Deemer Account Settlement Agreement with Avista Corporation

Administrator's Record of Decision

June 2009

DEEMER ACCOUNT SETTLEMENT AGREEMENT WITH AVISTA CORPORATION

ADMINISTRATOR'S RECORD OF DECISION

Bonneville Power Administration
U.S. Department of Energy

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I. INTRODUCTION

This Record of Decision ("ROD") represents the culmination of a series of negotiations and a public notice and comment process to establish a settlement agreement regarding a long-standing contractual dispute between Avista Corporation and Bonneville Power Administration ("BPA"). As explained in greater detail below, this dispute began in the mid-1980s and concerned the establishment of a negative account balance and the application of interest to that balance related to the implementation of the Residential Exchange Program ("REP") established by section 5(c) of the Northwest Power Act. 16 U.S.C. § 838c(c). The background of the dispute, a review of parties' comments on the proposed Deemer Account Settlement, and an analysis of such comments is presented below.

II. BACKGROUND

BPA is a Federal power marketing agency responsible for selling power generated at 31 Federal hydroelectric projects and several non-Federal projects. BPA markets power under federal statutes including the Pacific Northwest Electric Power Planning and Conservation Act of 1980, P.L. 96-501 (Northwest Power Act). 16 U.S.C. § 839 *et seq*. BPA also owns and operates approximately 75 percent of the Pacific Northwest's high-voltage transmission system. In 1974, under the Federal Columbia River Transmission System Act, P.L. 93-454, BPA became a self-financed agency that no longer receives annual congressional appropriations. *Id*. § 838i. BPA's rates must therefore produce sufficient revenues to repay all Federal investments in the power and transmission systems and carry out BPA's additional statutory objectives. *Id.* § 839e(a).

In the 1970s, threats of insufficient resources to meet the region's electricity demands led to passage of the Northwest Power Act in 1980. In that Act, Congress, among other things, directed BPA to offer new power sales contracts to all its customers. *Id*. §§ 839c, 839c(g). BPA's three primary customer groups are public agency customers ("preference customers"), investor-owned utility customers ("IOUs"), and direct service industrial customers ("DSIs"). Congress provided the preference customers and IOUs a statutory right for service from BPA to meet their net requirements loads. *Id*. § 839c(b)(1). BPA is authorized, but does not have the obligation, to serve the DSIs' firm loads after the expiration of their power sales contracts in 2001. *Id*. §§ 839c(b)(1), 839d. Congress also established the REP, which, as discussed in greater detail below, provides the residential and small farm consumers of Pacific Northwest utilities a form of access to the benefits of low-cost Federal power. *Id*. at § 839c(c).

A. The Residential Exchange Program (REP)

Section 5(c) of the Northwest Power Act established the REP. *Id*. § 839c(c). Under the REP, a Pacific Northwest electric utility (a preference customer utility, an IOU, or other entity authorized by state law to serve residential and small farm loads) may offer to sell power to BPA at the utility's average system cost ("ASC"). *Id*. § 839c(c)(1). BPA purchases such power and, in exchange, sells an equivalent amount of power to the utility at BPA's PF Exchange rate. *Id*. The amount of the power exchanged equals the utility's residential and small farm load. *Id*. In past practice, no actual power sales have taken place. Instead, BPA provided monetary benefits

to the utility based on the difference between the utility's ASC and the applicable PF Exchange rate multiplied by the utility's residential load. These monetary benefits must be passed through directly to the utility's residential and small farm consumers. *Id*. § 839c(c)(3). Although REP benefits have previously been monetary, the Northwest Power Act also provides for the sale of actual power to exchanging utilities in specific circumstances. Pursuant to section 5(c)(5) of the Northwest Power Act, in lieu of purchasing any amount of electric power offered by an exchanging utility, the Administrator may acquire an equivalent amount of electric power from other sources to replace power sold to the utility as part of an exchange sale. *Id*. § 839c(c)(5). However, the cost of the acquisition must be less than the cost of purchasing the electric power offered by the utility. *Id*. In these circumstances, BPA acquires power from an in lieu resource and sells actual power to the exchanging utility. The REP implements the key congressional goal of providing wholesale rate parity between regional customers by spreading the benefits of the Federal Columbia River Power System ("FCRPS") to all eligible regional residential and small farm consumers.

B. Average System Cost Methodologies

After passage of the Northwest Power Act in 1980, BPA and regional parties began two key processes necessary to implement the REP: a regional consultation process to establish an average system cost methodology and negotiations on the terms of the contracts that would be used to implement the REP. First, the parties worked to determine the major components of a methodology that would be used to establish a utility's average system cost of resources, or ASC, for the REP. Each exchanging utility's ASC is determined by the Administrator according to an ASC Methodology, which is an administrative rule developed by BPA in consultation with its customers and other regional parties. *Id*. § 839c(c)(7). In 1981, BPA conducted a consultation proceeding with regional parties to establish the 1981 ASC Methodology ("1981 ASCM"). Under the 1981 ASCM, a utility's ASC was the sum of a utility's production and transmission-related costs (Contract System Costs) divided by the utility's system load (Contract System Load). A utility's system load was the firm energy load used to establish retail rates. The 1981 ASCM used a "jurisdictional approach" to determine utilities' ASCs, which relied upon cost data approved by state public utility commissions (in the case of IOUs) and utility governing bodies (in the case of public utilities) for retail ratemaking. These data provide the starting point for BPA's determination of the ASC of each utility participating in the REP. Costs that had not been approved for retail rates were not considered for inclusion in Contract System Costs. The 1981 ASCM was completed in August 1981 and filed shortly thereafter with the Federal Energy Regulatory Commission (FERC) for approval.

As noted above, the 1981 ASCM relied primarily upon state utility commission orders as the source of data to calculate the IOUs' ASCs. Reliance on state regulatory agencies to determine the level of costs included in the ASC of a participating utility, also known as the "jurisdictional costing approach," caused several administrative problems for BPA. Routinely, the orders of regulatory agencies did not contain the specific numbers necessary for ASC computation. In such instances, values for ASC accounts had to be imputed.

Another drawback to the jurisdictional approach was that state rate regulators were not responsible for enforcing the requirements of section 5(c) of the Northwest Power Act. Instead,

they are charged by state law or local ordinance with setting reasonable rates that maintain the financial health and stability of the regulated utility. The interests of utility ratepayers and shareholders are commonly viewed as antagonistic. The courts have accorded regulators the latitude of a "zone of reasonableness" in which to set rates that balance these interests. *Federal Power Commission v. Natural Gas Pipeline Company*, 317 U.S. 575, 585 (1942). However, the choice of rates within this zone could be affected by BPA's obligation under the 1981 ASCM to provide whatever benefit payments a retail rate order dictated.

With benefits from BPA in the picture, higher retail rates did not necessarily produce higher bills for residential ratepayers. This phenomenon favored the establishment of retail rates at the upper end of the zone. As such, a participating utility might not be given an adequate incentive to control its costs. Yet, BPA could not intervene and participate in every regional rate proceeding to protect the interests of its own customers and its ability to recover its revenue requirement. Also, BPA did not want to influence the rate-setting because the purpose of the action taken by both parties was different.

There had also been instances when serious concern had been raised that costs approved for retail ratemaking purposes, and thus used to determine REP benefits under the 1981 ASC Methodology, had included terminated plant costs prohibited under section 5(c)(7)(C) of the Northwest Power Act. In one case, terminated plant costs were removed from an ASC filing during BPA review. *See* BPA's Average System Cost Report for Portland General Electric Company, Jurisdiction: Oregon (May 13, 1983). In another case, terminated plant issues were debated but became moot when another adjustment was made by BPA to an ASC filing. *See* Average System Cost Report for Pacific Power & Light Company, Jurisdiction: Oregon (November 2, 1983).

Terminated plant issues, in particular, caused all of BPA's DSI customers to request a change in the 1981 ASCM by invoking Section VI of the Methodology. BPA's public agency customers also requested a new consultation proceeding, which resulted in the 1984 Average System Cost Methodology ("1984 ASCM").

The proceeding leading up to the 1984 ASCM had its antecedents in a BPA review of an ASC filing by Pacific Power & Light Company ("PP&L") where it had been alleged that terminated power plant costs had been unlawfully included. After analyzing the available evidence on the issue, BPA concluded that it could not specifically identify any such costs in the filing. Probative data were not available to establish precisely what the Oregon Public Utility Commissioner had ruled in his rate order. In the BPA report on PP&L's ASC filing, dated December 27, 1982, BPA noted that:

> BPA has an express duty to comply with Section 5(c)(7)(C) of the Regional Act. This section requires BPA to exclude from Average System Cost any costs of generation facilities that are terminated prior to date of commercial operation. Our review did not identify cost associated with terminated plant in PP&L's rate base, cost of capital, expenses, or the effect of such costs on PP&L'S filed Average System Cost. However, we have concerns. The present Average System Cost Methodology is designed in such a way that the cost of capital, return on

> equity, and extraordinary gains and losses could conceal terminated plant costs. We think it would be appropriate to revise the Average System Cost Methodology to demonstrate clearly that the requirements of Section 5(c)(7)(C) (16 U.S.C. §839c(c)(7)(C)) are being met. BPA plans to initiate a consultation process to revise the Average System Cost Methodology.

ASC Report of December 27, 1982, at 1, FERC Docket No. ER83-266-000.

BPA issued the final Record of Decision for the 1984 ASCM on June 4, 1984 ("1984 ASCM ROD"). FERC subsequently granted interim approval of the methodology on June 12, 1984 (49 Fed. Reg. 24,146 (June 12, 1984)) and final approval on October 5, 1984 (49 Fed. Reg. 39,293 (Oct. 5, 1984)).

The 1984 ASCM made several significant changes to the 1981 ASCM. One was development of a formal ASC review process establishing a 210-day timeline for review of utility ASC filings. In addition, BPA restricted the inclusion of certain costs in ASC. For example, BPA limited the ability of the utility to include transmission-related costs in ASC to the transmission plant that was in service as of July 1, 1984, plus the cost of new transmission plant placed in service after July 1, 1984, if the facilities are used to integrate generation resources into the exchanging utility's grid, or the sum of new transmission plant that is used to connect the resource to BPA's grid plus wheeling costs to get the power across BPA's system to the exchanging utility's grid. Return on equity was also removed from the determination of an exchanging utility's ASC largely because of concerns that state commissions could use return on equity to compensate a utility for the costs associated with terminated plants. The Northwest Power Act prohibits the inclusion of terminated plant costs in utility ASC filings. Finally, Federal income taxes were also excluded from the calculation of an exchanging utility's ASC.

C. Residential Purchase and Sale Agreements

Concurrent with the establishment of the 1981 ASCM, BPA and regional parties began the process of negotiating the agreements that would implement the REP. The first set of these agreements, referred to as Residential Purchase and Sales Agreements ("RPSA"), was negotiated in 1981. During the negotiations, BPA and regional parties discussed whether exchanging utilities should be required under the RPSA to pay BPA if the utilities' ASCs were less than BPA's PF Exchange rate. Although the Northwest Power Act and the associated legislative history were reasonably clear that BPA was to provide residential and small farm consumers with benefits from the Federal system when a utility's ASC was above the PF Exchange rate, it provided little guidance on what BPA must do when a utility's ASC fell below the PF Exchange rate. The preference parties argued that wholesale rate parity between regional customers could only be achieved if the exchanging utilities were required to pay BPA when ASCs fell below the PF Exchange rate. The IOUs, however, countered that the REP was primarily designed to provide the benefits of the FCRPS to their residential and small farm customers and said nothing about whether "negative REP" payments should be made from the IOUs to BPA. The IOUs were wary of agreeing to any contractual provision that would saddle them and their ratepayers with obligations to pay BPA. As noted in the 1981 Staff Evaluation of Public Comments in Response to BPA's Prototype Power Sales Contracts and Residential Purchase and Sale

Agreement ("1981 Staff Evaluation of Comments"), absent some mechanism for minimizing the possibility of these net negative REP benefits, the IOUs and state utility commission representatives "expressed doubts that the [RPSAs] would be signed." 1981 Staff Evaluation of Comments, 1981 Contract Record at 002681.

To resolve this matter, BPA and the regional parties reached a compromise that recognized the two-way nature of the exchange program, while at the same time limiting the exchanging utility's exposure to paying BPA. Specifically, the parties agreed that when a utility's ASC is less than the PF Exchange rate, the utility may elect to deem its ASC equal to the PF Exchange rate. This compromise is described in BPA's 1981 Staff Evaluation of Comments:

> … BPA has agreed to allow a participating utility to "deem" its average system cost to be equal to BPA's firm power rate anytime during the life of the contract. This allows the utility to suspend the effects of the exchange arrangement when it would result in detriment while still preserving the "long-term" contract requirement of the Regional Act. Having "opted out" of the exchange, the utility may resume full participation in the exchange only after it has foregone [*sic*] economic benefits equal to the costs it would have paid had the utility's average system cost not been deemed equal to BPA's Firm Power Rate. This compromise has been embraced by all BPA customer groups.

See 1981 Staff Evaluation of Comments, 1981 Contract Record at 002681. The specific contractual language that implemented the deemer account concept in the RPSA is as follows:

> 10. Election to Equalize Rates. The Utility may elect to have its Exhibit C rate for any jurisdiction deemed equal to the Exhibit A rate. Such election shall be made in writing to Bonneville within 25 working days following confirmation and approval by the Federal Energy Regulatory Commission or its successor agency (FERC), on an interim or final basis, of a change in the Exhibit A rate or in Exhibit C methodology, and will take effect as of the date of the effective date of that change.
>
> During any period that such election is in effect, Bonneville shall debit to a separate account the net exchange payment to Bonneville, if any, that would have been required of the Utility if the Utility had not made such election and shall credit to that account any exchange payments that would have been made. The net balance in such account shall accumulate interest at the rate specified in section IV.E. of Exhibit C.
>
> During the period of any such election, any portion of the costs for terminated resources associated with section 7(g) of the Regional Act included in the Exhibit A rate which would have been charged to the Utility shall be payable by the utility by means of a surcharge to the Utility's power sales contract payments pursuant to section 5(b) of the Regional Act or, if the Utility is not party to such a contract, monthly in cash as accrued. Such surcharge payments shall not exceed the total costs incurred by Bonneville during the same period and attributable to terminated resources which the Utility has sold to Bonneville and which total costs are not otherwise recovered currently through such section 7(g)

> allocations to any other rate or rates paid by the Utility. Such payment also shall not exceed the payments which the Utility would have made to Bonneville during each exchange period had it not made such election. Section 7(g) costs so paid shall be excluded from the separate account maintained pursuant to this section.
>
> The Utility may rescind such election and resume full participation in the exchange provided at [sic] that (a) the debit balance of such separate account be less than or equal to zero; or (b) the Utility makes payments to Bonneville in agreed upon installments to bring the debit balance to zero. Such rescission may be either by notice in writing effective upon delivery to Bonneville within 25 working days following confirmation and approval by FERC, on an interim or final basis, of a change in Exhibit A, or by notice in writing effective on a date to be agreed upon by Bonneville and the Utility, which date shall be within 13 months following delivery to Bonneville of the notice of rescission.
>
> Upon termination of this agreement, any debit balance in such separate account shall not be a cash obligation of the Utility, but shall be carried forward to apply to any subsequent exchange by the Utility for the Jurisdiction under any new or succeeding agreement.

