

UNITED STATES OF AMERICA  
U.S. DEPARTMENT OF ENERGY  
BEFORE THE  
BONNEVILLE POWER ADMINISTRATION

Residential Exchange Program                    )  
Settlement Agreement Proceeding            )     BPA Docket No. REP-12

---

DIRECT TESTIMONY  
OF

Northwest Requirements Utilities; Public Utility District No. 1 of Cowlitz County, Washington; Eugene Water & Electric Board; Public Utility District No. 1 of Benton County, Washington; the Public Power Council; the City of Seattle; Public Utility District No. 1 of Snohomish County, Washington; the City of Tacoma; and Pacific Northwest Generating Cooperative and its Members.

JOINT PARTY 2

---

WITNESSES:

Paul M. Murphy  
Jeffrey R. Kallstrom

SUBJECT OF TESTIMONY:

Background and Description of the Settlement  
Agreement from the COU Parties' Perspective

February 15, 2011

REP-12-E-JP02-02

TABLE OF CONTENTS

TESTIMONY OF:

Paul Murphy  
Jeffrey Kallstrom

WITNESSES FOR:

JOINT PARTY 2

SUBJECT OF TESTIMONY:

Background and Description of the Settlement  
Agreement from the COU Parties' Perspective

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

Section 2: The Statutory Residential Exchange Program and Section 7(b)(2) Rate  
Protection Afforded to Preference Customers .....5

Section 3: BPA's Changing Interpretations of the REP and Sections 7(b)(2)  
and 7(b)(3) .....10

Section 4: Uncertainty Over the REP and Sections 7(b)(2) and 7(b)(3).....12

Section 5: Previous Settlement Efforts .....14

Section 6: Current Settlement Efforts .....18

Section 7: Summary and Explanation of the Settlement Agreement.....23

Section 8: Summary of Testimony.....32

TESTIMONY OF

Paul Murphy and Jeffrey Kallstrom

SUBJECT: Background and Description of the Settlement Agreement  
from the COU Parties' Perspective.

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

2 *Q. Please state your names and your qualifications to provide this testimony.*

3 A. My name is Paul M. Murphy. My qualifications are stated in REP-12-Q-JP01-01.

4 A. My name is Jeffrey R. Kallstrom. My qualifications are stated in REP-12-Q-SN-  
5 01.

6 *Q. On whose behalf do you offer this testimony?*

7 A. We are testifying on behalf of Northwest Requirements Utilities; Public Utility  
8 District No. 1 of Cowlitz County, Washington; Eugene Water & Electric Board;  
9 Public Utility District No. 1 of Benton County, Washington; the Public Power  
10 Council; the City of Seattle; Public Utility District No. 1 of Snohomish County,  
11 Washington; the City of Tacoma; and Pacific Northwest Generating Cooperative  
12 and its Members. These organizations have been jointly designated as Joint Party  
13 2. The individual utilities and utility organizations on whose behalf we present  
14 this testimony represent the majority of preference customers (consumer-owned  
15 utilities or "COUs"), both in terms of numbers of entities and amount of load  
16 served by BPA.

17 *Q. What is the purpose of this testimony?*

18 A. Our purpose is to help support and to explain the Settlement Agreement at issue in  
19 this proceeding from the perspective of COU Parties. The Settlement Agreement

1 is an effort to resolve the multitude of disputes regarding BPA’s implementation  
2 of the residential exchange program (“REP”) established in section 5(c) of the  
3 Pacific Northwest Power Planning and Conservation Act of 1980 (the “Act”),  
4 16 U.S.C. § 839 *et seq.*, and the rate protection which preference customers are  
5 afforded under sections 7(b)(2) and (3) the Act. Development of the Settlement  
6 Agreement has involved most of the interested parties affected by the costs and  
7 benefits of the REP working to resolve these matters for the period FY 2002  
8 through FY 2028 in a lawful, fair and reasonable manner. The COUs are the  
9 entities that will pay most of the cost of the REP benefits provided for in the  
10 Settlement Agreement.

11 *Q. Please briefly describe the Settlement Agreement.*

12 A. The anticipated parties to the Settlement Agreement include many COUs and  
13 COU representative organizations, all of the region’s investor-owned utilities  
14 (“IOUs”), three of the four commissions that regulate the IOUs, and the Citizens  
15 Utility Board (“CUB”, a non-governmental organization representing the interest  
16 of retail electricity consumers in Oregon). The Settlement Agreement will  
17 become effective only if BPA also joins in the Agreement.

18 The Settlement Agreement responds, in part, to ongoing litigation now  
19 pending in the United States Court of Appeals for the Ninth Circuit challenging  
20 the way BPA has implemented the REP and the rate protection afforded by  
21 sections 7(b)(2) and (3) of the Act from October 1, 2001 through September 30,  
22 2011. The roots of these disputes reach back to the “Comprehensive Review of  
23 the Northwest Energy System” (“Comprehensive Review”). The Comprehensive

1 Review was initiated at the request of the Governors of Idaho, Montana, Oregon  
2 and Washington in late 1995, with a final report issued in December 1996. In  
3 Response to the Comprehensive Review’s general recommendations that all  
4 parties continue settlement discussions and explore other paths of resolving the  
5 residential exchange issue, BPA bi-laterally entered into the REP Settlements that  
6 were set aside in the *PGE* case<sup>1</sup>.

7 There are currently 56 lawsuits pending in the Ninth Circuit addressing  
8 these matters (“pending litigation”). Twenty-one of those lawsuits challenge the  
9 manner in which BPA responded to three prior decisions of the Ninth Circuit  
10 invalidating BPA’s 2001 REP Settlements with the IOUs, setting aside some of  
11 BPA’s WP-02 rate determinations<sup>2</sup> and remanding to BPA its 2004 amendments  
12 to the 2000 REP Settlements.<sup>3</sup> We will refer to these 21 lawsuits as the *APAC*  
13 and *IPUC* litigation.<sup>4</sup> The *APAC* and *IPUC* litigation address exclusively issues  
14 relating to the implementation of the REP and section 7(b)(2) from FY 2002  
15 through FY 2008. The remaining 35 lawsuits challenge BPA’s rates and  
16 associated “Lookback” determination for FY 2009 through FY 2011.<sup>5</sup> These 35  
17 lawsuits are referred to as “Related Litigation” in the Settlement Agreement. The  
18 issues in the Related Litigation are not limited exclusively to challenges to REP  
19 and sections 7(b)(2) and (3) determinations made by BPA and related Lookback

---

<sup>1</sup> *Portland General Electric v. BPA*, 501 F.3d 1009 (9th Cir. 2007)(“*PGE*”).

<sup>2</sup> *Golden Northwest Aluminum v. BPA*, 501 F.3d 1037 (9th Cir. 2007) (“*GNA*”).

