-BPA-01, BPA states the costs of the Low Density Discount (LDD) and the Irrigation Rate Discount (IRD) are allocated entirely to the PF load pool. Given that Section 7(c)(2) directs that the IP rate "shall be based upon the Administrator's applicable wholesale rates to such public body and cooperative customers", which do include costs of the LDD and IRD, it seems appropriate that the IP loads should receive an allocation of those costs as well.

Q: Do you have any commentary on the calculation of the 7(c)(2) Industrial Margin?

A: Yes. First we would like to commend BPA for going through the effort to work with PPC to collect current data from preference customers serving large industrial loads to update the 7(c)(2) Margin Study comprehensively.

Q: Are there any issues with the calculation of the Margin?

A: Yes. We believe that the costs of Washington state revenue taxes should be included in the weighted margin calculation.

Q: Has this issue been argued before?

A: Yes. The issue of Washington state revenue taxes in the Margin calculation has been argued in previous BPA rate proceedings, most recently in WP-10. Before presenting our arguments for this proceeding, we would like to summarize our understanding of why BPA chose to exclude state revenue taxes in WP-10 based on the discussion of the issue in the WP-10 Final Record of Decision.

Although BPA's discussion of the issue is extensive, the conclusion reached on page 378 of WP-10-A-02 (Attachment 3) is relatively straightforward. In essence, BPA determines that Washington state revenue taxes are not a component of a "typical" industrial margin unless a majority of BPA's preference customers serving industrial loads are subject to such taxes. BPA then relies on evidence presented in the WP-02 proceeding to establish that fact.

Q: Do you agree with BPA's analysis?

A: No. BPA should follow the directives of Section 7(c)(2) in setting the typical margin. In particular, as stated in Section 7(c)(2) BPA should use "typical margins included by such public body and cooperative customers in their retail industrial rates but shall take into account the comparative size and character of the loads served."

To that effect, the question is not whether a majority of BPA's preference customers serving any type of industrial load are subject to Washington revenue taxes, but whether a majority of those serving *comparable* industrial loads are. In other words, the test should be whether a majority of those preference customers serving loads qualifying for inclusion in the 7(c)(2) Margin Study (those with peak loads over 3.5 MW) are located in the state of Washington.

The answer to this question is yes. Of the 33 utilities determined to have loads qualifying for inclusion in the Margin Study conducted for WP-12, 19, or 58%, are located in the state of Washington. Further, on an energy basis, 86% of the load in the study is served by those Washington utilities. Under the methodology established by BPA to determine loads of a comparable size and character pursuant to Section 7(c)(2), Washington state revenue taxes are clearly a component of "typical" margins and as such should be included in the final weighted calculation.

Q: *How did BPA go about calculating a Value of Reserves (VOR) credit in establishing the IP rate?*

A: BPA has valued the reserves to be supplied by DSIs by using BPA's own cost of supplying Operating Reserves (BP-12-E-BPA-17, p. 10). BPA assumes this represents a "marginal price." They based the marginal price on the cost BPA's Operating Reserves (Supplemental), $7.04 per kW per month, because "the DSI-supplied reserves are used to meet BPA's reserve obligations." (BP-12-E-BPA-01, p. 96, lines 17-18). Then, BPA determined the amount of interruptible load the DSIs will supply, or 10 percent of the total DSI load net of the wheel-turning load that cannot be curtailed, 33.4 aMW. Based on the quantity and price, BPA calculated the total yearly VOR and divided that dollar amount by the total DSI load being served, yielding a $0.95 credit on a per MWh basis.

Q: *Is this valuation appropriate?*

A: No. BPA has demonstrated no need for DSI operating reserves. BPA's Generation Inputs Study does not demonstrate that BPA is able to carry less contingency reserves or avoid a cost that it would otherwise incur in the absence of reserves available from the DSIs.

BPA has to this point refused to provide substantive responses to requests for its reporting to the Northwest Power Pool Reserve Sharing Group on BPA's share of contingency reserves. In the absence of evidence to the contrary we assume that BPA would be able to meet its contingency reserve obligations without the DSIs contribution to reserves. Thus, based on Section 5(d)(3)(A) of the Northwest Power Act, "additional power system reserves" are not "required for the region's firm loads."

To the extent that BPA is able to meet its contingency reserve obligations without DSI contribution and without a need to incur additional cost, the economic value of DSI reserves to BPA is zero and should be reflected as such. In the absence of evidence to the contrary we assume this is the case given the general flexibility of the FCRPS and given that BPA has had no known difficulties meeting its obligations during recent years when it was not receiving any reserves from DSI customers.

Q: Has BPA forecasted in its Generation Inputs Study any need for incremental operating or contingency reserves (non-spinning) beyond those reserves that it forecasts supplying from FCRPS generating resources?

A: Not to our knowledge.

Q: Does BPA's Generation Inputs Study reflect any reduction in operating or contingency reserves (non-spinning) forecasted to be supplied from FCRPS generating resources as a result of BPA obtaining such reserves from DSI customers?

A: Not to our knowledge.

Q: *Are there any other issues with BPA's calculation of the value of reserves credit?*

A: Yes. Even if we were to accept that the DSI reserves are being valued at an appropriate rate, in Table 3.22 of the Power Rates Study Documentation (WP-12-E-BPA-01A), BPA specifies that "PS may restrict 10 percent of all Net Firm Power under this Agreement for up to 105 Event Minutes per Event *and 1 event per day" (emphasis added).* If this is correct, the value of the interruptible reserves should reflect that they may only be called on once per day. If the reserves provide coverage for 105 minutes of any day, the quantity of interruptible load should be discounted by a factor of 105/1440, the number of minutes covered divided by the number of minutes in a day. Taking into account this factor, the value of the credit would be 0.07 $/MWh.

Q: *Does this conclude your testimony?*

A: Yes.

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing testimony on Bonneville Power Administration's Office of General Counsel and Hearing Clerk and all litigants in this proceeding by uploading the document to the 2012 Rate Adjustment Proceeding (BP-12) secure websites pursuant to BP-12-HOO-02.

DATED: January 21, 2011.

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