In simple terms, the deemer provision allows for the accumulation of negative benefits when a utility's ASC is lower than BPA's PF Exchange rate. Accumulated amounts are then netted against future positive benefits when the utility's ASC is again higher than BPA's PF Exchange rate. More specifically, upon specified conditions exchanging utilities may deem their ASC equal to BPA's PF Exchange rate. BPA would continue to track the relationship of the utility's ASC, now lower than the PF Exchange rate, with the PF Exchange rate. The amount that a utility would otherwise pay BPA is tracked in a "deemer account." At such time as the utility's ASC is higher than BPA's PF Exchange rate, REP benefits that would otherwise be paid to the utility act as a credit against the negative "deemer balance." Only after the "positive benefits" have completely offset the "negative balance," bringing the negative "deemer account" to zero, would the utility again receive actual monetary payments from BPA under an existing or new RPSA.

A utility could pay off its deemer balance by either allowing its prospective REP benefits to be reduced until the balance was gone or by making installment payments to BPA. In this way, the deemer account acted as a balancing account, accumulating negative REP benefits during periods when the utility's ASC was below the PF Exchange rate, and then setting off these amounts against prospective REP payments when the utility's ASC was above the PF Exchange rate. As noted in the last paragraph in section 10 of the RPSA, upon termination of the 1981 RPSA, the exchanging utility's outstanding deemer balance would be carried "forward to apply to any subsequent exchange by the Utility for the Jurisdiction under any new or succeeding agreement." The deemer balances were not, however, a cash obligation of the utility. As such, the balances could only be recovered pursuant to the terms of future exchange agreements.

D. Implementation of the Deemer Provision

From 1981 to 1984 the deemer account provision generally operated as expected. During this period, Idaho Power Company (Idaho Power or IPC), Montana Power Company (presently

NorthWestern), and Washington Water Power Company (presently Avista) accumulated relatively minor deemer balances of $1.5 million, $1.9 million, and $6.8 million, respectively. As noted above, in 1984, BPA substantially revised its 1981 ASCM. The new 1984 ASCM excluded significant costs from the calculation of ASC, which resulted in a dramatic downward effect on IOU exchanging utilities' ASCs. In a short time, payments to IOUs under the REP were reduced or eliminated altogether.

These reductions in ASC fell particularly hard on utilities that had deemed their ASCs equal to the PF Exchange rate. For the utilities that had existing deemer balances, continued participation in the REP under the 1984 ASCM meant almost certain accumulation of even larger deemer balances. Nevertheless, these utilities had few options. The terms of the 1981 RPSA for terminating or suspending the agreement were rigid. Section 9 of the RPSA allowed the utility to terminate or suspend its RPSA for up to a year if "the supplemental rate charge provided for in section 7(b)(3) of the Regional Act is applied by Bonneville and the cost of electric power sold to the Utility under section 3 of this agreement exceeds the ASC of the power sold to Bonneville under section 2." Stated another way, the utility could terminate its RPSA only if two conditions existed. First, BPA must have assessed section 7(b)(3) supplemental charges to the PF Exchange rate in BPA's most recent rate proceeding. Second, the utility's ASC must have fallen below the PF Exchange rate. Unless these conditions were met, exchanging utilities had no right under the 1981 RPSA to terminate their participation in the REP.

In the 1985 wholesale power rate case, the rate case that immediately followed BPA's adoption of the 1984 ASCM, no costs were allocated under section 7(b)(3) to the PF Exchange rate. Because the first condition for terminating the RPSA had not been met, Idaho Power and Washington Water Power (hereafter "WWP") had no right to terminate or suspend their participation in the REP, even though these utilities' ASCs were well below the PF Exchange rate due to the change in the ASCM. With no other options, the deeming utilities were forced to accumulate deemer balances that far exceeded the benefits they had received under the REP. This was particularly the case for WWP, which received only $6 million in total REP benefits during the first three years of the REP. After BPA changed the ASC Methodology, WWP's deemer balance increased from $6.8 million in 1984 to more than $39 million by 1987.

1. The 1987 Suspension of WWP's RPSA

In BPA's 1987 wholesale power rate case, BPA allocated costs to the PF Exchange rate pursuant to section 7(b)(3) of the Northwest Power Act. This action afforded exchanging utilities in deemer status the right to suspend or terminate their respective RPSAs. WWP and BPA subsequently executed a suspension agreement effective June 30, 1987 ("Suspension Agreement"), which suspended WWP's right to participate in the REP. The Suspension Agreement suspended WWP's RPSA "in accordance with and subject to the terms and conditions set forth" in the Suspension Agreement. *See* Suspension Agreement at § 1. Most importantly, the Agreement suspended WWP's right to exchange power with BPA under section 5(c) of the Northwest Power Act. Section 2 of the Agreement states that "until such time as revocation of this Suspension Agreement is effective, WWP shall not offer to sell electric power to the BPA Administrator pursuant to section 5(c) of the [Northwest Power Act]."

The Suspension Agreement was beneficial to both BPA and WWP. For BPA, the benefit came from the savings in time and administrative expense associated with conducting ASC review processes. Even though WWP was not receiving any positive benefits from the REP (and had not received REP benefits for over five years), WWP was still required by the RPSA and 1984 ASCM to file an ASC with BPA for each retail rate change it submitted to its state utility commissions. These ASC filings, in turn, triggered BPA's duty under the 1984 ASCM to commence an expensive and time consuming 210-day review of WWP's ASC. With the Suspension Agreement in place, BPA would not need to conduct these complex and administratively burdensome ASC review proceedings each time WWP changed its retail rates.

For WWP, the Suspension Agreement reduced the burden of an ever-growing deemer balance. Section 4 of the Agreement provides that "[d]uring the period of suspension under this Agreement, accruals to the deemer account shall cease, except for interest upon such amounts." Suspension Agreement, § 4, pg. 3. This provision was vitally important to WWP because it stopped the principal amounts of WWP's deemer balance from increasing further. It, however, did not stop all growth of WWP's deemer balance. WWP's outstanding deemer balance would be subject to interest calculated at the "average prime rate for each calendar quarter, which shall be the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate value published in the Federal Reserve Bulletin . . ." *Id.* The accrued interest would not be compounded. *Id.*

In addition to suspending WWP's participation in the REP and the accumulation of the deemer balance, BPA and WWP also agreed in the Suspension Agreement to the amount of WWP's deemer balance. Prior to the Suspension Agreement, BPA and WWP had an ongoing disagreement over the appropriate calculation of the outstanding deemer balance. To resolve this dispute, the parties agreed that $39.3 million was the balance as of the date of the Suspension Agreement. The $39.3 million balance was comprised of approximately $27 million in negative REP benefits for WWP's Washington jurisdiction and $11 million for its Idaho jurisdiction. Approximately $33 million of the $39.3 million balance was deemer principal and $6.3 million accumulated interest. This balance is described in the Suspension Agreement as a "compromise," where neither party expressly "approved, accepted, or consented to the facts, principal methods, or theories employed by either party in arriving at the stated balances of the deemer account as of June 30, 1987." Suspension Agreement at § 4.

While the Suspension Agreement removed WWP from the REP, it did so with the recognition that such displacement was not irreversible. In the "Term" provision in Section 2 of the Suspension Agreement, the parties agreed that the suspension would remain in effect until

> September 30, 1990, as WWP thereafter elects by giving a revocation notice to BPA as provided for in paragraph 6 of this Suspension Agreement, and shall terminate at 2400 on September 30, 1994, unless BPA and WWP shall have previously agreed in writing to extend the term of the Suspension Agreement, either as it is currently written or as modified by mutual agreement of BPA and WWP.

Suspension Agreement at § 2.

In effect, the Suspension Agreement would remove WWP from the REP until at least September 30, 1990. After that date, WWP could elect to terminate its suspension and resume its participation in the REP if it gave BPA a revocation notice pursuant to Section 6 of the Suspension Agreement. If such a revocation was not provided by September 30, 1994, then the Agreement would terminate by its own terms, unless the parties mutually agreed to extend the terms of the Suspension Agreement.

2. The 1993 Termination of the Suspension Agreement and RPSA

In BPA's 1993 rate case, BPA again allocated costs to the PF Exchange rate pursuant to section 7(b)(3) of the Northwest Power Act. This time WWP expressed an interest in terminating its RPSA. Because WWP's Suspension Agreement was still in effect, BPA maintained that WWP could not terminate the RPSA without first addressing the terms of the Suspension Agreement. BPA was willing to accept WWP's termination, provided that WWP agreed to certain additional conditions. Specifically, BPA wanted WWP to concur with the stated sum of the deemer balance, concur that the deemer balance would continue to accrue interest at the prime rate, agree that the deemer balance would accrue compound interest, and concur that any deemer balances would be carried forward to apply to any new or succeeding RPSA. BPA communicated in a request sent on September 21, 1993, that WWP include these additional terms in its request to terminate its 1981 RPSA.

In response, on September 29, 1993, WWP sent a one sentence letter notifying BPA of its intent to terminate its RPSA pursuant to section 9 of the RPSA. Specifically, WWP's letter stated:

> The Washington Water Power Company (Company) hereby gives notice, pursuant to Section 9 of its above-referenced [RPSA] . . . , of its election to terminate its RPSA effective September 30, 1993 and continuing through 2400 hours on June 30, 2001.

Letter from WWP, September 29, 1993.

Concurrent with this termination notice, WWP also filed a notice of termination with the Federal Energy Regulatory Commission.[1] Noticeably absent from both of these communications were the additional terms regarding WWP's deemer balance that BPA had outlined in its previous communications.

On October 19, 1993, BPA responded to WWP's September 29, 1993, termination notice. In this letter, BPA restated the conditions originally requested in its September 21, 1993, communication to WWP. In addition, BPA identified WWP's current outstanding deemer balance as $59,936,451. BPA concluded the letter by stating, "[t]ermination of the Company's RPSA without the above-stated conditions is unacceptable to BPA as not meeting the requirements of the Company's RPSA and Suspension Agreement." WWP never responded to

[1] On October 29, 1993, WWP revised its filing with the Commission, clarifying that the requested relief was cancellation, not termination, of its 1981 RPSA.

BPA's letter. On December 6, 1993, FERC granted WWP's request to cancel the RPSA. BPA did not intervene or otherwise participate in the FERC proceeding.

3. The Lingering Dispute Over WWP's Deemer Balance

Following BPA's October 19, 1993, communication, there appeared to be no general dispute between BPA and WWP that WWP's 1981 RPSA had terminated. From October of 1993 onward WWP did not submit, and BPA did not request, any ASC filings as required by the RPSA and the 1984 ASCM, even though WWP made numerous changes to its retail rates. In addition, no further correspondence regarding WWP's 1981 RPSA was received or sent by BPA. Despite BPA's tacit agreement that the RPSA was no longer in effect, significant disagreement remained over whether the conditions outlined in BPA's October letter attached to the termination.

As explained in comments submitted by WWP in 1998 to BPA's Subscription Principles process, WWP maintained that it never agreed to the conditions BPA requested in its October 19, 1993, letter. From WWP's viewpoint, the only part of its deemer balance that could be carried forward to a future contract was the portion associated with the 1981 ASCM. The remaining portion of the deemer balance, the portion generated under the 1984 ASCM, could not be transferred. As WWP explained it, "[w]hen WWP terminated its residential exchange agreement with Bonneville in 1993, WWP expressly did not agree with Bonneville's position that the deemer balance resulting from the changed average system cost methodology would be carried over to a new contract."

Avista raised a similar point in its comments on BPA proposed new RPSAs in 2000.[2] With the term of the 20-year 1981 RPSA coming to a close in 2001, BPA posted for comment new versions of the RPSA that would be in effect for FY 2001-2011 ("2000 RPSA"). In the 2000 RPSA, BPA proposed to include a provision that would track both positive and negative REP benefits through a deemer-like mechanism. Additionally, BPA proposed to require utilities with existing deemer balances from the 1981 RPSA to pay these amounts off before they could receive positive REP payments. During the comment period on the 2000 RPSA, Avista submitted comments that strongly objected to these provisions. Specifically, Avista argued that it was not the parties' intent in the 1981 RPSA to carry forward deemer balances accrued under a methodology other than the 1981 ASCM. Avista contended that BPA had no basis for asserting that the deemer balance from the 1981 RPSA could be carried forward to the 2000 RPSA. For support, Avista noted that it never agreed to the terms of BPA's October 1993 letter, which sought to bind Avista to such a commitment.

BPA responded to Avista's arguments in the 2000 RPSA Record of Decision ("2000 RPSA ROD.") In the 2000 RPSA ROD, BPA rebutted Avista's position that the deemer balances under the 1981 RPSA could not be carried forward to the new 2000 RPSA. BPA also presented its viewpoint that BPA's October 1993 letter required Avista to accept BPA's termination conditions. 2000 RPSA ROD at 55-56. With Avista's and BPA's respective positions staked out in the pages of the 2000 RPSA ROD, the issues over Avista's deemer balance were set to be resolved through litigation.

[2] On January 1, 1999, WWP changed its name to Avista Corp.

The need for such litigation, however, subsequently became moot when Avista and BPA entered into a Residential Exchange Program Settlement Agreement ("REP Settlement Agreement") in October of 2000. The REP Settlement Agreements were an alternative mechanism for providing benefits from the Federal system to the residential and small farm customers of the IOUs. BPA offered the REP Settlement Agreement concurrent with its offer of the 2000 RPSAs. Unlike the 2000 RPSAs, which used ASCs and the PF Exchange rate to establish REP benefits, the REP Settlement Agreements provided exchanging utilities with payments from the Federal system through a negotiated formula. Because utility ASCs were not a factor in the formulation of these payments, BPA did not require utilities to extinguish their deemer balances prior to receiving benefits under the REP Settlement Agreements. Instead, the REP Settlement Agreements provided that "[a]s a result of entering [the REP Settlement Agreement], neither BPA nor Avista has prejudiced its right, if any, to assert that a Deemer Account balance, if any, from the 1981-2001 . . . [RPSA] is required to be carried over to any subsequent agreement offered by BPA pursuant to section 5(c) . . ." REP Settlement Agreement at § 9. BPA explained that its decision to not address deemer balances in the context of the REP Settlement Agreements was due to the disputed nature of the deemer balances. As explained in the REP Settlement Agreements, Administrator's Record of Decision, October 4, 2000, ("2000 REP Settlement ROD"):

> The 1981 RPSA, therefore, does not require the payment of a deemer balance before executing a Settlement Agreement, but rather requires the payment of a deemer balance before continuing participation in the REP through a new RPSA. It is therefore appropriate to hold deemer balances, if any, in abeyance during the term of the Settlement Agreement.
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> * * * *
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> The existence of deemer balances and the amount of such balances, if any, must be determined in negotiations between BPA and the IOUs and will not be finally determined until BPA and the IOUs have discussed and resolved the issue or the issue is resolved through litigation. Due to the uncertainty of deemer balance, the IOUs' disagreement with BPA's preliminary calculation of such balances, and the dispute over the very existence of the balances, it is appropriate to simply hold this issue in abeyance during the term of any settlement.