<sup>3</sup> *Snohomish PUD v. Bonneville Power Administration*, 506 F.3d 1145 (9th Cir. 2007) (“*Snohomish*”).

<sup>4</sup> The Settlement Agreement refers to the *APAC* and *IPUC* lawsuits as “Current Litigation”.

<sup>5</sup> Lookback is BPA’s term for its determination of amounts the COUs were overcharged for REP costs in FY 2002 through FY 2008 that BPA intends to recover from IOUs and refund to COUs.

1           determinations. The Settlement Agreement is designed to settle all REP, sections  
2           7(b)(2) and (3), and Lookback issues in all 56 lawsuits. In addition, the  
3           Settlement Agreement is designed to settle, as among the Parties to the Settlement  
4           Agreement, all REP and sections 7(b)(2) and (3) issues for the period FY 2012  
5           through FY 2028. We will describe in more detail below the terms of the  
6           Settlement Agreement.

7           The Settlement Agreement is the culmination of approximately four years  
8           of settlement talks, contested proceedings before BPA, litigation in the Ninth  
9           Circuit, mediation, and further settlement discussions that followed the Ninth  
10          Circuit decisions in May 2007.

11       *Q. How is your testimony organized?*

12       A. Section 1 is this introduction. Section 2 provides a brief summary of the section  
13       5(c) REP and the section 7(b)(2) and (3) rate protection for COUs. Section 2  
14       presents our view of how sections 7(b)(2) and (3) of the Act are generally  
15       understood by most COUs. Section 3 describes some history of how BPA's  
16       interpretations of its responsibilities under sections 5(c) and 7(b)(2) have evolved  
17       over time. Section 4 describes the uncertainty that has come to surround the REP  
18       and associated implementation and rate-setting issues. Section 5 discusses  
19       previous efforts to settle the REP, and rate protection, and Lookback issues  
20       following the *PGE* and *GNA* decisions. Section 6 describes the most recent  
21       settlement efforts and includes a discussion of factors that motivated the COU  
22       Parties to enter into the Settlement Agreement. Section 7 is an examination of the  
23       Settlement Agreement itself and reasons for the particular manner in which the

1 Settlement Agreement addresses certain issues. Section 8 includes our summary  
2 of what we would like BPA and other parties to take away from this testimony.

3 **Section 2: The Statutory Residential Exchange Program and Section 7(b)(2) Rate**  
4 **Protection Afforded to Preference Customers.**

5 *Q. Briefly describe the REP set up by section 5(c) of the Act.*

6 A. Section 5(c)(1) of the Act provides that if any utility in the Pacific Northwest  
7 offers to sell electric power to BPA at its average system cost (“ASC”), then BPA  
8 must purchase such electric power and offer, in exchange, an equivalent amount  
9 of power for resale to the utility’s “residential users” (which includes small  
10 farms). The rate for such power sold by BPA is established under section 7(b) of  
11 the Act. Section 5(c)(5) allows BPA to decline the power offered at the utility’s  
12 ASC and acquire power from some other, less expensive source, but requires that  
13 the sale by BPA to the utility nonetheless take place. Sections 5(c)(2), (3), (4) and  
14 (6) establish certain limits on the size of the exchange transaction, require that the  
15 economic benefits of the transaction flow through to the residential loads, and  
16 provides a limited circumstance when the exchange transaction may be  
17 terminated. Finally, section 5(c)(7) requires BPA to develop a methodology for  
18 determining ASCs.

19 BPA does not actually exchange power with the exchanging utilities.

20 BPA simply pays the exchanging utility the difference between the total cost of  
21 the utility’s power (residential load x ASC) and the cost of BPA’s power.

22 Nonetheless, in order to comply with the rate directives in section 7(b) of the Act,

1 BPA must treat the exchange as an actual purchase and sale for ratemaking  
2 purposes.

3 *Q. What factors led to the development of the REP?*

4 A. According to the three reports prepared by the committees in the United States  
5 Senate and House of Representatives, the REP was the legislative response to a  
6 growing disparity between the retail rates for electric power sold to residential and  
7 small farm consumers served by COUs and the retail rates for power sold to  
8 residential and small farm consumers served by IOUs. This disparity arose  
9 because in the early 1970's BPA concluded that it would soon have inadequate  
10 power to meet the combined demands of COUs, IOUs, and direct service  
11 industrial customers ("DSIs").

12 BPA terminated its power sales contracts with the IOUs in 1973 to  
13 preserve the power for service to preference customers, as it was required by then  
14 applicable law to do. This required the IOUs to replace the power they had  
15 previously purchased from BPA, as well as power to meet load growth, from  
16 other sources. BPA would meet the load growth of COUs with the power BPA  
17 had withdrawn from the IOUs and with additional power that would become  
18 available as the DSIs' contracts expired starting in 1981.

19 During the 1970s, new sources of power were significantly more  
20 expensive than power from existing resources (whether federal or non-federal)  
21 due to rapid inflation and high capital costs throughout the decade. As a result,  
22 the IOUs' rates increased much more rapidly than the COUs' rates. Advocates  
23 for the interests of residential and small farm consumers served by IOUs,

1 including the City of Portland and the State of Oregon, took political action to  
2 remedy what they characterized as a grave inequity to such consumers. While the  
3 Act was passed to address a larger range of perceived problems caused by BPA's  
4 inability to increase the supply of federal power, the REP was a response to the  
5 particular political problem described above. Although the REP was created  
6 primarily to address the IOU problem, COUs were also allowed to participate in  
7 the REP.

8 *Q. How was the cost that the REP imposed on BPA to be paid for?*

9 A. The answer to that question has been and continues to be a large part of the  
10 disputes subject to the pending litigation. One thing is clear: any amount BPA  
11 pays out in REP benefits to IOUs must be recovered in rates to other customers  
12 because BPA is required to recover all of its costs through its rates for power,  
13 transmission and other related services. It is clear who was to pay between the  
14 effective date of the Act in December 1980 and June 30, 1985. Section 7(b)(1)  
15 requires that rates for the combined "general requirements" of COUs and sales  
16 under the section 5(c) REP were to be based first on FBS resources (*i.e.* then  
17 existing or contracted for federal resources) and any load in excess of FBS  
18 resources was to be met with power acquired under section 5(c). During this  
19 period, the rates to DSIs were to be based on the cost of resources used to serve  
20 them, plus the net cost of the REP not recovered from other sales, that is, the  
21 7(b)(1) sales.