2000 REP Settlement ROD at 58-59. Thus, with the execution of the REP Settlement Agreement, Avista's deemer balance issues would once again remain unresolved.

E. The Termination of the REP Settlement Agreements and the Reinstatement of Avista's Deemer Balance Challenges

Following BPA's execution of the REP Settlement Agreements, several preference customers challenged BPA's authority to provide REP benefits to the IOUs under BPA's alternative method. Parties also challenged BPA's decision to recover the costs of the REP Settlement Agreements through the preference power rates established by BPA in its WP-02 rate proceeding. On May 3, 2007, the Ninth Circuit issued two companion decisions. In *Portland*

General Elec. Co. v. Bonneville Power Admin., 501 F.3d 1009, 1037 (9th Cir. 2007) ("*PGE*), the Ninth Circuit held that BPA's REP Settlement Agreements with the IOUs were "inconsistent with the NWPA." In *Golden NW Aluminum v. Bonneville Power Admin.*, 501 F.3d 1037, 1047-48 (9th Cir. 2007) ("*Golden NW*"), the same Court found that BPA improperly allocated the costs of the REP Settlement Agreement to BPA's PF Preference rates. As a result, the Court remanded BPA's WP-02 rates, with the instruction that BPA must "set rates in accordance with this opinion." *Id.* at 1053.

In response to the Court's decisions, BPA commenced a rate proceeding, the WP-07 Supplemental Rate Proceeding, to correct its existing rates and to determine the amount of refunds, if any, that BPA should provide to its preference customers. Concurrent with this process, BPA also commenced a series of public meetings to begin the process of restarting the traditional REP. Part of that process included re-examination of the 2000 RPSA, which had been displaced when BPA and the IOUs executed the REP Settlement Agreements. With the REP Settlement Agreements no longer in effect, and BPA looking to restart the REP, the issues regarding Avista's deemer balance once again came to the forefront. As explained more fully in the following sections, the dispute over Avista's deemer balance became a serious point of contention in both the WP-07 Supplemental Rate Proceeding and during the development of the 2008 RPSAs. In each forum, Avista vigorously challenged the existence and calculation of its deemer balance.

1. Avista's Challenges to its Deemer Balance in BPA's WP-07 Supplemental Rate Proceeding

The WP-07 Supplemental Rate Proceeding was designed to accomplish four objectives: (1) determine the amount of benefits that BPA's IOU customers received, or would have received, from FY 2002-2008 as a result of the REP Settlement Agreements; (2) determine the amount of REP benefits the IOUs would have received under a traditional RPSA for this same period in the absence of the REP Settlement Agreements; (3) address any differences between these two amounts; and (4) establish new power rates for FY 2009. *See 2007 Supplemental Wholesale Power Rate Adjustment Proceeding, Public Hearing and Opportunities for Public Review and Comment,* 73 Fed. Reg. 7539, 7540 (Feb. 8, 2008); *see also* 2007 Supplemental Wholesale Power Rate Case, Administrator's Final Record of Decision (Conformed), WP-07-A-05, September 22, 2008, at 9 ("WP-07 Supplemental ROD"). The construct BPA adopted for "looking back" over the FY 2002-2008 period and determining what level of benefits the IOUs should have received is generally referred to as the "Lookback." *See* WP-07 Supplemental ROD at 9-10. The net difference between what BPA paid the IOUs under the REP Settlement Agreements and what the IOUs would have received under a traditional RPSA arrangement is the amount that BPA overcharged its preference customers. This amount, which is akin to a refund, is referred to generically as the "Lookback Amount." *Id.* Under BPA's construct, the Lookback Amounts are collected from the IOUs and returned to the preference customers by setting off future REP payments. *Id.*

To determine the amount of REP benefits the IOUs would have received under a traditional RPSA, BPA assumed that the IOUs would have participated in the REP from FY 2002-2008 under the 2000 RPSAs so long as it appeared such participation would be beneficial. *Id.* at 218.

Because the 2000 RPSAs required utilities to extinguish their deemer balances prior to receiving any REP benefits, BPA also assumed that any utility with an existing deemer balance as of 2000 had to apply the reconstructed REP benefits against such balance until the balance was gone. *Id.* at 216-225.

To calculate Avista's deemer balance for rate case purposes, BPA assumed that Avista's deemer balance continued to grow at a simple rate of interest pursuant to the terms of the Suspension Agreement after BPA and Avista terminated the 1981 RPSA in 1993. Under this assumption, Avista's deemer balance grew from $59 million in 1993 to approximately $85.6 million as of October 1, 2001.

Avista and Idaho Power Company ("IPC") vigorously opposed BPA's decision to account for outstanding deemer balances as part of BPA's Lookback process. *Id*. They argued that the deemer balances were disputed contractual matters that should not be considered in determining the amount of refunds owed to the preference customers. *Id.* In addition, Avista and other parties raised a host of legal, contractual, equitable, regulatory, and constitutional arguments against the calculation and validity of the deemer balance. *See generally, Id.* at 216-248. BPA agreed that deemer balances were contractual issues that would need to be resolved in other forums. *Id.* at 219. Nonetheless, BPA believed that it would not have been reasonable to assume that the deemer balances, whatever their value, would have simply disappeared had BPA not executed the REP Settlement Agreements. *Id.* at 225. The deemer balances needed to be taken into account to properly calculate the REP benefits the IOUs would have received. In making this assumption, BPA repeatedly stated that it was not deciding the size or validity of Avista's deemer balance in BPA's rate case. *Id.* at 218-219, 225, 231, 238, 241-242. The deemer assumptions used in the rate case were only placeholders. These assumptions could be replaced with the deemer balance determined to be appropriate after settlement or litigation of the deemer balance issues. As noted in the WP-07 Supplemental ROD:

> Consistent with BPA's position that the decisions in this proceeding do not constitute final determinations of disputed deemer issues, if deemer issues are settled or otherwise determined subsequent to this proceeding, BPA will reflect the resolution of issues in the respective IOUs' Lookback Amounts.

Id. at 222. Therefore, once the deemer disputes between BPA and Avista were finally resolved, BPA would adjust Avista's Lookback Amount to reflect the newly determined deemer balance. Despite these offerings, Avista and other parties continued their vigorous challenges to BPA's decision to account for the deemer balances. In the end, BPA dedicated over 32 pages of its Record of Decision responding to all of the arguments raised by Avista and other parties regarding the calculation and validity of the deemer balance accounts.

On December 16, 2008, Avista filed a petition seeking review of BPA's WP-07 Supplemental ROD. *See* Petition for Review of Avista Corp., Case No. 08-75098. BPA expects Avista will challenge in this petition, among other things, BPA's decision to consider the deemer balances in the calculation of Avista's Lookback Amount.

2. Avista's Challenges to its Deemer Balance and the Deemer Provision in the 2008 RPSAs

At the same time BPA was commencing its WP-07 Supplemental Rate Proceeding, BPA also was in the process of developing RPSAs with IOUs and preference customers to restart the traditional REP. Throughout the summer of 2008, BPA was engaged in negotiations with regional parties over the terms of the RPSAs that would replace the 2000 REP Settlement Agreements. The negotiators worked on two versions of the RPSA. The first covered the remaining years of the REP Settlement Agreement. This RPSA is referred to as the "Bridge RPSA" and covers FY 2009-2011. The longer-term version of the RPSA is referred to as the "Long-Term RPSA"; it covers the FY 2012-28 period. In both agreements, BPA proposed to include a deemer provision, referred to as a "balancing account," to reflect the fact that the REP was not simply a "one-way street." *See* Short-Term Bridge Residential Purchase and Sale Agreement for the Period Fiscal Years 2009-2011 and Regional Dialogue Long-Term Residential Purchase and Sale Agreement for the Period Fiscal Years 2012-2028, Administrator's Record of Decision ("2008 RPSA ROD"), September 4, 2008, at 25.

Avista and other parties strongly objected to BPA's decision to include the deemer provision in the final new RPSAs, arguing that BPA did not have the statutory authority to include a provision which allowed for benefits to flow both to and from exchanging parties. *Id.* Following BPA's publication of the final 2008 RPSA ROD, on December 1, 2008, Avista filed a petition in the Ninth Circuit challenging BPA's Bridge and Long-Term RPSAs. *See* Petition for Review of Avista Corp., Case No. 08-70265. In filing this petition, Avista intends to challenge, among other things, the "validity and calculation of the deemer amount asserted by Bonneville and the legality of the Balancing Account provisions (*i.e.*, the deemer provisions) in the Bridge and Long-Term RPSAs." (Avista, ADS090010, at 5.)

III. OVERVIEW OF PROPOSED SETTLEMENT

Faced with these pending challenges and with the prospect of potential other challenges from Avista, BPA and Avista began negotiations in the fall of 2008 to consider settlement of the long-standing disputes surrounding Avista's deemer balance. After extensive negotiations, BPA and Avista arrived at a proposed settlement that resolved all issues related to the creation, accumulation, and calculation of Avista's deemer balance. Under the proposed Deemer Account Settlement (Settlement), Avista would drop all claims against BPA pending before the Ninth Circuit that seek to challenge BPA's decisions related to the deemer balance provisions. The proposed Settlement considers BPA's risk and cost of litigating the deemer disputes in court and the equitable considerations surrounding the unique set of circumstances that led to the creation and accumulation of Avista's deemer balance.

In the WP-07 Supplemental Rate Proceeding, BPA assumed a beginning of FY 2002 deemer balance for Avista of $85.6 million. As noted above, this figure was not agreed to by Avista and was a contested issue throughout the WP-07 Supplemental Proceeding. Under the proposed Avista Deemer Settlement, BPA would replace this number with $55 million and re-run the

Lookback calculations in the WP-07 Supplemental Rate Proceeding Final Proposal. This results in different values for Avista's 1) beginning FY 2008 deemer balance, 2) reconstructed REP benefits applied to Lookback, 3) FY 2008 Definitive Benefit Amount, 4) beginning FY 2009 Lookback Amount and 5) beginning FY 2009 deemer balance (referred to as the Balancing Account balance in the Bridge RPSA). BPA would use these recalculated amounts to implement the Residential Exchange Interim Relief and Standstill Agreement, Contract No. 08PB-12438, between BPA and Avista and to implement the REP in FY 2009 and beyond.

The recalculated amounts are as follows:

1) Beginning FY 2008 deemer balance	$17.055 million
2) Reconstructed FY 2008 REP benefits applied to Lookback	$ 5.835 million
3) FY 2008 Definitive Benefit Amount	$12.010 million
4) Beginning FY 2009 Lookback Amount	$69.933 million
5) Beginning FY 2009 deemer (Balancing Account) balance	$0.0 million

The above amounts, in conjunction with the Final FY 2009 ASCs and associated 7(b)(3) Supplemental Rate Charges, will be used in the FY 2009 ASC True-Up.[3]

In consideration of BPA's use of the lower FY 2002 deemer balance, Avista would accept the establishment of the new deemer account balance, agree to resolve all past deemer issues, agree not to challenge BPA's use of deemer amounts to determine the Lookback Amounts pursuant to the WP-07 Supplemental ROD, and agree not to challenge the Balancing Account provisions in the Bridge and Long-Term RPSAs.

The revised FY 2002 deemer balance of $55 million was determined as follows. When BPA and Avista entered into an REP Suspension Agreement in 1987, Avista's deemer balance stood at $39.3 million. During the settlement negotiations, the parties agreed to use that amount as a starting point for discussion. BPA and Avista then agreed to adjust this amount for inflation to arrive at a beginning FY 2002 deemer balance. BPA escalated the $39.3 million using the Gross Domestic Product Implicit Price Deflator (GDP Deflator), which resulted in an outstanding deemer balance of $55 million at the beginning of FY 2002.

BPA believes that the foregoing settlement strikes a reasonable balance between the interests of BPA ratepayers in general (who benefit from the accumulation of interest on outstanding deemer balances) and the interests of Avista and, in particular, its residential and small-farm consumers (who incur the costs of the accrued interest) and is therefore an appropriate basis for settlement of the deemer issue.

[3] Due to a timing difference between the establishment of the 2008 ASCM and the start of the first exchange period, BPA started paying exchanging utilities based on their "As-Filed" ASCs in October of 2008. The As Filed ASCs are subsequently replaced by the final ASCs BPA determines in its FY 2009 ASC Review Processes. The FY 2009 ASC True-Up refers to the process whereby BPA adjusts the utility's exchange payments to reflect the results of BPA's final ASC determinations.

IV. REVIEW OF COMMENTS

Issue 1

Whether the BPA Administrator has the statutory authority to exercise his discretion to execute a Deemer Account Settlement with Avista.

Parties' Positions

BPA's preference customers oppose BPA's proposed deemer account settlement with Avista. (PPC, ADS090004; Inland Power, ADS090001; NRU, ADS090003; PNGC, ADS090006; APAC, ADS090007; WPAG, ADS090005.) Such customers' comments may imply that BPA lacks statutory settlement authority to enter into the settlement.

IPC, PGE, PacifiCorp, and Avista state that BPA has the authority to settle deemer disputes, particularly because such disputes are contract disputes which are not based on statutory requirements. (IPC, ADS090002; PGE, ADS090008; PacifiCorp, ADS090009; Avista, ADS090010.)

BPA Staff's Position

BPA has statutory authority to settle contract disputes provided such settlements are not contrary to statutory directives.

Evaluation of Positions

Before addressing the issues raised in parties' comments, it is helpful to review BPA's broad authority to settle contract claims.

A. The Bonneville Project Act and the Northwest Power Act Provide BPA Broad Discretion to Enter into Contracts and Arrangements and to Compromise and Settle Disputes

In BPA's organic legislation, Congress granted the BPA Administrator broad discretion not normally provided to government organizations to take such actions as the Administrator determined to be appropriate and necessary in the conduct of BPA's business. These actions include the establishment of contracts and settlement agreements. Section 2(f) of the Bonneville Project Act provides as follows:

> Subject only to the provisions of this Act, the Administrator is authorized to enter into such *contracts, agreements, and arrangements*, including the amendment, modification, adjustment, or cancellation thereof, and *the compromise or final settlement of any claim arising thereunder*, and to make such expenditures, *upon such terms and conditions and in such manner as he may deem necessary*.

16 U.S.C. § 832a(f) (emphasis added).

Section 2(f) is a broad statutory grant of authority to a Federal agency, which recognizes the unique nature of BPA as a business in the electric power industry. Congress enacted this revised version of section 2(f) in 1945 to "put the Bonneville [Power] Administration on a more businesslike basis." *Hearings on H.R. 2690 and H.R. 2693 Before the House Comm. on Rivers and Harbors*, 79th Cong. 2 (1945) (statement of Rep. Jackson).[4] Because Congress amended section 2(f), Congress carefully considered the words used in the provision. Therefore, it is significant that Congress intended the BPA Administrator to enter into contracts and arrangements and compromise and settle claims arising thereunder "upon such terms and conditions and in such manner as he may deem necessary." 16 U.S.C. § 832a(f).