22  
23

1 Q. What happened to the REP costs beginning July 1, 1985?

2 A. The Act set up a different structure as of July 1, 1985. The amount of residential  
3 and small farm load that could be served with exchange power was phased-in in  
4 10% increments per year from an initial 50%. By July 1, 1985, a utility could  
5 exchange power for 100% of its qualifying load. (See section 5(c)(2).) Three  
6 important rate directives took effect as of July 1, 1985. Under section 7(c)(1)(B),  
7 the DSIs were no longer directly assigned any “net cost” of the REP. Instead,  
8 their rates were to be based on the rates charged to the COUs, subject to other  
9 explicit terms in the rate directive. Second, the provisions of section 7(b)(2),  
10 which the legislative history refers to as the “rate ceiling,” became effective and  
11 set a limit on the rates payable by COUs. Finally, section 7(b)(3) provides that  
12 amounts excluded from the COUs’ rates by virtue of section 7(b)(2) are to be  
13 collected through a surcharge applicable to other BPA power sales. These other  
14 power sales include BPA’s sales under the REP, sales to the DSIs, and according  
15 to some parties, market based transactions. Consequently, who pays for REP  
16 costs under the Act today depends on how sections 7(b)(2) and 7(b)(3) are  
17 interpreted.

18 Q. How does section 7(b)(2) work?

19 A. Again, this is one of the central issues in the pending litigation because the parties  
20 cannot agree. In general terms, section 7(b)(2) provides that the power  
21 component (*i.e.* the total amount less certain listed non-power costs) of BPA’s  
22 rates cannot exceed the cost of power needed to supply the COUs’ general  
23 requirements under five assumptions set out in section 7(b)(2). The legislative

1 history states that section 7(b)(2), coupled with section 7(b)(1), was intended to  
2 preserve the economic benefits of preference for preference customers. The Act  
3 specifically preserved the preference and priority COUs enjoyed under the  
4 Bonneville Project Act (16 U.S.C. § 832 *et seq.*), but the Act also authorized BPA  
5 to acquire power to meet the loads of customers that did not have preference – the  
6 IOUs and DSIs – and established the REP.

7 COUs have always believed that section 7(b)(1) preserves their priority  
8 access to the financial benefits of the FBS and that section 7(b)(2) protects them  
9 from the costs of the REP by listing the non-existence of REP exchange  
10 transactions as one of the five assumptions BPA is required to make. Other  
11 section 7(b)(2) assumptions require BPA to assume that certain financial benefits  
12 thought to become available to COUs under the Act do not actually materialize.<sup>6</sup>  
13 In short, the COUs believe that the section 7(b) rate directives preserve for them  
14 access to the entire FBS at cost and protects them from any REP costs after July  
15 1, 1985 to the extent those costs are not offset by certain benefits identified in  
16 section 7(b)(2) of the Act.

17 *Q. How does section 7(b)(3) work?*

18 *A.* The parties do not agree on how section 7(b)(3) is intended to work either. All  
19 parties agree that section 7(b)(3) requires BPA to recover any amounts not  
20 charged the COUs due to section 7(b)(2) through a surcharge applicable to other  
21 power sold by BPA. For power to which a surcharge can be simply added to the  
22 rate otherwise chargeable absent section 7(b)(2), such as the IP rate to DSIs, the

---

<sup>6</sup> These benefits, if any, can be source of revenues to fund the REP.

1 PF exchange rate for exchange sales, and the NR rate for IOU loads and new large  
2 single loads, section 7(b)(3) is not very controversial. However, there is  
3 considerable dispute regarding the applicability of section 7(b)(3) to sales that do  
4 not provide additional revenues if subject to a section 7(b)(3) surcharge, as the  
5 REP costs “recovered” from these sales are effectively shifted to and recovered  
6 from the COUs.

7 **Section 3: BPA’s Changing Interpretations of the REP and Sections 7(b)(2) and**  
8 **7(b)(3).**

9 *Q. Has BPA consistently implemented the REP and sections 7(b)(2) and (3)?*

10 A. No. BPA has on several occasions made significant changes to the  
11 implementation of the REP. BPA has twice modified the ASC methodology it  
12 initially adopted in 1981. It has revised its initial Section 7(b)(2) Legal  
13 Interpretation and Implementation Methodology, and later adopted a new Legal  
14 Interpretation and a new Section 7(b)(2) Implementation Methodology that differ  
15 significantly in the amount of rate protection they provide. Further, for almost six  
16 years (from FY 2002 through FY 2007) BPA believed sections 5(c), 7(b)(2) and  
17 (3) were not applicable to REP benefits BPA could pay to the IOUs under a  
18 settlement of the REP or to the rates BPA could charge COUs to recover the costs  
19 of that settlement. Finally, BPA has periodically modified key inputs to the  
20 section 7(b)(2) rate test, and these changes have dramatically influenced the level  
21 of rate protection provided to the COUs. Some of these changes have harmed  
22 exchanging IOUs by reducing the benefits they are eligible to receive, while other

1 changes have harmed COUs by increasing the cost of the REP reflected in their  
2 rates.

3 *Q. What is the nature of these changes?*

4 A. BPA's participation in the REP has been controversial from its inception. Only  
5 three years after the REP began, BPA modified the methodology for calculating  
6 ASCs in response to complaints from COUs and DSIs that the cost of the REP in  
7 their rates was too high. The modified ASC methodology reduced the IOUs'  
8 exchangeable costs and their REP benefits, eliminating benefits entirely for two  
9 IOUs. The IOUs sued BPA in the Ninth Circuit to restore the initial  
10 methodology, but the Court upheld BPA's modifications.<sup>7</sup>

11 In 1996, in response to falling market power prices, BPA modified three  
12 key inputs to the section 7(b)(2) rate test and significantly lowered REP benefits  
13 for the rate period FY 1997 through FY 2001. This time the IOUs turned to  
14 Congress for relief. Congress gave the IOUs a one-year reprieve from the lower  
15 REP benefits, but otherwise allowed BPA's action to stand. However, the  
16 governors of the four states in the Pacific Northwest convened the Comprehensive  
17 Review to make recommendations for the future of the Northwest Energy System,  
18 particularly BPA, in light of significant industry restructuring, including  
19 addressing options for implementing the REP beginning October 2001.

20 Following the Comprehensive Review, BPA adopted what it called a  
21 Subscription Strategy that radically changed how BPA would implement the REP.  
22 Under BPA's Subscription Strategy, BPA decided to abandon as of FY 2002 the

---

<sup>7</sup> *PacifiCorp v. FERC*, 795 F2d 816 (9th Cir. 1986).

1 traditional REP and the section 7(b)(2) rate protection to the COUs as established  
2 by the Act. BPA substituted a “REP Settlement” that it negotiated with the IOUs  
3 and the utilities commissions of the four Northwest states, and BPA determined  
4 that section 7(b)(2) rate protection did not apply to REP benefits paid under the  
5 REP Settlement. The REP Settlement quickly became much more expensive than  
6 anyone anticipated.

7 The REP Settlement and BPA’s failure to implement the section 7(b)(2)  
8 rate protection were set aside and remanded to BPA in May 2007 in the *PGE* and  
9 *GNA* decisions cited above. BPA stopped making REP payments to the IOUs but  
10 continued to collect REP costs in the rates to COUs.

11 BPA subsequently initiated two proceedings to carry out the Court’s  
12 remand. In one proceeding, BPA revised its ASC methodology for the second  
13 time. BPA also revised a key legal interpretation of section 7(b)(2), and treated it  
14 as applicable, retroactively, beginning in FY 2002. BPA adopted a new formal  
15 Section 7(b)(2) Legal Interpretation and a new Implementation Methodology,  
16 which applied the revised legal interpretation prospectively and made other  
17 changes. The new ASC methodology, Legal Interpretation and Implementation  
18 Methodology substantially increased the cost of the REP to COUs when  
19 compared with the cost of the REP calculated under BPA’s prior methodologies.

20 **Section 4: Uncertainty Over the REP and Sections 7(b)(2) and 7(b)(3).**

21 *Q. What conclusions do you draw from these periodic changes?*

22 *A. The REP costs reflected in COU rates have varied dramatically, depending on*  
23 *how BPA measured ASCs and how BPA implemented sections 7(b)(2) and*

1 7(b)(3) of the Act. Between FY 2001 and FY 2002, REP costs increased from  
2 approximately \$40 million to over \$360 million, a nine-fold increase. This is a  
3 huge source of uncertainty in COU rates.

4 *Q. Are there other sources of uncertainty regarding REP costs?*

5 *A. Yes. As noted above, there are currently 56 lawsuits pending in the Ninth Circuit*  
6 *challenging the appropriateness of BPA's response to the PGE, GNA and*  
7 *Snohomish decisions as they apply to past overcharges to the COUs and the*  
8 *legality and adequacy of the remedies BPA adopted to address those overcharges.*  
9 *These lawsuits also challenge BPA's newest interpretations of sections 7(b)(2)*  
10 *and 7(b)(3). There is considerable uncertainty about how the Ninth Circuit may*  
11 *resolve the multitude of issues before it, how much guidance the Court might give*  
12 *BPA if the Court were to differ with BPA's resolution of those issues, and how*  
13 *BPA might implement any decisions issued by the Court. BPA's implementation*  
14 *of the Court's decisions will likely spur additional litigation, forcing the parties to*  
15 *repeat the cycle.*

16 There is also considerable uncertainty as to when the Court might rule on  
17 these pending cases. The *PGE* and *GNA* cases were not decided until six years  
18 after they were filed. This long delay was partly due to stays requested by the  
19 parties to try to settle the cases, but the complexity of the cases also resulted in  
20 considerable delay between when the cases were fully argued and when the  
21 decisions were issued. The pending cases are far more complex than the earlier  
22 cases, and it is reasonable to expect a similar or longer time-lag before any  
23 decision could issue.

1 *Q. How does this uncertainty affect the COUs?*

2 A. The uncertainty over the costs of the REP complicates any long-term planning by  
3 COUs, including resource planning. The uncertainty also affects the COUs' long-  
4 term management of rates, because one major cost component of their most  
5 significant power source is unpredictable. The time-lags created by fighting the  
6 issues out in rate cases before BPA and then challenging BPA's determinations in  
7 court also create potential inequities because of the practical inability to get any  
8 relief into the hands of whichever retail consumers may have been harmed. These  
9 numerous and significant uncertainties are among the major factors that have  
10 encouraged the COUs to attempt to develop a settlement with BPA and the IOUs  
11 that addresses both the pending litigation and the future REP costs. The  
12 significant money and human resource costs required to continually debate and  
13 challenge REP determinations also impel the COUs toward settlement.

14 **Section 5: Previous Settlement Efforts.**

15 *Q. What efforts have been made to settle the disputes you have described?*

16 A. As explained above, the current round of disputes over the REP and section  
17 7(b)(2) rate protection had its genesis in BPA's 1996 rate case. The IOUs, their  
18 state regulators, advocates for retail rate payers, and all four Northwest governors  
19 did not accept BPA's resolution of the REP in that case. At the time, power  
20 markets throughout the West were changing significantly. The Comprehensive  
21 Review the governors convened to address those changes included a wide array of  
22 stakeholders of BPA. One of the issues they took up was the REP program. In  
23 1996, the Comprehensive Review made certain non-binding recommendations

1 regarding the REP, including that BPA and its customers settle the REP in a  
2 manner equitable to the IOUs' residential and small farm consumers.

3 BPA then initiated what it called the "Subscription" process with  
4 stakeholders to evaluate and potentially implement the recommendations of the  
5 Comprehensive Review as they pertained to BPA. The REP was a major issue in  
6 this process. Over the next few years, BPA and stakeholders discussed a number  
7 of issues, including the IOUs' access to federal power for the benefit of their  
8 residential customers. Ultimately, BPA adopted a Subscription Strategy that  
9 included a resolution of the REP that was acceptable to the IOUs and their  
10 regulators, but was opposed by the DSIs and many COUs. BPA incorporated its  
11 Subscription Strategy plan for the REP in the 2000 REP Settlements between  
12 BPA and each IOU. These were challenged by COUs and DSIs in 2000 in the  
13 *PGE* case.

14 *Q. Were there any additional attempts to settle the REP?*

15 *A. Yes. The parties to the PGE case asked the Court to stay briefing of the case to*  
16 *allow time for a substantial effort to reach a compromise. Although a large*  
17 *number of customers on both sides of the issues came very close to agreement,*  
18 *the effort eventually failed to produce a settlement. The parties then proceeded to*  
19 *brief the PGE case.*

20 In 2004, BPA again engaged customers to try to settle the REP issues.  
21 Again, although a substantial number of customers were prepared to settle, a few  
22 were not and there was no settlement. However, BPA and the IOUs agreed to  
23 certain modifications to the 2000 REP Settlements to address certain problems in

1 the implementation of the REP Settlement that destabilized BPA's costs. The  
2 2004 amendments to the REP Settlements were challenged in the Ninth Circuit in  
3 what became the *Snohomish* case cited above.