The broad grant of authority in section 2(f) is based on the premise that BPA is a regional and business agency, and the broad discretion would permit it to "function in a more businesslike manner." *Hearings on H.R. 2690 and H.R. 2693 Before the House Committee on Rivers and Harbors*, 79th Cong. 2 (1945) (statement of Rep. Jackson). "The Bonneville Power Administration is not engaged in a governmental regulatory program. It operates a business enterprise . . . . [The amendment] will facilitate its operations as a regional and business agency." S. Rep. No. 79-469, 79th Cong., 1st Sess. 13 (1945).[5] The legislative history provides that "[t]he Department of the Interior has wisely recognized that such a regional agency [as BPA] must be as free as possible to deal with problems which are essentially local matters," and that the purpose of the bill was to allow BPA "to employ business principles and methods" in performing its functions. H.R. Rep. No. 79-777, at 3 (1945) *reprinted in* 1945 U.S. Code Cong. Serv. 874.[6]

More specifically, the expansive language of section 2(f) gives the Administrator broad authority to settle contract claims. Legislative history confirms this point:

> [Section 2(f)] authorizes the Administrator to amend, modify, and cancel contracts. Strong contracts, containing provisions in favor of the United States sufficient to permit it to control situations when such control is necessary, should be required. At the same time Bonneville should have authority to relax the

[4] Some of the changes to section 2(f) of the 1937 Bonneville Project Act were (1) adding "only" at the beginning of the sentence; (2) adding the words "upon such terms and conditions and in such manner as he may deem necessary"; and (3) dropping the phrase "to carry out the purposes of this Act."

[5] The Comptroller General has concluded that this provision provides the Administrator with broad discretion. Comp Gen. Dec. B-105397 (Sept. 21, 1951). In that decision, the Comptroller General ruled that the Administrator had the authority to finance a cloud seeding operation even though such an authority was not explicitly granted in the Bonneville Project Act. In a 1979 opinion, the Comptroller General similarly found that the Administrator, though lacking any explicit statutory authority, could finance electric conservation activities if he determined they constituted reasonable means of achieving the responsibilities imposed on him by law. Comp. Gen. Dec. B-114858 (July 10, 1979).

[6] Other laws relating to BPA also demonstrate congressional intent that BPA be operated with the requisite autonomy to ensure its programs are implemented successfully. In the Federal Columbia River Transmission System Act of 1974, Congress recognized the businesslike nature of BPA's responsibilities by giving BPA self-financing authority. Further, BPA's budget and accounting procedures were made subject to the Government Corporation Control Act to give BPA the autonomy and flexibility of its day-to-day decisions and operations similar to a private corporation. In addition, Bonneville's statutes are replete with references to the Administrator's use of "sound business principles." 16 U.S.C. §§ 825s, 838g, 839e(a)(1). Section 9(d) of the Northwest Power Act directs the Administrator to "take such steps as are necessary to assure the timely implementation of this Act in a sound and business-like manner." 16 U.S.C. § 839f(b). *See generally Tenaska v. U.S.*, 34 Fed. Cl. 434, 441-43 (1995) (discussing BPA's section 2(f) authority).

> contracts when good business dictates that it do so. . . . *The section also permits the Administrator to compromise claims arising out of contracts he has executed. The Administrator is a responsible officer of the Government and is the one who is most familiar with the claim and the facts out of which it arose. The discretion to compromise and settle it should be a part of Bonneville's business operations.*

H.R. Rep. No. 79-777, at 3 (1945), *reprinted in* 1945 U.S. Code Cong. Serv. 874-75 (emphasis added).

Congress carried forward this broad authority into subsequent legislation. In the Department of Energy Reorganization Act, Congress intended that this authority remain unabridged as the functions and authorities of BPA were transferred from the Department of the Interior to the new Department of Energy. 42 U.S.C. § 7152(a). The Senate Report on the legislation states:

> This legislative history reflects a congressional recognition of the significant role played by BPA in the Pacific Northwest, and an effort to enable this organization to operate in a businesslike fashion and to free it from the requirements and restrictions ordinarily applicable to the conduct of Government business. The transfer of the functions of BPA from the Department of Interior to the Department of Energy is not intended to diminish in any way the authority or flexibility which is requisite to the efficient management of a utility business.

S. Rep. No. 95-164, at 30 (1977), reprinted in 1977 U.S.C.C.A.N. 884.

In 1980, Congress again affirmed the BPA Administrator's broad authority to contract and settle claims according to section 2(f) of the Bonneville Power Act. This express affirmation is contained in section 9(a) of the Northwest Power Act. 16 U.S.C. § 839f(a). Section 9(a) of that Act states "[s]ubject to the provisions of this chapter, the Administrator is authorized to contract in accordance with section 2(f) of the Bonneville Project Act of 1937 (16 U.S.C. § 832a(f))." 16 U.S.C. § 839f(a). The legislative history of the Northwest Power Act confirms that section 9(a) "provides the Administrator the same general contracting authority for actions under the [A]ct as is provided under section 2(f) of the Bonneville Project Act." S. Rep. No. 96-272, 96th Cong., 1st Sess. 33 (1979). In addressing section 9(a), Congressman Swift made the following statement during floor debate:

> Section 9(a) extends Bonneville's existing special contracting authorities (and related expenditure authorities) contained in section 2(f) of the Bonneville Project Act to include the new contract and expenditure responsibilities provided in this legislation. In 1945, Interior Secretary Ickes in supporting the inclusion of 2(f) . . . recognized that Bonneville is not engaged in an "ordinary government . . . regulating enterprise." Rather, Bonneville, then and even more so now, operates and functions as an integral part of the region's power system. *When Congress amended Section 2(f) into the Bonneville Project Act of 1945, it recognized the need for Bonneville to have the ability to employ business principles and methods not normally applicable to governmental agencies.* The Comptroller General in reviewing this unique authority and its application summarized the intent of Congress as "*enabling the (Bonneville Power) Administrator to conduct the*

> *business of Bonneville with a freedom similar to that which has been conferred on public corporations carrying on similar or comparable activities.*" The amendment to Section 9(a) applies this important legislative principle into Bonneville's future contracts (and related expenditures) under this Act as well as the Bonneville Project Act, the Federal Columbia River Transmission Act and other related statutes, while continuing to effect the laws currently applicable to BPA contracting and expenditures . . . .

126 Cong. Rec. 27,808, 27,821 (1980) (emphasis added). Overall, the legislative history of sections 2(f) and 9(a) supports BPA's broad authority to settle contracts and agreements, provided such settlements do not violate a clear statutory directive.[7]

B. The Courts Have Affirmed the BPA Administrator's Broad Discretion to Enter into Contracts and Settlement Agreements

The Ninth Circuit Court of Appeals' previous decisions involving section 2(f) of the Bonneville Project Act and section 9(a) of the Northwest Power Act have affirmed the BPA Administrator's broad discretion in entering into contracts and arrangements, in compromising and settling claims thereunder, and in making decisions that concern BPA's business interests, provided the contracts are consistent with the Bonneville Project Act and Northwest Power Act. There are seven published cases that address BPA's authority to modify or settle contracts pursuant to section 2(f) of the Bonneville Project Act and section 9(a) of the Northwest Power Act. All of these cases support the Administrator's broad contract and settlement authority. Two cases provide the most detailed review of BPA's contract and settlement authority.[8]

The first case is *Util. Reform Project v. Bonneville Power Admin.*, 869 F.2d 437, 443 (9th Cir. 1989) (*"Util. Reform Project"*). In *Util. Reform Project*, certain BPA preference customers challenged a settlement agreement between BPA and its IOU customers. The settlement agreement resolved a dispute arising from BPA's recommendation that the construction of the WNP-3 nuclear plant be delayed and the plant "mothballed." *Id*. at 440. A halt to construction followed, and the IOUs brought an action in federal district court challenging the suspension. *Id*. at 441. In that action, the IOUs claimed that certain "Net Billing Agreements," which required the Washington Public Power Supply System to sell its 70 percent share of WNP-3 to the participating preference utilities, which in turn assigned their shares of the output to BPA, prohibited the construction delay and required BPA to pay the costs of construction. *Id*. While

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[7] In *Util. Reform Project v. Bonneville Power Admin.*, 869 F.2d 437, 443 (9th Cir. 1989) (citing H.R. Rep. No. 79-777, at 3 (1945), *reprinted in* 1945 U.S. Code Cong. Serv. 874-75), discussed in greater detail below, the Ninth Circuit Court of Appeals concluded that the legislative history of section 2(f) confirmed the Administrator's broad settlement authority.

[8] Three cases briefly mention BPA's statutory contract authority. *Bell v. Bonneville Power Admin.*, 340 F.3d 945, 948-49 (9th Cir. 2003) (BPA's curtailment amendments to DSI power sale contracts were within BPA's authority because BPA "has explicit statutory direction to amend contracts 'upon such terms and conditions and in such manner as he may deem necessary'" according to section 9(a) of the Northwest Power Act and 2(f) of the Bonneville Project Act); *Coos-Curry Elec. Coop., Inc. v. Jura*, 821 F.2d 1341, 1345 (9th Cir. 1987) (BPA had statutory authority to grant mitigation relief under section 9(a) of the Northwest Power Act where BPA had created a program to reimburse utilities for transformer costs); *Vulcan Power Co. v. Bonneville Power Admin.*, 89 F.3d 549, 550 (9th Cir. 1996) (section 2(f) of the Bonneville Project Act and section 9(a) of the Northwest Power Act give BPA broad discretion to establish contracts for the acquisition of resources).

this claim was a monetary claim, BPA and the IOUs negotiated a settlement agreement in which BPA would provide power to the IOUs. *Id*. The settlement agreement provided that BPA, over a 30-year period, would transfer an amount of power to the IOUs equal to that which WNP-3 would have generated for the IOUs if it had been completed. *Id*. In return for the BPA power, the IOUs were obligated to make an equal amount of energy available to BPA annually. *Id*. If BPA accepts the energy, it pays for it at the IOUs' higher costs. *Id*. The agreements for this exchange of power also contained a fallback agreement that would take effect if the settlement agreement were held invalid. *Id*. The fallback agreement provided for BPA to make monetary payments to the IOUs so that they could purchase the power BPA would have provided them in the exchange. *Id*.

The Court concluded that the case was heavily colored by the fact that the Court was reviewing a *settlement.* *Id*. at 443. The Court noted that BPA was facing a claim with estimated damages of approximately $2.5 billion. *Id*. The Court concluded that "[t]here was clearly an overriding public interest in settling the controversy." *Id*.

In reviewing the petitioners' claim, the Court cited section 2(f) of the Bonneville Project Act, concluding that "[t]he unrestricted language of the statute gives the Administrator expansive authority to settle contract claims." *Id*. The Court concluded that the legislative history of the Act confirmed this authority. *Id*. (*citing* H.R. Rep. No. 79-777, at 3 (1945), *reprinted in* 1945 U.S. Code Cong. Serv. 874-75.)

The Court also reviewed the scope of BPA's settlement authority under section 2(f) in *Association of Public Agency Customers, Inc. v. Bonneville Power Admin.*, 126 F.3d 1158, 1170 (9th Cir. 1997) ("*APAC*"). In *APAC*, the Court reviewed BPA's adoption of a market-driven business plan, power sales contracts with the DSIs, and the extension of transmission agreements with the DSIs. *Id*. In affirming BPA's interpretation of its authority to transmit non-Federal power, the Court cited section 2(f) of the Bonneville Project Act and concluded that this "section was enacted to allow BPA to function more like a business than a governmental regulatory agency," *APAC*, 126 F.3d at 1170 (*citing* S. Rep. No. 79-469, 79th Cong., 1st Sess. 13 (1945)). The Court also concluded that subsequent legislation reaffirmed BPA's broad authority to further its business mission. *Id*. (*citing* S. Rep. No. 95-164, 30 (1977), *reprinted in* 1977 U.S.C.C.A.N. 854, 883). In addition, the Court noted that section 9(a) of the Northwest Power Act, 16 U.S.C. § 839f(a), "reaffirmed the Administrator's broad authority to contract in no uncertain terms." *APAC*, 126 F.3d at 1170. The Court in *APAC* concluded that:

> BPA's new, more typically governmental responsibilities suggest the propriety of even greater deference to the Administrator's decisions. He must continue to run BPA like a business on a sound financial basis, enabling it to repay its debt to the federal treasury in a timely fashion, while discharging costly new public duties assumed after the Northwest Power Act's passage.

Id. at 1170-71. These "costly new public duties" include implementing the REP. 16 U.S.C. § 839c(c).

APAC is also relevant to the instant case in its consideration of BPA's interpretation of its organic statutes. In *APAC*, petitioners challenged BPA's authority to transmit, or "wheel," non-

Federal power over BPA's transmission lines. There was no express statutory authority to do so. The Court inquired whether Congress left a void for the Administrator to construe. *Id.* at 1171. The Court held that "the 'gap' Congress left for the Administrator is how best to further BPA's business interests consistent with its public mission." *Id.* The Court noted that "[t]he statutes governing BPA's operations are permeated with references to the 'sound business principles' Congress desired the Administrator to use in discharging his duties." *Id.* The Court concluded:

> Thus, although Congress did not prescribe the parameters of the Administrator's authority, it granted BPA an unusually expansive mandate to operate with a business philosophy. Accordingly, it seems wise to defer to the agency's actions in furthering its business interests, especially when the agency is responding to unprecedented changes in the market resulting from deregulation.
>
> That Congress never foresaw unbundled transmission service as a valuable commodity, and thus never considered whether BPA could sell transmission services to the DSIs separate from BPA power, does not change this conclusion. Congress gave the Administrator the authority to run BPA like a business. In that sense Congress addressed BPA's authority to act in response to unforeseen eventualities, as businesses frequently must. In this context, BPA's statutory construction of its organic statutes appears reasonable, requiring our deference to its judgment.

Id.

Although *APAC* did not involve a settlement, the Court found that Congress had granted wheeling authority to BPA by directing BPA to operate like a business and respond to unforeseen eventualities. As a result, the Court concluded that:

> . . . the Administrator made a reasoned business decision. As with all such choices in an uncertain market, we cannot foretell if the strategy will succeed or not. Time may prove the Administrator's plan unsound. However, it would be improper of us to substitute our business acumen, or lack of it, for the Administrator's.

Id. at 1182.

C. Response to Comments

The foregoing analysis provides an important background for the issues related to BPA's authority to settle Avista's long-standing deemer dispute. At its core, the Avista Deemer Settlement resolves a *contractual dispute* that has existed between BPA and Avista for two decades. BPA reached this settlement after carefully considering the factual, legal, and equitable elements regarding Avista's deemer balance. As the foregoing discussion makes clear, resolving complicated contractual disputes (such as Avista's deemer balance dispute) outside of time-intensive and costly litigation is precisely the reason Congress granted to the Administrator "expansive authority to settle contract claims." *Util. Reform Project,* 869 F.2d at 443.

A number of parties concurred with this view of BPA's settlement authority, noting that the proposed Deemer Account Settlement is consistent with BPA's statutory authority to seek compromises and settlements. These parties supported BPA's authority to establish the proposed Settlement. For example, IPC states that BPA has the authority to negotiate settlements concerning deemer balances. (IPC, ADS090002, at 2.) IPC states that deemer balances are wholly a non-statutory creation of BPA and are not required by or described by any legislation. (*Id*.; *see* PGE, ADS090008, at 1; PacifiCorp, ADS090009, at 1.) Therefore, BPA's legal authority to settle disputes concerning deemer balances is fundamentally different from recent cases where BPA's settlement authority was arguably constrained because of specific requirements of the Northwest Power Act. (IPC, ADS090002, at 2.) IPC believes that BPA should use its settlement authority to move beyond litigation, which only delays a final resolution of issues concerning deemer balances to the further disadvantage of residential and small farm customers. (*Id*.)