4 *Q. What efforts to settle the REP occurred after the PGE and GNA cases were*  
5 *decided?*

6 *A. The PGE and GNA decisions were issued in May 2007. Shortly after the*  
7 *decisions were issued, BPA discontinued REP payments to the IOUs and again*  
8 *convened customers in an effort to settle the REP. Customers met regularly for*  
9 *the next several months and developed a joint proposal, the basic terms of which*  
10 *were supported by most, but not all, of the parties working on it. The joint "2007*  
11 *Proposal" was a tentative agreement in principle, which recommended the*  
12 *magnitude of future REP payments but did not address many issues regarding*  
13 *implementation. During this period, the Ninth Circuit remanded the 2004*  
14 *Amendments for BPA to reconsider in light of its decision in PGE setting aside*  
15 *the REP Settlement. (See Snohomish.)*

16 *Q. What happened to the "2007 Proposal"?*

17 *A. BPA could not presume that a settlement would eventually be reached, so it*  
18 *initiated a proceeding in February 2008 to determine how it should respond to the*  
19 *PGE, GNA and Snohomish decisions. BPA treated this proceeding as*  
20 *supplemental to its WP-07 rate case because BPA's WP-07 rates had yet to*  
21 *receive final approval by FERC and the WP-07 rates were set in the same manner*  
22 *as the WP-02 rates that the Court in GNA found not to comply with the Act. As*  
23 *part of its case, BPA requested parties to consider implementing the 2007*

1 Proposal. Although the IOUs endorsed BPA's suggestion, the COUs largely did  
2 not address the 2007 Proposal in their evidentiary presentations. BPA decided the  
3 issues in the WP-07 Supplemental ("WP-07S") proceeding based on the  
4 conflicting evidentiary record and legal arguments presented by the IOUs, COUs,  
5 and other parties to the case. Concurrent with its final Record of Decision in WP-  
6 07S, BPA again urged the parties to return to the bargaining table and settle the  
7 issues generated by the decisions in *PGE* and *GNA* and the future level of REP  
8 benefits under the Regional Dialogue contracts.

9 *Q. Did the parties re-engage in settlement discussions as requested by the*  
10 *Administrator?*

11 *A. Yes. The Parties to the WP-07S proceeding met to discuss whether they could all*  
12 *coalesce around the 2007 Proposal. Many of the parties who had initially*  
13 *supported the 2007 Proposal continued to support it. Some that initially*  
14 *supported the 2007 Proposal no longer supported it. No party that initially*  
15 *rejected the 2007 Proposal changed its position. Initial discussions following the*  
16 *WP-07S decision were unsuccessful, and virtually every party to the WP-07S case*  
17 *filed petitions in the Ninth Circuit challenging BPA's decisions and their*  
18 *implementation in new Residential Purchase and Sale Agreements between BPA*  
19 *and each IOU. Those challenges were consolidated into two dockets, *Association**  
20 *of *Public Agency Customers v. BPA*, Dockets Nos. 08-74725 et al., ("APAC") and*  
21 *Idaho Public Utilities Commission v. BPA*, Dockets Nos. 08-74927 et al.  
22 *("IPUC"). Those cases have now been fully briefed, but they have been stayed*  
23 *pending the current settlement effort.*

1 Q. Why have the REP and implementation of sections 7(b)(2) and (3) been so  
2 difficult to settle?

3 A. There are a number of reasons these matters have been difficult to settle. For one  
4 thing, the IOUs and COUs have approached the REP and section 7(b)(2) from  
5 dramatically different perspectives since adoption of the Act, and those  
6 perspectives are sometimes charged with emotion. The REP also involves a great  
7 deal of money, so parties see their perspectives as worth fighting for. The  
8 statutory language relevant to the REP and sections 7(b)(2) and (3) is complex,  
9 and the circumstances that have existed in the Northwest are very different than  
10 those envisioned by Congress when they passed the Act thirty years ago. Also,  
11 many parties assumed that lasting settlement was not possible without unanimous  
12 support from customers, and there has never been complete agreement among all  
13 customers.

14 **Section 6: Current Settlement Efforts.**

15 Q. What, if anything, has changed that would permit a settlement at this time?

16 A. The ongoing conflict over the REP has been deeply unsatisfactory to everyone  
17 involved. The conflict is costly and fraught with uncertainty. The parties are  
18 facing the aftermath of the 2000 REP Settlements, their challenge in *PGE*, BPA's  
19 response in *WP-07S*, and the wholesale return to Court in the *APAC* and *IPUC*  
20 dockets. The prospect for never-ending, inconclusive litigation caused most of  
21 them to recognize the unlikelihood of achieving any certainty through litigation  
22 and remand in a time frame they considered reasonable. And, increasingly,  
23 parties have realized that a small minority of the parties affected by the costs or

1 benefits of the REP could embroil everyone else through a seemingly endless  
2 cycle of conflict and related expense. Another difference in the current effort is  
3 that the parties agreed to mediated negotiation as a potential means to bring them  
4 together.

5 *Q. Did COUs worries about their prospects for success in the litigation enter into*  
6 *their judgment when they decided to accept a REP settlement?*

7 *A.* We do not believe so. Although BPA suggested in its initial testimony that the  
8 COUs have only a three percent probability of achieving better results through  
9 litigation than through the Settlement, *see* E-BPA-04 pp 31-32, this does not  
10 remotely reflect our views. In that assessment BPA assumed the COUs would  
11 have to prevail on five, presumably independent, issues “to achieve higher rate  
12 protection” than available under the Settlement Agreement. By assigning an  
13 arbitrary 50% probability of success on each issue, BPA arrived at the three  
14 percent figure.

15 The COUs’ desire to reach a settlement was far more influenced by their  
16 recognition that the litigation route was unlikely to produce an acceptable  
17 outcome within a reasonable time frame. Although the settling COUs were  
18 generally aware of the risks inherent in litigation, most probably did not base their  
19 decisions to settle on any numerical analysis of probability of success in Court on  
20 any issues. And, contrary to what BPA has suggested, many COUs believe their  
21 financial situation could improve if they were to prevail over BPA on as few as  
22 two issues.

1           Unless the Court decision sustains BPA on all issues, which we believe to  
2 be very unlikely, the Court would most likely remand to BPA, with the significant  
3 risk of another unsatisfactory result and further litigation by COUs, IOUs, DSIs,  
4 or all of them. BPA has shown an ability to alter the level of section 7(b)(2) rate  
5 protection by various devices BPA asserts are not addressed by, or are not  
6 impermissibly inconsistent with, the language of section 7(b)(2).

7           For example, in BPA's 1996 rate case, BPA assumed that, for the four-  
8 year period following the five-year rate period, BPA would exercise its *in lieu*  
9 authority under section 5(c)(5) of the Act to substantially reduce REP benefits  
10 during such four-year period. WP-96-A-02 p 111. Though counterintuitive, the  
11 effect of this assumption was to reduce the level of section 7(b)(2) protection to  
12 COUs during the rate period.<sup>8</sup> Then, after the 1996 rates expired at the end of FY  
13 2001, in response to political and other pressures, BPA provided the IOUs with  
14 markedly higher REP benefits than they enjoyed in the 1996 rate period.  
15 Regardless of the cause or legality of these changes, they inject significant  
16 uncertainty into the calculation of REP benefits and section 7(b)(2) protection.

17           In our view settlement is the only reliable route to known, acceptable  
18 results within a reasonable time frame. If the majority of the COUs can agree  
19 with the IOUs on the resolution of all REP related issues for the period FY 2002  
20 through FY 2028 they will have their answer long before litigation could provide  
21 one, and the COUs can be sure the agreed-upon answer is acceptable to them.

---

<sup>8</sup> This is because the assumption of reduced REP costs in years outside the applicable rate period makes the projected nine-year REP costs from the exchange appear to be lower than they otherwise would be. The assumption did not lower actual REP costs in the five-year rate period.

1 Q. Briefly explain how the proposed parties to the Settlement Agreement were able to  
2 reach agreement.

3 A. The parties agreed that they should complete briefing in the APAC and IPUC  
4 cases and then reengage in settlement discussions. This was so that each party  
5 would be fully aware of its opponents' best arguments and could better weigh its  
6 own probability of success. Second, the parties agreed to try mediated discussion  
7 in the hope of increasing the candor from the parties. Also, because it appeared  
8 that there was only slight likelihood of all parties settling, we focused on how to  
9 create a reasonable, legally supportable, and durable settlement that would  
10 terminate the costly litigation and disputes among the COUs, IOUs and BPA even  
11 if some parties opposed it.

12 Pursuant to this plan, BPA and the parties engaged former U.S. District  
13 Judge Layn Phillips to mediate settlement discussions that were started in late  
14 spring of 2010. Most of the IOUs, representatives of their rate payers (*i.e.* CUB),  
15 three state regulators, most of the COUs acting directly or through umbrella  
16 organizations, DSIs, and members of the Association of Public Agency  
17 Customers ("APAC") all convened to begin the mediation. With the help of  
18 Judge Phillips, the IOUs, their regulators, CUB, and the majority of the COUs  
19 were able to agree on the broad terms of a settlement. Those terms were reduced  
20 to writing in the Agreement in Principle ("AIP"). See E-BPA-01B pp 2-11.  
21 APAC, the DSIs and a small number of COUs did not agree to the terms of the  
22 AIP.

1           The AIP was not binding on any of its signatories, but it called upon the  
2 signatories to negotiate, prepare, execute and deliver binding settlement  
3 documents by November 1, 2010. The IOU Group (the IOUs, regulators and  
4 CUB) and the COUs active in the mediation each tasked a relatively small  
5 drafting and negotiating team to prepare the Settlement Documents.

6 *Q. Did the drafting teams produce final Settlement Agreements by the November 1<sup>st</sup>*  
7 *target date?*

8 *A.* No. Many contentious issues had either not been fully resolved or were not  
9 addressed in the AIP, and resolving those issues was far more complicated than  
10 parties had envisioned. The drafting teams negotiated terms missing from the  
11 AIP with frequent input from their principals, and from time to time the principals  
12 met to address particularly difficult issues.

13           However, significant progress had been made by November 1, 2010, and  
14 the active parties could see that their counterparts were committed to work with  
15 them to develop a mutually agreeable Settlement Agreement. Before initiating  
16 the REP-12 proceeding, BPA's legal and technical staff also participated in the  
17 discussion, often as passive observers or sources of information. On some issues,  
18 such as dispute resolution, BPA staff took a very active role in the discussions  
19 because of limitations to BPA's ability to engage in binding arbitration. The  
20 drafting parties also worked hard to structure the Settlement Agreement so that it  
21 would be binding on the Parties to it – even if successfully challenged as to Non-

1 Settling Entities<sup>9</sup> – and to resolve the issues address by the Settlement Agreement  
2 in a manner that is reasonable and lawful as to all of BPA’s customers.

3 **Section 7: Summary and Explanation of the Settlement Agreement.**

4 *Q. Please describe the Settlement Agreement?*

5 A. The Settlement Agreement is designed to settle or moot all of the claims and  
6 issues in the pending litigation that relate to the REP, sections 7(b)(2) and (3) of  
7 the Act, the Lookback issues and certain Deemer issues (“REP-related matters”).  
8 It provides a stream of payment to the IOUs that is conceptually composed of two  
9 elements: (i) REP benefits to which the IOUs would be entitled from FY 2012  
10 through FY 2028; and (ii) a component to reflect a refund to the COUs for  
11 claimed overcharges from FY 2002 through FY 2011. In addition, the IOUs are  
12 entitled to a share of future Environmental Attributes that may be assigned to the  
13 Tier 1 system. The Settlement Agreement provides for allocation of REP benefits  
14 and Environmental Attributes among the IOUs based on each IOU’s ASC and  
15 certain other factors. It also provides for the release to certain IOUs of certain  
16 “Interim True-Up Agreement Payments” currently held by BPA.

17 The Settlement Agreement specifies how BPA will recover the cost of the  
18 REP benefits in rates, including provisions designed to reflect that BPA’s  
19 customers were not identically affected by the FY 2002 through FY 2011  
20 overcharges. The Settlement Agreement also insures that the costs that go into  
21 rates for the COU Parties will be as specified in the Settlement Agreement even in

---

<sup>9</sup> “Non-Settling Entities” is the term the Settlement Agreement uses to refer to anyone that is not a party to the Settlement Agreement.

1 the unlikely event a court were to hold the settlement is not lawful as to Non-  
2 Settling Entities. In such a case, the IOUs may receive more or less REP benefits  
3 from Non-Settling Entities, but the Parties commit to adhere to the terms of the  
4 Settlement Agreement among themselves and waive any right they might  
5 otherwise have to more favorable treatment.

6 These are the essential elements of the Settlement Agreement, but there  
7 are a number of terms that address implementation issues. These include the  
8 process for seeking legislative authorization for BPA to implement the Settlement  
9 Agreement, the manner in which the Parties will resolve disputes that may arise  
10 under the Settlement Agreement, and how the Parties' rights and existing claims  
11 would be affected if a court were to set the entire Settlement Agreement aside.

12 *Q. How does the Settlement Agreement resolve the claims and issues in the pending*  
13 *litigation?*

14 *A.* Sections 7.4, 7.7 and 7.8 of the Settlement Agreement provide that, as among the  
15 Parties, the rights and obligations undertaken by the Parties in the Settlement  
16 Agreement satisfy all claims and liabilities among the Parties regarding the REP-  
17 related matters in the pending litigation. If adopted by BPA, the Settlement  
18 Agreement creates a new set of obligations and responsibilities for BPA that  
19 replace BPA's determinations of REP-related matters under review in the pending  
20 litigation. These new obligations and responsibilities extend back to FY 2002  
21 (replacing the determinations made in the WP-07S and WP-10 rate proceedings)  
22 and continue through the end of FY 2028. These should moot the pending  
23 litigation, and any challenge will have to be to the new set of rights and

1 obligations created by the Settlement Agreement. The IOUs do not release their  
2 claims against Non-Settling Entities (*see* section 7.5), but under section 3.8 the  
3 IOUs may only assert such claims in defense of efforts by anyone to cause BPA  
4 to act inconsistent with the Settlement Agreement. Thus, we believe that only a  
5 successful direct challenge to the Settlement Agreement in its entirety can revive  
6 the pending claims among the Parties. A successful challenge to the Settlement  
7 Agreement rate provisions with respect to Non-Settling Entities could revive the  
8 claims only as to such entities.