Similarly, PacifiCorp states that the proposed Settlement is a compromise by the parties to resolve a contractual dispute arising out of the 1981 RPSAs. (PacifiCorp, ADS090009, at 2.) PacifiCorp states that BPA is authorized to settle such issues, and to enter into settlement agreements regarding such issues by section 9(a) of the Northwest Power Act and section 2(f) of the Bonneville Project Act. (*Id*.)

BPA received only one comment that questioned its authority to enter into the Deemer Account Settlement. PNGC argues (without citation) that the Ninth Circuit ruled in May 2007 that BPA may not use its settlement authority to do what its governing statutes do not authorize. (PNGC, ADS090006, at 2.) PNGC presumably refers to *Portland General Electric Co. v. Bonneville Power Admin.*, 501 F.3d 1009, 1032-1036 (9th Cir. 2007) ("*PGE*"), where the Court reviewed REP Settlement Agreements executed between BPA and the IOUs in 2000. The settlements eliminated the need to implement the REP in its entirety, instead providing monetary and power benefits to the IOUs' residential consumers to settle disputes regarding BPA's implementation of the REP. The Court in *PGE* concluded that when BPA entered into a settlement that essentially replaced the implementation of the entire REP, the settlement had to be consistent with the provisions of the Bonneville Project Act and the Northwest Power Act, including sections 5(c) and 7(b) of the latter Act. *Id.* at 1037. Because the REP Settlement Agreements did not strictly conform to sections 5(c) and 7(b) of the Northwest Power Act, the Court held the Agreements were inconsistent with BPA's statutory directives. *Id.*

PNGC's reliance on *PGE* is misplaced. In stark contrast to *PGE*, the Deemer Account Settlement is not a wholesale replacement of the "purchase and exchange sale obligations" of section 5(c) of the Northwest Power Act. Instead, it is a settlement of a narrow and discrete contract dispute. As established previously, the deemer account is solely a contractual construct. The Northwest Power Act contains no provision that requires the creation of a deemer account or requires that any particular form of interest should be applied to a balance in such an account. Section 5(c) of the Northwest Power Act, which established the REP, provides:

(c) Purchase and exchange sales

(1) Whenever a Pacific Northwest electric utility offers to sell electric power to the Administrator at the average system cost of that utility's resources in each year, the Administrator shall acquire by purchase such power and shall offer, in exchange, to sell an equivalent amount of electric power to such utility for resale to that utility's residential users within the region.

(2) The purchase and exchange sale referred to in paragraph (1) of this subsection with any electric utility shall be limited to an amount not in excess of 50 per centum of such utility's Regional residential load in the year beginning July 1, 1980, such 50 per centum limit increasing in equal annual increments to 100 per centum of such load in the year beginning July 1, 1985, and each year thereafter.

(3) The cost benefits, as specified in contracts with the Administrator, of any purchase and exchange sale referred to in paragraph (1) of this subsection which are attributable to any electric utility's residential load within a State shall be passed through directly to such utility's residential loads within such State, except that a State which lies partially within and partially without the region may require that such cost benefits be distributed among all of the utility's residential loads in that State.

(4) An electric utility may terminate, upon reasonable terms and conditions agreed to by the Administrator and such utility prior to such termination, its purchase and sale under this subsection if the supplemental rate charge provided for in section 839e(b)(3) of this title is applied and the cost of electric power sold to such utility under this subsection exceeds, after application of such rate charge, the average system cost of power sold by such utility to the Administrator under this subsection.

(5) Subject to the provisions of sections 839b and 839d of this title, in lieu of purchasing any amount of electric power offered by a utility under paragraph (1) of this subsection, the Administrator may acquire an equivalent amount of electric power from other sources to replace power sold to such utility as part of an exchange sale if the cost of such acquisition is less than the cost of purchasing the electric power offered by such utility.

(6) Exchange sales to a utility pursuant to this subsection shall not be restricted below the amounts of electric power acquired by

> the Administrator from, or on behalf of, such utility pursuant to this subsection.
>
> (7) The "average system cost" for electric power sold to the Administrator under this subsection shall be determined by the Administrator on the basis of a methodology developed for this purpose in consultation with the Council, the Administrator's customers, and appropriate State regulatory bodies in the region. Such methodology shall be subject to review and approval by the Federal Energy Regulatory Commission. Such average system cost shall not include –
>
> (A) the cost of additional resources in an amount sufficient to serve any new large single load of the utility;
>
> (B) the cost of additional resources in an amount sufficient to meet any additional load outside the region occurring after December 5, 1980; and
>
> (C) any costs of any generating facility which is terminated prior to initial commercial operation.

16 U.S.C. § 839c(c). As seen by a review of the foregoing statutory language, there is no provision of the Northwest Power Act that requires the establishment of a deemer account or prescribes the interest to be applied to such an account. Instead, the deemer account provision is a product of contract negotiations and a public notice and comment process that established the 1981 RPSAs. Therefore, the proposed Deemer Account Settlement, which settles disputes related to this *contractually created mechanism*, is not inconsistent with the Northwest Power Act. Indeed, instead of being contrary to statutory directives, the Deemer Account Settlement is consistent with them. As noted previously, the Bonneville Project Act and Northwest Power Act grant the Administrator broad authority to enter into settlement agreements to resolve contract disputes. 16 U.S.C. § 832a(f); § 839f(a).

BPA acknowledges that it cannot enter into a settlement that is inconsistent with the clear statutory directives of the Bonneville Project Act or the Northwest Power Act. There is no such inconsistency in the instant case. The Ninth Circuit has recognized, however, that even if there were doubt regarding whether a BPA action is contrary to a statute, any doubt should be resolved in favor of the settlement. In *Util. Reform Project*, 869 F.2d at 443, the Court stated:

> This is not to say that BPA could act contrary to a clear statutory directive in settling, but if there is room for doubt, we ought not to resolve it in a manner that sends the parties back to litigation. This settlement will therefore be set aside only for the strongest of reasons.

Again, in the instant case, there is a complete absence of a conflict between the Northwest Power Act and the proposed Deemer Account Settlement. Where there is no conflict between a BPA

contract settlement and the Northwest Power Act, the settlement should be upheld unless it is arbitrary and capricious or an abuse of discretion. The proposed Deemer Account Settlement, however, is well-reasoned and, as explained in this ROD, supported by the administrative record. The deemer account settlement is thus not arbitrary and capricious, and is a lawful exercise of the Administrator's discretion.

In addition to reviewing the nature of BPA's statutory settlement authority, the *PGE* Court reviewed BPA's exercise of its settlement authority. *PGE*, 501 F.3d at 1032. The Court stated that the benefits under the 2000 REP Settlement Agreements were based in part on BPA's assumption that the IOUs would challenge BPA's then-existing 1984 ASCM and BPA would return to positions originally taken in the 1981 ASCM. *Id.* at 1034. The Court found that BPA's assumption was poorly founded because there was no then-existing legal challenge to the 1984 ASCM and BPA had not proposed changing the Methodology. *Id.* at 1035. Particularly troubling for the Court was the fact that the 1984 ASCM had already been challenged by the IOUs and sustained by the Court in 1986. *Id.* The Court concluded that BPA had settled the REP as if it had changed its regulations, which it had not. *Id.* at 1035-36.

The instant case could not be more different. The proposed Deemer Account Settlement does not attempt to revise the ASC Methodology in any manner. Rather, it takes the results of BPA's then-effective ASC Methodologies in determining the settlement amount. BPA's 1981 ASCM was in effect when Avista first incurred a portion of its deemer account balance. BPA recognized this fact when developing the proposed Deemer Account Settlement. BPA's 1984 ASCM was in effect when Avista incurred additional deemer account balances. BPA also recognized this fact when developing the proposed Settlement. The 1984 ASCM was in effect until it was replaced by BPA's 2008 ASC Methodology, effective October 1, 2008. BPA also recognized this fact when developing the Deemer Account Settlement. In summary, in developing the Deemer Account Settlement, BPA correctly assumed the existence and application of the ASC Methodology that was in effect at any relevant time. In contrast to *PGE*, BPA relied on then-effective ASC Methodologies and did not assume any change in its regulations when developing the proposed Deemer Account Settlement.

Furthermore, the proposed Deemer Account Settlement does not settle simply "potential" or purely "hypothetical" claims against BPA as was the case in *PGE*. Rather, it settles existing claims that are currently pending before the Ninth Circuit Court of Appeals. As noted above, Avista has already filed two petitions in two separate cases challenging BPA's decisions related to Avista's deemer balance. These claims create a real and immediate legal risk to BPA. The Deemer Account Settlement rids BPA of the deemer account aspects of Avista's challenges, thereby reducing BPA's overall legal exposure in the pending cases.

Although the *PGE* Court held that BPA's 2000 REP Settlement Agreements were unlawful, *PGE* reaffirmed the Administrator's broad settlement authority. In *PGE*, the Court stated:

> We have recognized within this opinion that BPA has broad authority to settle claims under the NWPA. We repeat: flexibility inheres in compromises under that authority.

PGE, 501 F.3d 1009, 1037 (9th Cir. 2007). Similarly, the Court stated:

> We note that we do not in any way rule on the legality of BPA's settlement authority when it settles out of contractual power obligations in a manner consistent with the requirements of the NWPA. We simply hold that BPA cannot bypass the requirements of §§ 5(c) and 7(b) altogether when it settles out of purchase and exchange sale obligations.

Id. at 1032 n.20.

In summary, the *PGE* Court found that BPA's 2000 REP settlements were inconsistent with the requirements of section 5(c) and 7(b) of the Northwest Power Act and were therefore unlawful. BPA acknowledges it cannot enter into a settlement that is inconsistent with the clear statutory directives of the Bonneville Project Act or the Northwest Power Act. Therefore, in developing the proposed Deemer Account Settlement, BPA was careful to ensure that the settlement was not inconsistent with any statutory provision.

Decision

Pursuant to section 2(f) of the Bonneville Project Act and sections 5(c) and 9(a) of the Northwest Power Act, the BPA Administrator has the statutory authority to exercise his discretion to execute a Deemer Account Settlement with Avista.

Issue 2

Whether BPA's decision to settle Avista's deemer balance for $55 million is consonant with BPA's legal risk.

Parties' Positions

Avista states that the proposed Settlement appropriately resolves a long-standing contractual dispute with BPA for a reasonable amount. (Avista, ADS090010, at 3.) Avista notes that it has always disputed the existence and calculation of its deemer balance. (*Id*.) Avista explains the basis for its belief that the deemer balances are invalid, and notes that the proposed Settlement avoids the costs and uncertainty of litigating these issues. (*Id.* at 4-6.)

PacifiCorp, PGE and IPC support the proposed Settlement. (PacifiCorp, ADS090009; PGE, ADS090008; IPC, ADS090002.)

Inland Power & Light ("Inland"), Northwest Requirements Utilities ("NRU"), Public Power Council ("PPC"), Western Public Agencies Group ("WPAG"), Pacific Northwest Generating Cooperative ("PNGC"), and the Association of Public Agency Customers ("APAC") generally argue that the settlement is not reasonable in light of BPA's legal risk. (*See* Inland, ADS090001, at 1; NRU, ADS090003, at 2; PPC, ADS090004, at 2-3; WPAG, ADS090005, at 2-3; PNGC, ADS090006, at 1-2; APAC, ADS090007, at 1.) These parties argue that BPA has very little, if

any, legal risk to seek the full deemer balance from Avista. (*Id.*) As such, these parties argue that BPA should not be seeking from Avista anything less than the full value of what the respective agreements require Avista to pay BPA. (*Id.*)

BPA Staff's Position

BPA performed an extensive review of the legal and factual context relating to Avista's claims prior to considering settling Avista's deemer balance. This review revealed that BPA had significant legal risk on the interest assumptions BPA presumed were valid when initially calculating Avista's deemer balance to be $85.6 million. In light of the legal uncertainties associated with BPA's untested claim for interest, and in consideration of the risk of Avista's other challenges to its deemer balance, BPA believes the Deemer Account Settlement properly resolves the deemer balance dispute with Avista in a manner consonant with BPA's overall legal risk by allowing recovery of a substantial amount of the disputed balance while avoiding legal risks and expenses.

Evaluation of Positions

Avista notes in its comments that it has "long disputed the existence and calculation of its deemer balance." (Avista, ADS090010, at 3.) For example, Avista points to statements it submitted to BPA on June 8, 2000, wherein Avista argued (1) that Avista had not independently verified BPA's calculation of the asserted deemer balance; (2) that carrying over the deemer balance calculated using the 1984 ASCM would be inconsistent with the Northwest Power Act; and (3) that carrying over the deemer balance calculated using the 1984 ASCM would be inconsistent with the intent of the 1981 RPSA. (*Id.* at 4.) In addition to these claims, Avista notes a fourth claim that challenges BPA's calculation of interest on the current deemer balance. (*Id.* at 3.) Avista states it did not agree to any deemer balance, and has not agreed to either the calculation or the accumulation of interest on any alleged balance since the termination of its RPSA in 1993. (*Id.*)

Although BPA believes the terms of the RPSA allow the ASCM to change and the deemer balances to be carried forward to new RPSAs, Avista expresses a number of forceful arguments supporting its position. In particular, Avista contends that there is a serious legal issue of whether the changes made in the 1984 ASCM were the types of changes contemplated when the deemer provision was constructed. Although BPA believes the contract language favors its view, BPA cannot be certain that its position would ultimately prevail. The deemer provision is a contractual rather than a statutory provision, and as such, BPA's interpretation of the deemer provision would not be afforded special deference. In a contractual litigation setting, where the Court looks to the intentions of the parties at the time of contracting, there is real legal risk that a Court could find persuasive Avista's contention that the parties never intended the deemer provision to accumulate deemer balances under a methodology that was substantially different from the 1981 ASCM. If the Court were to hold for Avista on this issue, a significant portion of Avista's deemer balance, approximately 92 percent, could be lost. The proposed Settlement eliminates this legal uncertainty and locks in the value of the deemer balance at $55 million beginning in FY 2002, which is beneficial to both BPA and its regional ratepayers.

Many preference customers question the soundness of BPA's decision to settle the Avista deemer balance for $55 million on the basis that BPA is "giving up" on what they view as a clear right to $85.6 million. These parties generally discount any exposure that Avista's claims may create, and argue that BPA should allow this matter to be settled by the courts. For example, Inland states that in its view "the appropriate means to settle this dispute is via the court system (Ninth Circuit Court). . . . the 'deemer account' mechanism was a clear component of the REP contracts and the financial implication of such mechanism should not be significantly altered unless the mechanism is found by the court to be inconsistent with law." (Inland, ADS090001, at 1. Other public agency parties hold a similar view. (*See* NRU, ADS090003, at 2; PPC, ADS090004, at 2-3; WPAG, ADS090005, at 2-3; PNGC, ADS090006, at 1-2; APAC, ADS090007, at 1.)

BPA does not deny that it has a sturdy case against Avista's first three claims. Thus, BPA has no intention of "giving up" anything that it reasonably believes it can win. What these comments miss, however, is that BPA's case is not without its own weaknesses. In particular, BPA became concerned about its position on the application of interest to the deemer balance after Avista approached BPA to consider settlement of this dispute. To prepare for the negotiations, BPA reviewed its records to ensure that the $85.6 million deemer balance that BPA had believed existed was supported by the available documents. BPA evaluated in detail the contractual basis for the interest rates BPA believed applied to Avista's balance from the time that Avista's 1981 RPSA terminated (1993) to the time that BPA commenced the WP-02 rate period (2001). As a result of this review, BPA discovered that the legal foundation for applying interest to the deemer balance was not as sound as originally thought. Contrary to the generally held belief, there is no single contractual provision that clearly and indisputably establishes that interest applies to Avista's outstanding deemer balance. Instead, the case for BPA's application of interest relies on the terms of an unanswered letter and the vague terms of two expired contracts. Discovery of this issue exposed a serious gap in BPA's position. As BPA carefully considered these documents, and the facts surrounding their implementation, it became readily apparent to BPA that it would have a difficult time sustaining a claim of $85.6 million against Avista.

Accumulated interest makes up a significant portion of the contested deemer balance. From 1993 to 2001, Avista's deemer balance grew from approximately $59 million to approximately $85.6 million based on what may now be infirm grounds. Thus, of the total disputed outstanding balance of $85.6 million, roughly $26.6 million, or 30 percent of the balance, hinges on BPA's case for interest. With the revelation of this new information, and considering the risk of Avista's other claims, BPA reconsidered its litigation position and found that a settlement that secured $55 million, roughly 64 percent of what BPA believed was outstanding, was a reasonable way of preserving the value of the deemer balance for BPA and the region while avoiding contentious, and possibly unsuccessful, litigation.

BPA explained the basis for the proposed Settlement, including its concerns regarding interest, in both its letter to the region on January 28, 2009, as well as in a public meeting held at BPA on February 11, 2009. Because the basis for BPA's case for interest is complicated and nuanced, it is understandable how many of the commenters would not appreciate the legal risk facing BPA if Avista were to commence litigation on this issue. Nonetheless, in a trial setting where the facts of the case will be subject to scrutiny, BPA is convinced that it would have been subject to

substantial legal risk had Avista pursued its challenges to BPA's interest assumptions. Because these issues are far more complicated than the comments appear to recognize, BPA provides below a detailed analysis of the agreements and other documents that would have been the key pieces of evidence in a contractual lawsuit with Avista. In providing the below discussion, it must be emphasized that this discussion focuses on the issues BPA uncovered with respect to the interest issue alone. During a trial on the merits of Avista's deemer balance, Avista would have also brought all of its other claims regarding the existence and calculation of its deemer balance.

A. BPA's October 19, 1993, Letter

BPA's case for application of interest to the deemer balance begins with its October 19, 1993, correspondence with Avista. As noted earlier, in September of 1993, Avista informed BPA that it was going to terminate its 1981 RPSA. BPA requested Avista to include in its termination letter four items: an acknowledgment of the outstanding deemer balance, concurrence that the deemer balance would continue to accrue interest at the prime rate, agreement that such interest would be compounded, and finally, acknowledgement that the deemer balance would be carried forward to apply to any new or succeeding RPSA. In response, Avista wrote a single sentence letter on September 29, 1993, that flatly stated that Avista was exercising its right to terminate the RPSA pursuant to Section 9. Avista's letter made no mention of BPA's stated conditions. BPA responded with its October 19, 1993, letter, which conditioned BPA's acceptance of Avista's termination on the terms outlined in BPA's original request. Avista never responded to BPA's notice. Avista subsequently asked FERC to remove the Agreement from the Commission's tariff sheets, effectively canceling the exchange provisions of the Agreement from a regulatory perspective. BPA took no further action before FERC to protest or prevent Avista's cancellation of the RPSA.

In light of these undisputed facts, BPA is uncertain of the legal enforceability of the October 1993 letter. It is basic contract law that both parties to a contract must agree to any modifications or changes to the terms of an existing contract. *See* 17A AM. JUR. 2D *Contracts* § 507 (West 2004). Such changes must be made through the typical offer and acceptance process that underlies every legally cognizable agreement. If one party offers a change to a term in a contract, the other party must express some form of assent to the new term for it to be legally enforceable. *Id.*

In the instant case, BPA has significant doubts about whether a court would agree that BPA's "conditional acceptance" of Avista's termination, and Avista's subsequent silence, satisfies the basic requirements necessary to make the October 19, 1993, terms enforceable. Because Avista never objected to BPA's October 1993 letter, BPA's argument would be that Avista must have agreed with BPA's conditions. The problem with this argument, though, is that it runs against the general rule that silence may not be construed as an acceptance of an offer. *See Radioptics, Inc. v. U.S.*, 621 F.2d 1113, 1121 (Ct. Cl. 1980); *see also* 2 WILLISTON ON CONTRACTS § 6.5 (4th Ed. 2009). In cases where the courts have found that a party's silence is sufficient for acceptance, it is usually because the parties' past conduct or current action supports a finding that silence could be construed as acceptance. *Id.* In a litigation setting, Avista would undoubtedly argue that neither its past conduct nor its subsequent actions demonstrate in any way that it conceded to BPA's terms. For support, Avista could point to the fact that it initially rebuffed

BPA's request that Avista add to its termination letter the four items included in BPA's September communication. When BPA again requested the additional terms in its October letter, Avista continued to ignore BPA's request, and went forward with a regulatory proceeding that removed the RPSA from the Commission's files. These facts would make it extremely hard for BPA to sustain a position that it is "reasonable" to consider Avista's silence to BPA's request as acceptance of the additional terms.

The public agencies' comments do not seriously question BPA's statement that there is legal risk with enforcing the terms of its October 19, 1993, letter. Rather, the thrust of the public agencies' complaint appears to be that notwithstanding the risk, BPA should presume that it has a claim for compound interest and should approach its settlement with Avista assuming that this claim will be sustained. For example, PPC acknowledges that there is a legitimate dispute over whether Avista's deemer balance should have accrued only simple interest at the prime rate, or whether BPA was justified in charging higher compound interest beginning in 1993. (PPC, ADS090004, at 1-2.) Nevertheless, PPC contends without analysis that Avista "arguably" agreed to compound interest starting in 1993. (*Id.* at 2.) APAC makes a similar statement in its comments. (APAC, ADS090007, at 1.) APAC contends that BPA is getting nothing of value for giving up its "demand for compound interest contained" in the October 1993 letter as a precondition to Avista's termination. (*Id.*)

BPA understands that it can make a *claim* against Avista for compound interest on its deemer balance beginning in 1993. BPA's litigation assessments, however, are not based on what BPA can claim, but what BPA can reasonably expect to win. As the case now stands, both the facts and the applicable law weigh against BPA's argument that Avista's *silence* should be construed as acceptance of BPA's terms. BPA does not believe that it is in the agency's interest to pursue every conceivable claim against one of its customers, particularly where it appears that the likelihood of success on such claim is questionable. Although PPC and APAC encourage BPA to adopt a more aggressive litigation position, they do so without describing any rationale that persuades BPA that it has improperly evaluated the legal risk of its case. Devoid of any additional concrete evidence or analysis, BPA believes the most reasonable course is to accept that its chances of receiving compound interest are uncertain, and to discount its claim against Avista accordingly by settling for a substantial portion of the alleged balance owed.

B. WWP's 1987 Suspension Agreement

PPC, NRU, WPAG, APAC, and PNGC contend that notwithstanding BPA's legal exposure on the enforceability of BPA's October 19, 1993, letter, the proposed Settlement is still unreasonable because it ignores the interest terms from the Suspension Agreement that would have applied to Avista's deemer balance from 1993 to 2001. For example, NRU argues that interest accrued as it should have under the Suspension Agreement from FY 1988 through FY 2001. (NRU, ADS090003, at 2.) NRU argues that the Suspension Agreement also provided that it could be revoked with notice and that Avista could return to the RPSA. (*Id.*) NRU notes that Avista requested termination in September 1993, and BPA accepted its termination subject only to the terms of the RPSA and the Suspension Agreement. (*Id.*) Avista did not accept the terms that it had previously agreed to, and the suspension was not consummated. (*Id.*) As a result the deemer balance continued to grow until 2001. (*Id.*) PPC makes a similar point in its comments.

(PPC, ADS090004, at 2-3.) PPC states that the use of simple interest at the prime rate was explicitly agreed to by BPA and Avista, and arguably Avista assented to compound interest starting in 1993. (*Id.*) APAC argues that Avista should be held to the interest rate which it "agreed [to] in its Suspension Agreement. . . ." (APAC, ADS090007, at 1.) WPAG and PNGC express similar arguments in their comments, noting that it is not reasonable for BPA to give up on the "contractually" required $85.6 million for only $55 million. (WPAG, ADS090005, at 2; PNGC, ADS090006, at 1-2.)

BPA understands the concerns expressed in the parties' comments. A quick review of the relevant material would appear to suggest that even if Avista had not agreed to the compound interest terms in BPA's October 1993 letter, the terms of the Suspension Agreement would remain in effect. The commenters are correct that the Suspension Agreement clearly requires interest to accrue on the deemer balance during the *term* of the Agreement. *See* Suspension Agreement at § 4 ("From and after October 1, 1987, such amounts shall accrue interest, which shall not be compounded, . . ."). Thus, there is no question that so long as the Suspension Agreement remained in effect, BPA had the right to charge interest. If Avista did not accept BPA's additional terms in the October 1993 letter, then it is logical to assume that the Suspension Agreement had not terminated, and Avista's deemer balance remained subject to the interest provisions in the Suspension Agreement. Consequently, simple interest would apply to Avista's deemer balance from 1993 onward, which results in a deemer balance of $85.6 million in FY 2002. This is the assumption BPA came to in the WP-07 Supplemental Rate Proceeding, and the position advocated by many of the commenters. *See* WP-07 Supplemental ROD at 227-38.

Although the foregoing analysis may appear to resolve the question of interest, a closer look at the relevant documents reveals that the case for simple interest is far less clear. What the foregoing analysis misses is the important point that the Suspension Agreement was set to expire in September of 1994 *by its own terms*. As noted previously, in Section 2 of the Agreement, the parties agreed that the suspension would remain in effect until

> September 30, 1990, as WWP thereafter elects by giving a revocation notice to BPA as provided for in paragraph 6 of this Suspension Agreement, and shall terminate at 2400 on September 30, 1994, unless BPA and WWP shall have previously agreed in writing to extend the term of the Suspension Agreement, either as it is currently written or as modified by mutual agreement of BPA and WWP.

Thus, the only way that the interest provisions in the Suspension Agreement could have continued to apply to Avista's deemer balance after September of 1994 was by "mutual agree[ment] in writing. . ." by *both* parties. Without an express agreement from Avista "in writing," BPA had no right to charge simple interest at the prime rate after 1994. BPA's only defense would be to argue that its unanswered October 1993 letter somehow met the "in writing" requirement of the Suspension Agreement. For obvious reasons, Avista would have a strong argument that its silence cannot constitute assent "in writing" to BPA's request to extend the interest provisions from the Suspension Agreement.

In light of this new information, BPA believes that the legal validity of its assumption that Avista's deemer balance grew to $85.6 million because of the Suspension Agreement is highly uncertain. Section 2 of the Suspension Agreement was not addressed in the WP-07 Supplemental ROD, or by any of the parties in the WP-07 Supplemental Proceeding. *See generally,* WP-07 Supplemental ROD at 216-48. Indeed, BPA only recently discovered this omission. If this detail had come to light during the WP-07 Supplemental Rate Proceeding, BPA would likely have adjusted its deemer assumption for Avista to reflect this important consideration. Now that BPA is aware of this information, BPA believes there is a legal defect in its prior position. As such, this new information substantially changes BPA's legal risk assessment. BPA believes that in view of the legal uncertainty surrounding BPA's calculation of the $85.6 million deemer balance, a settlement of $55 million, roughly 64 percent of the $85.6 million balance assumed in the WP-07 Supplemental Proceeding, is a reasonable compromise.

Several public agency parties seize upon the $85.6 million assumption BPA used in its WP-07 Supplemental Proceeding as a basis for arguing that the $55 million settlement is unreasonably low. (NRU, ADS090003, at 2; PPC, ADS090004, at 2-3; WPAG, ADS090005, at 2-3.) WPAG argues that the proposed Settlement of $55 million substantially alters the values that BPA "determined" in the WP-07 Supplemental ROD. (WPAG, ASD090005, at 2.) WPAG further claims that BPA is "abandoning" the $85.6 million deemer balance it determined in FY 2002 and any additional interest accruals since that date. (*Id.*) WPAG's assertion, however, that BPA "determined" Avista's deemer balance to be $85.6 million in the WP-07 Supplemental ROD is flatly incorrect. The only determination BPA made in the WP-07 Supplemental ROD related to Avista's deemer balance was the decision to include *a* deemer balance in the Lookback Model. *See* WP-07 Supplemental ROD at 225. In reaching this decision, BPA made it clear that because the balances were disputed, BPA was *not* making final determinations as to their value or validity. As noted in the ROD:

> Before addressing the specific arguments of these parties, BPA must emphasize here that it is *not* finally determining the validity or invalidity of the deemer balances in this proceeding. BPA is only proposing an assumption as to the deemer balances for purposes of calculating the Lookback Amounts. This assumption, however, will not finally resolve either BPA's or the deeming utilities' rights.

Id. at 218. Consequently, WPAG's concern that the Settlement diverges from the decisions BPA made in the WP-07 Supplemental ROD is unfounded.

WPAG further asserts that the Settlement reduces the repayment obligation of Avista by about $30 million through FY 2002, and by about $50 million through the present. (WPAG, ADS090005, at 2.) WPAG claims that this means that BPA is proposing to forgo repayment by Avista of about $50 million, and thereby increase the costs borne by its preference customers by an equal amount. (*Id.*) The PPC raises a similar point in its comments, arguing that BPA is proposing to settle for about "two-thirds" of what BPA would be "owed" under the terms of its contracts with Avista. (PPC, ADS090004, at 1.) NRU notes that under the proposed Settlement, Avista's deemer account balance "obligation" is reduced from $85.6 million to $55 million. (NRU, ADS090003, at 2.) The $55 million deemer obligation was derived by taking the $39.3

million and applying the GDP deflator to it for the years FY 1988 to FY2001. (*Id.*) This amount, NRU argues, is not consistent with the terms of the Suspension Agreement. (*Id.*)

WPAG, PPC, and NRU, however, are incorrect to accuse BPA of "forgoing" its right to collect from Avista an alleged $30 million obligation. As the preceding discussion makes clear, BPA's assumption that Avista's deemer balance was $85.6 million is subject to significant legal risk. The proposed Settlement, therefore, does not pardon Avista from having millions of dollars in accumulated deemer balance, including interest, offset against REP benefits. Instead, BPA is settling its disputable (and highly questionable) $85.6 million *claim* against Avista for a fixed balance of $55 million. Because of all of the legal uncertainty associated with BPA's right to charge interest, BPA believes fixing Avista's deemer balance at $55 million, which is 64 percent of BPA's claim, coupled with the elimination of any disputes related to the derivation and calculation of the deemer balance, is hardly an act of charity, but rather a reasonable and prudent business decision.