9 *Q. Please describe the rate provision of the Settlement Agreement.*

10 A. Section 3 of the Settlement Agreement, which sets out the core financial terms of  
11 the settlement, specifies in section 3.1 a precise “Scheduled Amount” for each  
12 fiscal year of the Payment Period (FY 2012 through FY 2028). The Scheduled  
13 Amounts are the basis for the REP benefits to be provided to each eligible IOU  
14 each fiscal year, and they are the basis for the REP costs to be included in BPA’s  
15 rates during the Payment Period. The Scheduled Amounts reflect resolution of:  
16 (i) all disputed claims arising from BPA’s REP, section 7(b)(2) and (3) and  
17 Lookback determinations for FY 2002 through FY 2011; and, (ii) the IOUs’  
18 entitlement to REP benefits and the customers’ responsibility to pay for such REP  
19 benefits for FY 2012 through FY 2028. Although the IOUs and COU Parties did  
20 not attempt to agree separately on the magnitude of each of the two components  
21 of the Scheduled Amounts, the fact that Settlement Agreement was intended to  
22 address both the past and the future is reflected throughout the Settlement  
23 Agreement.

1 Q. How is the dual purpose of the Scheduled Amounts reflected in the Settlement  
2 Agreement?

3 A. The allocation among the IOUs of REP Settlement Benefits is based on each  
4 IOUs' future ASCs and qualifying loads, but it also reflects differences in the  
5 Lookback amounts recovered from each IOU as of the end of FY 2011. The fact  
6 that the magnitude of the Scheduled Amounts reflects satisfaction of the COUs'  
7 refunds of past over-charges is reflected throughout the rate provisions in sections  
8 3.2 through 3.5.

9 Q. Please continue your explanation of the rate provisions in section 3 of the  
10 Settlement Agreement.

11 A. Section 3.2 identifies "Refund Amounts" for each year in Table 3.2. These  
12 Refund Amounts reflect the amount by which the COU parties concluded the  
13 Scheduled Amounts had been reduced due to the claims of COUs for Lookback  
14 refunds. The Refund Amounts for years FY 2012 through FY 2019 (\$76,537,617  
15 per year) are equal to the \$510 million in Lookback amounts that will not have  
16 been refunded to COUs as of the beginning of FY 2012, paid out in eight equal  
17 mortgage-like payments at a 4.25% interest rate. For purposes of section 3.3  
18 through 3.5, these Refund Amounts are treated just like the refunds BPA is  
19 currently paying to COUs. Such refunds are treated as a refund of past over-  
20 charges; they are not treated as if they were a reduction in future REP costs. In  
21 short, the actual REP costs for ratemaking purposes are the sum of the net  
22 payment to the IOUs (*i.e.*, Scheduled Amounts) plus the REP benefits not paid out  
23 to the IOUs and refunded to the COUs instead (*i.e.*, Refund Amounts). This

1 treatment of Refund Amounts prevents customers not entitled to Lookback  
2 refunds from benefiting at the COUs' expense for the past overcharges of the  
3 COUs.

4 Section 3.3 provides for BPA to recover the sum of the Scheduled  
5 Amounts and the Refund Amounts (called "REP Recovery Amounts") in part  
6 through a REP Surcharge on the adjustable rates subject to a section 7(b)(3)  
7 surcharge, with the remainder recovered from all adjustable rates (PF, IP and  
8 NR). This treatment reflects how BPA recovers REP costs currently.

9 *Q. What happens to the Refund Amounts recovered under this method?*

10 A. The same thing that happens to the REP costs BPA now recovers in rates that are  
11 withheld from the IOUs with outstanding Lookback obligations: the amounts are  
12 refunded to COUs.

13 Section 3.4 provides that 50% of the Refund Amounts are to be refunded  
14 to COUs in proportion to the amount each COU paid for power at the PF-02 rate  
15 and 50% are to be refunded to COUs in proportion to their Tier One Cost  
16 Allocators ("TOCAs"). This allocation is designed to reflect the fact that not all  
17 COUs were harmed equally by the over-charges to COUs from FY 2002 through  
18 FY 2011. The specific 50-50 split is based on the COUs' judgment of a fair  
19 distribution under the totality of the circumstances.

20 *Q. Continue your description of the rate provisions in sections 3 of the Settlement*  
21 *Agreement.*

22 A. The subsections we describe above are the main operative subsections of section  
23 3. Section 3.5 prohibits BPA from allocating any REP costs to federal power sold

1 as surplus energy if such allocation would result in COU Parties paying additional  
2 REP costs.

3 Sections 3.6 and 3.7 are still under discussion with IOUs. They should  
4 make clear that BPA will set rates applicable to Parties consistent with sections  
5 3.1 through 3.5 even if a court were to require (or BPA were to determine) that  
6 rates to Non-Settling Entities must be set in a different manner. This assures that  
7 Parties' rates would not be affected by any such court ruling or BPA  
8 determination, while rates to Non-Settling Entities would conform to the court's  
9 ruling or BPA's determination. The rates to the Non-Settling Entities could be  
10 higher or lower than the rates to Parties, depending how the court were to rule and  
11 how BPA responded on remand to the ruling (or how BPA's determination  
12 specified such rates were to be set). Any difference, positive or negative, in the  
13 REP costs collected from Non-Settling Entities (compared with their share of  
14 costs otherwise applied to them under the settlement) would be reflected in the  
15 actual REP benefit BPA would pay to the IOUs.

16 Subsections 3.8.1 and 3.8.2 prohibit any Party from challenging BPA  
17 actions to carry out the Settlement Agreement, but preserves Parties' rights to  
18 respond as they choose to arguments of other entities that BPA should not follow  
19 the Settlement Agreement. Finally, subsection 3.8.3 makes clear that the  
20 Settlement Agreement is not intended to affect Parties' claims concerning BPA  
21 service to DSI loads.

1 *Q. Please explain the remaining sections of the Settlement Agreement.*

2 A. We briefly addressed sections 4, 5 and 6 above. These sections primarily affect  
3 the IOUs, so we will not comment on them further except for section 5. Section 5  
4 and Exhibit C to the Settlement Agreement provide for the transfer to the IOUs of  
5 14% of the value of any newly-created Tier 1 Renewable Energy Credits or  
6 Carbon Credits. This tracks the value of any such Tier 1 RECs or Carbon Credits  
7 that BPA has estimated the IOUs would receive through application of section 9  
8 of Exhibit H to COUs' CHWM Contracts absent a settlement. To allow BPA to  
9 transfer any such Tier 1 RECs or Carbon Credits to the IOUs in kind rather than  
10 in monetized form (with a corresponding cost adjustment to COU Parties' rates),  
11 the Settlement Agreement amends Exhibit H of the CHWM Contracts of all COU  
12 Parties.

13 *Q. You previously discussed several subsections of section 7, but you did not mention*  
14 *subsection 7.1, 7.2 and 7.3. What is the purpose of those subsections?*

15 A. Section 7.2 and section 7.3 are waivers by the COUs and IOUs, respectively, of  
16 their right to seek or accept more value, rate protection or REP benefits from BPA  
17 or the other Parties than are provided for in the Settlement Agreement. Section  
18 7.1 is intended to demonstrate that the waivers in sections 7.2 and 7.3 are made  
19 knowingly and voluntarily. These waivers are a key component to insulate the  
20 Settlement Agreement against being frustrated by actions of Non-Settling Entities.

21 This waiver arrangement contributes significantly to the certainty and  
22 predictability that the Settlement Agreement provides to Parties, as COU Parties'  
23 rates will be set consistent with the Settlement Agreement in all cases other than

1 the unlikely event of a court invalidation of the entire Settlement Agreement. The  
2 certainty provided by the waivers eliminates many of the implementation  
3 problems that contributed to the failure of earlier settlement efforts, allowing a  
4 broader range of COUs to support the settlement.

5 *Q. What is the purpose of the legislation addressed in section 8?*

6 A. Early on, the IOUs felt strongly that legislation was important to the certainty of  
7 the settlement. Without legislation, the possibility remains that the IOUs' REP  
8 benefits could differ somewhat from the Scheduled Amounts if recovery of REP  
9 costs in the rates applicable to Non-Settling Entities differs from COU Parties. In  
10 addition, the Parties would like all disputes arising from the Settlement  
11 Agreement to be resolved through binding arbitration. BPA's ability to arbitrate  
12 certain disputes that may come up under the Settlement Agreement is limited  
13 under current law.

14 Although the COU Parties are ambivalent about seeking legislation, they  
15 are willing to try if it is clear that any Party may cease supporting any legislative  
16 effort and even oppose the legislation if it appears to present unacceptable risks.  
17 The IOUs agreed to this caveat. If legislative authorization is obtained promptly,  
18 the Parties also avoid the risk of litigation by the Non-Settling Entities creating a  
19 court precedent that could affect the Parties adversely after the Settlement  
20 Agreement expires. That risk could frustrate the Parties' intent to settle all the  
21 pending litigation without any rulings on the merits or binding precedent.

22  
23

1 *Q. Please describe the dispute resolution terms in the Settlement Agreement.*

2 A. As discussed in previous sections of this testimony, litigation is not a very  
3 satisfactory means to resolve certain disputes with BPA. The disputes that could  
4 arise under the Settlement Agreement are likely to fall into the category of  
5 disputes for which litigation cannot provide prompt and certain resolution.  
6 Binding arbitration can provide better promptness and certainty. However, BPA  
7 has limited authority currently to engage in binding arbitration. Therefore, the  
8 Parties drafted two alternative paths for dispute resolution.

9 If the legislation provided for in section 8 is in effect, then all disputes  
10 under the Settlement Agreement are subject to mandatory binding arbitration. If  
11 such legislation is not in effect, any dispute over whether any Party (other than  
12 BPA) received or kept money that should have gone to a different Party is subject  
13 to binding arbitration among the affected Parties. BPA has agreed to make  
14 adjustments on the bills or invoices of the Parties as necessary to implement an  
15 arbitrator's award. We believe most disputes that could arise under the  
16 Settlement Agreement can largely be remedied in this manner even if the  
17 legislation is not in effect. The Parties retain all their existing rights with respect  
18 to disputes that cannot be remedied fully under section 9.

19 *Q. Are there other important terms in the Settlement Agreement you wish to*  
20 *highlight?*

21 A. Yes. Under section 1.2.2, the proposed Settlement Agreement will become void  
22 if it has not been signed on or before April 15, 2011 by all of the IOU Group and  
23 by COUs having 91% of the Transition High Water Marks of COUs. This

1 provision is designed to limit the risk to the IOUs inherent in the possibility that  
2 the REP cost collectable from Non-Settling Entities could differ from the amounts  
3 collectible from COU Parties. Inasmuch as BPA's direct testimony indicates that,  
4 in the absence of the settlement, BPA would charge COUs more for REP costs  
5 than contemplated by the Settlement Agreement, it is vital that all COUs evaluate  
6 the Settlement Agreement promptly and decide whether they want the certainty it  
7 provides.

8 Finally, there is some risk that the law or other legal requirements could be  
9 amended such that BPA is no longer required to serve the COUs' general  
10 requirements under the cost based rate requirements currently in section 7 of the  
11 Act. The COUs and IOUs are currently negotiating language that may address  
12 this possibility. Currently, the thought is that, if the legal requirements were to  
13 change and BPA's rates for the COUs' general requirements were at or above  
14 79% of the average of the IOUs' ASCs, then the Settlement Agreement could be  
15 terminated. We believe this is a highly unlikely event, but we also believe it is  
16 important to many COUs to address this issue. We do not know if the COUs and  
17 IOUs will reach agreement on this provision, which is not contained in any of the  
18 drafts posted in this REP-12 proceeding.

19 **Section 8: Summary of Testimony.**

20 *Q. Please summarize your testimony.*

21 A. Parties have been fighting over the REP established by the Act continuously since  
22 1981. How BPA handles REP costs in rates has been a major issue in every rate  
23 case. There have also been major disputes, several of them leading to litigation,

1 over how BPA implements the REP itself. Much of this litigation is still pending  
2 in the Ninth Circuit. The REP also imposes major staffing costs on BPA and  
3 exchanging utilities.

4 In addition to the costly administrative and litigation burdens that have  
5 arisen from the REP, the REP has created great uncertainty about the size of REP  
6 benefits and their effect on rates. Parties' previous attempts to narrow these  
7 uncertainties through rate case and court litigation have failed. Continuing on this  
8 path is almost certainly doomed to failure for the reasons described in this  
9 testimony.

10 Over the past few years, dedicated representatives from BPA, the COUs,  
11 the IOUs, their regulators, and customers have worked hard to craft a settlement  
12 that is legally sustainable, fair, and acceptable to the vast majority of interested  
13 parties – one that can provide certainty and the hope for peace on this issue for  
14 many years. The economic compromise struck between the IOUs and COUs in  
15 the Settlement Agreement may not be the best possible deal for either the COUs  
16 or the IOUs, but it is firmly founded in the requirements of sections 5(c) and 7(b)  
17 of the Act. It provides known results that are better for the COUs than BPA's  
18 current approach if the Settlement Agreement is not adopted. If the COUs fail to  
19 grasp this opportunity to settle the REP, the alternative will be years of continued,  
20 contentious litigation. We believe the Settlement Agreement is far preferable to  
21 such an uncertain future.

22 *Q. Does this conclude your testimony?*

23 *A. Yes.*