WPAG also asserts that BPA is proposing to forgo repayment by Avista of about "$50 million," which increases the costs borne by preference customers. (WPAG, ADS090005, at 2.) The derivation of the referenced $50 million figure is unclear from WPAG's comments. BPA presumes this number represents WPAG's view that if BPA had applied interest on the $85.6 million from FY 2002 to the present, Avista's deemer balance would have grown even more. If that is what WPAG intends, then WPAG's argument is seriously flawed because it fails to recognize that Avista's deemer balance would have been reduced significantly during the FY 2002-2008 period due to the application of offsetting REP benefits. As discussed at length in the WP-07 Supplemental ROD, BPA assumes that had the IOUs not entered the REP Settlement Agreements, they would have executed the RPSAs, filed ASCs with BPA, and thereby received REP benefits for the FY 2002-2008 period. *See* WP-07 Supplemental ROD at 117-128. In the final analysis, BPA determined that Avista would have been entitled to roughly $86.1 million in REP benefits for this period. *See* WP-07 Supplemental Power Rate Case Final Proposal FY 2002-2008 Lookback Study, Table 15.2, WP-07-FS-BPA-08 at 267. These REP benefits would have been applied against Avista's outstanding deemer balance, with the result that Avista's deemer balance would have been substantially reduced during the FY 2002-2008 period. This reduction in Avista's deemer balance occurs regardless of the proposed Settlement. Indeed, at present, Avista's outstanding deemer balance is expected to be paid off in full by the end of FY 2009 as a result of the application of these offsetting reductions. It is odd that WPAG's comment would omit this important consideration. WPAG, in fact, was the only party that *supported* BPA's decision to adjust the IOUs' Lookback Amounts for outstanding deemer balances. *See* WP-07 Supplemental ROD at 218. Consequently, WPAG's assertion that BPA is releasing Avista from a $50 million obligation is inaccurate because it fails to take into account the offsetting REP benefits that substantially reduced Avista's deemer balance even without the Settlement.

Furthermore, WPAG is incorrect in suggesting that "no interest" accrues on the $55 million balance agreed to by BPA and Avista in the Settlement. Under the Settlement, Avista's deemer balance is established at $55 million beginning in FY 2002. This figure is entered into BPA's Lookback Model to calculate whether Avista was overpaid REP benefits during the FY 2002-2008 period. The Lookback Model is designed to add simple interest at the prime rate to a

utility's deemer balances for each year in the FY 2002-2008 period. *See* WP-07 Supplemental Power Rate Case Final Proposal FY 2002-2008 Lookback Study, Table 15.2, WP-07-FS-BPA-08 at 267. That is, for each year of the FY 2002-2008 period, the remaining portion of Avista's deemer balance will accrue interest. For example, in FY 2002, BPA determined that Avista was entitled to $3.29 million in REP benefits. *Id.* at 282. In the Lookback Model, these benefits are first applied to Avista's outstanding deemer balance, which under the proposed Settlement would be $55 million. The remaining portion of Avista's deemer balance, $51.71 million, would then accrue simple interest at the prime rate. In short, BPA is not releasing Avista from paying interest on its deemer balance from FY 2002-2008. Rather, interest accrues at the prime rate and is charged to Avista through the implementation of the Lookback Model. The total interest charged to Avista over the FY 2002-2008 period is $13.3 million. Taken together, then, BPA receives from Avista not only the $55 million from the Settlement, but also an additional $13.3 million in accumulated interest to cover the period from FY 2002-2008, for a total of $68.3 million.

PNGC argues that the proposed Settlement value, $55 million, is substantially below not only the agreed-to interest rate in the Suspension Agreement, but also is well below the value of the obligation measured in current dollars. (PNGC, ADS090006, at 1.) PNGC asserts that the inflation adjusted value of the 1987 deemer balance is $72.49 million. (*Id.*) PNGC's comments are not persuasive. First, as explained above, BPA is far from certain that it will be able to sustain a claim that the interest terms of the Suspension Agreement should apply to Avista's deemer balance beyond 1994. Thus, PNGC's concern that the Settlement results in a value that is below the "agreed to interest rate" in the Suspension Agreement is misplaced.

Second, PNGC's concern that the settlement value of $55 million is below the "inflation adjusted value of the 1987 deemer balance" of $72.49 million is incorrect. PNGC's comment does not explain how it arrived at its "inflation adjusted" balance of $72.49 million. BPA was able to approximate PNGC's $72 million amount by using the CPI to inflate Avista's 1987 deemer balance of $39.3 million to a mid-2008 (the point in time that Avista extinguishes its deemer amount under the proposed Settlement) value of approximately $72 million. Assuming this approximates PNGC's calculation, the $72 million overstates the inflation-adjusted balance because it fails to reflect the fact that Avista is paying down its deemer principal balance plus interest over the 2002-2008 period. As noted above in the response to WPAG's comment, BPA assumes Avista would have been paying down its deemer balance during the FY 2002-2008 period. Following this assumption, Avista would have paid, in total, $68.3 million ($55 million principal plus $13.3 million interest discussed above) in deemer payments to BPA by mid-2008. The $68.3 million amount is slightly lower than PNGC's (apparent) CPI-based calculation but slightly higher than the $65 million result derived by simply inflating Avista's 1987 deemer balance of $39.3 million by the GDP Deflator. Thus, contrary to PNGC's conclusion, the proposed Settlement actually provides BPA with an amount of deemer payments that exceed the "inflation adjusted value" of the 1987 deemer balance.

In any event, the fact that the present value of Avista's 1987 deemer balance of $39.3 million by one measure of inflation might result in $72.49 million does not establish that BPA's decision to settle for $55 million (or $68.3 million if interest is included) is inappropriate. The key legal question facing BPA is whether it has the right to apply *any* rate of interest to Avista's deemer

balance after 1993. If BPA is found to not have this right, then application of any measure of interest (even at a rate of inflation) would not be appropriate. From a legal perspective, then, applying inflation to Avista's outstanding deemer balance is no different than applying compound or simple interest at the prime rate. In the end, if challenged, BPA would have to supply a contractual or legal basis to support its application of the applicable interest rate. PNGC's comment, however, fails to articulate the legal rationale that would require Avista to pay the inflation adjusted value of its deemer balance. In addition, BPA has been unable to find legal support to assert that Avista's deemer balance should be adjusted for inflation. Without this legal justification, BPA sees no purpose in measuring the proposed Settlement value against the "inflation adjusted" figure asserted by PNGC. PNGC's comparison is therefore inapposite.

C. WWP's 1981 Residential Purchase and Sales Agreement

If the Suspension Agreement's interest provision is not found to be the source of BPA's right to charge interest, the only remaining agreement that could supply BPA with this right is the 1981 RPSA. Like the Suspension Agreement, the RPSA is clear that during the term of the agreement, interest would accrue on a utility's outstanding deemer balance. Section 10 of the RPSA provides that "[d]uring any period that [Avista's deeming] election is in effect, . . . [t]he net balance in such account shall accumulate interest at the rate specified in section IV.E. of Exhibit C." Based on this language, there can be little dispute that interest accrued on the deemer balance during the term of the RPSA. The only real legal question, then, is whether the RPSA had terminated in 1993. If it did not, then BPA would have had a clear right to continue to charge interest to Avista from 1993 until 2001, the year the RPSA was set to expire.

On this point, BPA believes the available record evidence strongly supports a conclusion that the RPSA terminated in 1993. Avista's September 29, 1993, letter unambiguously stated that Avista was exercising its right to terminate the contract pursuant to Section 9. BPA's response to this letter was its October 19, 1993, letter which "conditionally accepted" the termination notice subject to certain conditions. Although there is a dispute regarding the enforceability of BPA's proposed provisions, there is generally no dispute among BPA and Avista that the RPSA terminated in 1993. The parties' subsequent conduct supports this conclusion. From 1993-2001, Avista did not file, and BPA did not request, ASC filings as required by the RPSA. In addition, no further communications were sent regarding the 1981 RPSA after 1993. Finally, the RPSA was removed from the Commission's files at the request of Avista in 1993, without protest or objection from BPA. BPA believes these facts point to the conclusion that the RPSA terminated in 1993, and therefore, significantly weakens BPA's ability to argue that the RPSAs provide the terms for interest on Avista's deemer balance.

PPC and PNGC argue that BPA is giving undue weight to the fact that FERC granted Avista's request to cancel the 1981 RPSA. PPC quibbles with BPA's description of the facts noting that BPA's January 28th summary of the issues associated with the deemer balance states that Avista "filed a request at FERC to cancel the 1981 RPSA, which FERC granted." (PPC, ADS090004, at 1, FN 1.) PPC explains that, more precisely, Avista filed a "notice of cancellation" with FERC, which FERC accepted "for filing." (*Id.*) PPC then argues that BPA provides no explanation of how notifying a third party of a purported cancellation of a contract could serve to make that cancellation valid, or trump the terms between the contractual parties. (*Id.*) PNGC

raises a similar point in its comments. (PNGC, ADS090006, at 1-2.) PNGC argues that BPA's justification for the settlement is based on a claim by Avista that it canceled its RPSA effective September 30, 1993, and that FERC "granted" that request. (*Id.*) PNGC concurs with PPC's observation that the Commission did not approve canceling the contract, and that the Commission's approval did nothing to the parties' underlying contractual rights. (*Id.*)

PPC and PNGC, however, are reading too much into BPA's reference to the FERC proceeding that removed Avista's 1981 RPSA from the Commission's files. In mentioning this proceeding, BPA was not attempting to suggest that the Commission resolved any of the contractual issues involving Avista's 1981 RPSA, such as the merits of Avista's deemer balance claims or whether the 1981 RPSA was in fact terminated properly. These issues, as the comments note, are contractual matters that the Commission has no jurisdiction to review.

Nevertheless, BPA does not agree with the conclusion that Avista's cancellation notice is irrelevant to the underlying contract dispute. Avista's RPSA is an agreement for the purchase and sale of wholesale power. As such, Avista is required by the Federal Power Act to file its RPSA for review and approval by the Commission. If the Commission removes the RPSA from its files, Avista cannot legally sell or purchase energy from BPA under the REP. The import of the Commission's acceptance of Avista's filing, then, is that it rendered the purchase and sale provisions of the RPSA a nullity from a regulatory perspective in 1993. Without the RPSA on file, Avista can no longer file ASCs with BPA or otherwise participate in the REP. BPA believes this fact is important because it cuts against any arguments that the RPSA in some way remained in effect past 1993. If BPA were to argue in litigation that the RPSA had not terminated in 1993 because BPA only "conditionally accepted" Avista's termination notice, Avista could use the foregoing facts as strong evidence to show that, whether by the terms of the RPSA or by BPA's acquiescence, the RPSA ceased to exist after 1993. Although not dispositive of the issue, the regulatory cancellation of the RPSA is simply another factor that supports such a finding. As such, it would be difficult for BPA to argue that the RPSA supplied the interest terms applicable to Avista's deemer balance.

PNGC argues that it is "inappropriate" for BPA to give any weight to an assertion that the notice from the Commission somehow permitted Avista to unilaterally cancel its obligation. (PNGC, ADS090006, at 1.) PNGC notes that if it had that purpose, PNGC would have expected BPA to protest the notice. (*Id.* at 1-2.) BPA was apparently aware of the notice filing and filed no protest in this docket at FERC. (*Id.* at 2.) Nor, to the best of PNGC's knowledge, did BPA provide any notice to its preference customers or other interested parties that it intended to allow Avista to walk away from such a large liability. (*Id.*) PNGC states that there are not good legal or business reasons to discount Avista's deemer account obligation based on the prospect of a patently insubstantial claim by Avista that it simply walked away from its contract liability over 15 years ago. (*Id.*)

PNGC's comment misconstrues the importance of the FERC proceeding to BPA's decision to settle Avista's deemer balance. Contrary to PNGC's comment, as just discussed, BPA did not view the Commission's decision to remove the RPSA as "canceling" Avista's obligations regarding the deemer balance. Nothing in BPA's January 28, 2009, letter requesting comments on the Deemer Settlement Agreement states that BPA viewed the Commission's actions as

somehow allowing Avista to "walk away" from its deemer liability. Rather, the legal import of the Commission's decision goes to the more general question of whether the RPSA's interest provisions remained in effect after 1993. In this context, BPA believes that the Commission's actions would be one of a number of facts that Avista could use to support a conclusion that the RPSA terminated in 1993. If the RPSA terminated in 1993, it could not be used as the source of BPA's authority to charge *interest* on the outstanding deemer balance. PNGC's assertions are, therefore, without merit.

NRU argues that Avista had the opportunity to suspend the RPSA prior to 1987 and did not do so; in light of the fact that BPA's preference customers have only recently signed up for 20-year take-or-pay power purchases, BPA should not be imposing these new costs on its preference customers now when Avista could have resolved the issue in 1987. (NRU ADS090003, at 2.) The first part of NRU's comment is factually incorrect. As discussed in the Background section of this ROD, Section 9 of the 1981 RPSA provided Avista with a very limited right to suspend or terminate its RPSA. Specifically, Avista could suspend or terminate its agreement only if "the supplemental rate charge provided for in section 7(b)(3) of the Regional Act is applied by Bonneville and the cost of electric power sold to the Utility under section 3 of this agreement exceeds the ASC of the power sold to Bonneville under section 2." RPSA at § 9. Prior to 1987, BPA did not allocate any cost to the PF Exchange rate pursuant to section 7(b)(3) of the Northwest Power Act. Thus, contrary to NRU's claim, Avista did not have the "opportunity to suspend the agreement prior to 1987…"

The second part of NRU's comment is also incorrect. BPA's preference customers are not being "imposed" upon with additional costs by the proposed Settlement because deemer balances are not a "cost" to BPA. Instead, payment of a deemer balance operates as a general credit to BPA's costs. Current preference customers are receiving a credit associated with a deemer balance, most of which is now the result of accumulated interest. As explained more fully in the discussion of Issue 5, NRU's members are not being injured by the fact they are not reaping the benefits of the interest that accumulated on a deemer balance that accrued over 20 years ago and that have an uncertain legal basis.

NRU argues that BPA should not be imposing new costs on its preference customers now when Avista could have resolved the issue in 1987. (NRU, ADS090003, at 2.) BPA understands this comment to mean NRU believes that just because the deemer balance dispute was not resolved in 1987, NRU's members should not be harmed today by lower deemer balance credits. This observation, however, supports the proposed Settlement. The Deemer Account Settlement is designed specifically to preserve the value of Avista's deemer balance that existed as of 1987. The $55 million agreed to by the parties was derived by adjusting the agreed-to deemer balance of $39.3 million in the Suspension Agreement for inflation until 2001. Thus, NRU's members would not be injured by the proposed Settlement because the settlement figure of $55 million preserves the value of the $39.3 million originally agreed to in the Suspension Agreement in 1987.

D. Conclusion

To conclude, the case for recovering $85.6 million from Avista is not as simple or clear cut as the public agencies' comments suggest. As with most contractual disputes, the contract provisions are ambiguous, the facts complicated, and the outcome is anything but certain. Viewed in light of the factual and legal uncertainties facing BPA's claim for $85.6 million, BPA believes that reaching a settlement with Avista that secures $55 million from Avista for BPA and its regional ratepayers is appropriate, consonant with the legal risks facing BPA's claim, and an exercise of sound business judgment.

Decision

BPA's decision to settle Avista's deemer balance for $55 million is consonant with BPA's legal risk because it allows BPA to recover the majority of the disputed balance while mitigating serious legal expenses and risks.

Issue 3

Whether BPA's decision to settle Avista's long-standing deemer balance dispute is consistent with sound business judgment.

Parties' Positions

WPAG and PNGC argue that the proposed deemer account settlement is not consistent with sound business principles. (WPAG, ADS090005; PNGC, ADS090006.)

NRU and PPC argue the proposed Deemer Account Settlement is not consistent with good business practice or a legitimate business interest of BPA. (NRU, ADS090003; PPC, ADS090004.)

PacifiCorp, PGE and IPC state that by resolving disputed issues with Avista, BPA is able to avoid the substantial cost and uncertainty of litigation. (PacifiCorp, ADS090009, at 2; PGE, ADS090008; IPC, ADS090002.) Thus, a decision to enter into the proposed Settlement would be consistent with BPA's charge to act in a businesslike manner. (*Id*.)

BPA Staff's Position

Although not a substantive legal requirement, BPA Staff believe the proposed Deemer Account Settlement is based on sound business judgment.

Evaluation of Positions

PacifiCorp notes that the proposed Deemer Account Settlement is a compromise by the parties to resolve a contractual dispute arising out of the 1981 RPSA. (PacifiCorp, ADS090009, at 2.) PacifiCorp and PGE note that the disputes that the parties propose to resolve arise out of a term

in the1981 RPSA, which is neither required by nor part of the REP statutory scheme set out in the Northwest Power Act. (*Id*.; PGE, ADS090008, at 1.) PacifiCorp states that BPA is authorized to settle such issues, and to enter into settlement agreements regarding such issues, by section 9(a) of the Northwest Power Act and section 2(f) of the Bonneville Project Act. (PacifiCorp, ADS090009, at 2.) PacifiCorp states that by fully and finally resolving disputed issues with Avista, BPA is able to avoid the substantial cost and uncertainty of litigation; thus, BPA's decision to enter into the proposed Deemer Account Settlement is consistent with its charge to act in a businesslike manner. (*Id*.)

Avista notes that on September 4, 2008, BPA issued its "Short-Term Bridge Residential Purchase and Sale Agreement for the Period Fiscal Years 2009-2011 and Regional Dialogue Long-Term Residential Purchase and Sale Agreement for the Period Fiscal Years 2012-2028: Administrator's Record of Decision" ("RPSA ROD"). (Avista, ADS090010, at 5.) Pursuant to the RPSA ROD, BPA subsequently offered Avista a short-term bridge RPSA ("Bridge RPSA") and a Regional Dialogue long-term RPSA ("Long-Term RPSA") for execution to implement the REP. (*Id*.) Avista executed both the Bridge RPSA and the Long-Term RPSA. (*Id*.) In executing both the Bridge RPSA and the Long-Term RPSA, Avista expressly reserved its rights to any and all arguments or claims Avista has made or may make, or any rights or obligations it has or may have, regarding, among other things, "the calculation, implementation, or settlement of the Residential Exchange Program benefits for any period of time," including any and all of Avista's arguments regarding the disputed deemer issues. (*Id*.)

On December 1, 2008, Avista filed a petition for review with the United States Court of Appeals for the Ninth Circuit challenging the RPSA ROD, the Bridge RPSA, and the Long-Term RPSA ("RPSA Appeal").[9] (Avista, ADS090010, at 5.) In filing the RPSA Appeal, Avista intended to challenge, among other things, the validity and calculation of the deemer amount asserted by BPA and the legality of the Balancing Account provisions (*i.e*., the deemer provisions) in the Bridge and Long-Term RPSAs. (*Id*.) Avista notes that the proposed Settlement will fully and finally resolve those issues without the need for further litigation of those issues. (*Id*.)

Avista states that under the terms of the proposed Settlement, Avista's 2002 deemer balance is reduced from the $85.6 million assumed by BPA in the WP-07 Supplemental Rate Proceeding to $55 million. (Avista, ADS090010, at 5.) Consistent with the WP-07 Supplemental ROD, BPA will reflect the proposed Settlement in Avista's Lookback by replacing in the calculation employed in the WP-07 Supplemental Proceeding that established the assumed $85.6 million deemer amount with the $55 million agreed to by the parties. (*Id*.) In consideration for BPA's agreement to reduce Avista's deemer balance, Avista will accept the new deemer account balance, agree to resolve all past deemer issues, agree not to challenge BPA's use of deemer amounts to determine the Lookback Amounts pursuant to the WP-07 Supplemental ROD, and agree not to challenge the Balancing Account provisions in the Bridge and Long-Term RPSAs.[10] (*Id*.) Avista supports the proposed Settlement because it fully and finally resolves a long-standing dispute and it allows Avista to pass through prospective REP benefits to its customers. (*Id*.)

[9] Avista's petition for review is currently pending in Ninth Circuit Case No. 08-70265.
[10] Avista's Bridge RPSA is BPA Contract No. 08PB-11964. Avista's Long-Term RPSA is Contract No. 09PB-13200.

Avista states that the proposed Settlement is a compromise by the parties to resolve a contractual dispute arising out of the 1981 RPSA. (Avista, ADS090010, at 6.) As noted previously, the disputes that the parties propose to resolve arise out of a particular term in the 1981 RPSA. Avista notes that the deemer provision in the 1981 RPSA is neither required by nor part of the REP statutory scheme set out in the Northwest Power Act. (*Id*.) BPA is authorized to settle such issues, and to enter into settlement agreements regarding such issues, by section 9(a) of the Northwest Power Act, 16 U.S.C. § 839f(a), and section 2(f) of the Bonneville Project Act, 16 U.S.C. § 832a(f). (*Id*.) Moreover, by fully and finally resolving disputed issues with Avista, BPA is able to avoid the substantial cost and uncertainty of litigation. (*Id*.) Accordingly, BPA's decision to enter into the proposed Settlement is consistent with its charge to act in a businesslike manner. (*Id*.)

A number of public agencies framed their comments to state that the proposed Settlement is not consistent with "sound business principles." (WPAG, ADS090005, at 3; PNGC, ADS090006, at 2.) Other public agencies' comments were similar, suggesting the proposed deemer account settlement is not consistent with good business practice or a legitimate business interest of BPA. (NRU, ADS090003, at 2; PPC, ADS090004, at 1.) Such comments appear to rely on the Ninth Circuit's decision in *Pacific Northwest Generating Cooperative v. Bonneville Power Admin*., 550 F.3d 846 (9th Cir. 2008) ("*PNGC*"). In *PNGC*, certain parties challenged three three-party contracts BPA executed with a local public utility company and an aluminum company that is a direct service industrial customer ("DSI") of BPA. In the contracts, BPA committed to make payments to the aluminum DSIs of a total $59 million per year for 5 years in lieu of supplying them with electric power, while retaining the right to sell them electric power instead in the final 2 years. *Id.* at 852. In addition, in September 2006, BPA agreed to sell power to a non-aluminum DSI through a contract between BPA and a local utility company. *Id.* The Court reviewed the validity of the contracts, including (1) whether BPA is authorized and/or obligated to sell power to the DSIs; (2) whether BPA is permitted to offer the DSIs monetary benefits in lieu of physical power; (3) whether BPA may offer a contract to the local utility for power to serve the non-aluminum DSI that differed from those offered the aluminum DSIs; and (4) whether BPA must treat the non-aluminum DSI as a new large single load.

In *PNGC*, the Court stated that BPA's monetization of its contracts to provide payments to the DSIs was inconsistent with its statutory obligation to provide "the lowest possible rates to consumers consistent with sound business principles," where BPA had voluntarily agreed to forgo revenues by charging DSIs a rate below what was authorized by statute and below what was available on the open market, with the foregone revenues resulting in higher rates for all other customers. *Id.* at 874. The proposed Deemer Account Settlement, however, does not involve charging Avista a BPA rate that was below the rate authorized by statute. The rates used in BPA's calculations of Avista's deemer account balance were the PF Exchange rates established by BPA and approved by FERC for each relevant rate period within the deemer period. The rates used in BPA's calculations of Avista's deemer account balance also had no relationship to the price of power in the market. The proposed Deemer Account Settlement, therefore, does not present the same issue presented in *PNGC*.

Also, the fact that a BPA action regarding one customer class may result in BPA incurring costs that increase other customers' rates does not mean the action is improper. To the contrary, this is a natural consequence of implementing the Northwest Power Act's rate directives. For example, if BPA had breached a contract with a non-preference customer and BPA determined there was a significant risk of losing a legal challenge, BPA (like any business) would weigh the risks and costs and might enter into a settlement with the aggrieved non-preference party. By reaching a settlement, BPA would have incurred costs. BPA would include these costs in its revenue requirement and establish rates that would recover BPA's total costs. Settlement costs may be recovered in large part from BPA's preference customers because those customers purchase the most power from BPA. Nevertheless, by avoiding the costs BPA would have incurred in the absence of a settlement, BPA would have kept its costs and preference customers' rates lower than they would have otherwise been. The fact that there may in some cases be uncertainty about those costs means that BPA should prudently manage the risks of that uncertainty, which is precisely BPA's purpose here.

Contrary to preference customer arguments that the proposed Deemer Account Settlement is inconsistent with sound business principles, the *PNGC* Court stated that the "sound business principles" standard *did not apply to the REP*, which is implemented by the RPSAs. The Court stated that

> [a]s the Supreme Court has observed, '[b]ecause th[e] exchange program essentially requires BPA to trade its cheap power for more expensive power, it is obviously a money-losing program for BPA.' In the case of the exchange program, Congress specifically directed BPA to conduct its operations in a manner that does not conform with the 'sound business principles' that the agency is generally required to follow.

PNGC, 550 F.3d at 877 (internal citations omitted). Similarly, although Section 5 of the Flood Control Act of 1944 provides that BPA "shall transmit and dispose of such power and energy in such manner as to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles," 16 U.S.C. § 825s, the Court in *PNGC* stated that the REP is not a true sale of power, and "[r]ather than actually trade power with the IOUs, BPA simply pays the cost differential to the IOUs." *PNGC*, 550 F.3d at 876. Thus, if one were to always construe "sound business principles" as dictating avoiding money losing propositions, that standard would not apply to the REP, including the RPSAs.

In any event, it may be inappropriate to rely on the *PNGC* decision's language regarding "sound business principles." BPA is seeking rehearing of the *PNGC* decision because certain statements in the opinion appear contrary to established law. In remanding the DSI contracts, the Court in *PNGC* relied on a clause in 16 U.S.C. § 838g that the Court has previously determined, along with several other circuits, is so suffused with discretion that it cannot supply a basis for a Federal justiciable claim because it provides "no law to apply." *City of Santa Clara v. Andrus*, 572 F.2d 660 (9th Cir. 1978), *cert. denied*, 439 U.S. 859 (1978); *see also Salt Lake City v. WAPA*, 926 F.2d 974, 977 (10th Cir. 1991); *Brazos Elec. Power Coop. v. Southwestern Power Admin.*, 819 F.2d 537, 543-44 (5th Cir. 1987); *Electricities of N. Car. v. Southeastern Power Admin.*, 774 F.2d 1262, 1266-67 (4th Cir. 1985); *Greenwood Util. Comm'n v. Hodel*, 764 F.2d

1459, 1464-65 (11th Cir. 1985); *Pacific Power & Light v. Duncan*, 499 F. Supp. 672, 681-83 (D. Or. 1980).

In *Santa Clara*, the Court construed language in Section 5 of the Flood Control Act of 1944, 16 U.S.C. § 825s, that closely tracks the language in Section 9 of the Transmission System Act on which PNGC relied,[11] and determined that it is "too vague and general to provide law to apply." *Santa Clara*, 572 F.2d at 668. Although the scope of the language from 16 U.S.C. § 825s that the Court's ruling in *Santa Clara* encompasses is not entirely clear from the face of the opinion, the Court made clear in a later case that the ruling in *Santa Clara* encompasses both the criterion for BPA to encourage the most widespread use of power as well as the criterion calling for it to provide the lowest possible rates to consumers consistent with sound business principles. *Aluminum Co. of America v. BPA*, 903 F.2d 585, 599 (9th Cir. 1990) (indicating that "widespread use" standard incorporates both such criteria, as laid out on pp. 590-91 of the opinion); *cert. denied sub nom.*, 498 U.S. 1024 (1991)("*ALCOA*"); *see also Pacific Power & Light*, 499 F. Supp. at 682 (offering similar reading). Along these same lines, the Court more recently has cited to the language in 16 U.S.C. § 838g not as a hard-and-fast statutory constraint that was designed principally to limit BPA's authority, but rather as one of several provisions in BPA's statutory framework that confers upon the agency "an unusually expansive mandate to operate with a business-oriented philosophy." *Association of Pub. Agency Customers v. BPA*, 126 F.3d 1158, 1169-71 (9th Cir. 1997).

In *PNGC*, the Court stated that BPA failed to explain how the payments to the DSIs in that case were consistent with its "mandate to operate with a business-oriented philosophy" because BPA had not "shown how offering the DSIs rates below the market rate and below what it is statutorily authorized to offer 'further[s] BPA's business interests consistent with its public mission.'" *PNGC*, 550 F.3d at 877-878 (internal citations omitted). In the instant case, however, BPA is not providing benefits to Avista in the absence of a legitimate business interest. As explained in detail previously, BPA faces significant legal risk regarding Avista's deemer balance in response to pending litigation that could eliminate or substantially reduce Avista's deemer balance. The proposed Settlement eliminates that risk by setting Avista's deemer balance to $55 million, roughly 64 percent of BPA's outstanding claim. Prudent risk management is essential to the exercise of sound business principles. As discussed previously in connection with the legislative history of the Bonneville Project Act, Section 2(f) was passed in order to better allow BPA to operate with business-like flexibility.

PPC states that the argument that BPA is reducing its litigation risk through the Deemer Account Settlement is weakened by the fact that only one aspect of Avista's prior obligations has been settled – the balance of Avista's deemer account. (PPC, ADS090004, at 2-3.) PPC states Avista would remain free to pursue litigation against BPA's use of the Lookback calculation, or to argue that the Lookback Amount should be zero. (*Id*.) PPC states that if the settlement were really aimed at reducing BPA's litigation risk and the exposure of its preference customers, the

[11] Section 5 of the Flood Control Act of 1944 provides that BPA "shall transmit and dispose of such power and energy in such manner as to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles," 16 U.S.C. § 825s, and Section 9 of the Transmission System Act similarly provides that the Administrator shall establish power rate schedules in accordance with three criteria, the first of which is "with a view to encouraging the widest possible diversified use of electric power at the lowest possible rates to consumers consistent with sound business principles." 16 U.S.C. § 838g.

agreement would require a broader waiver of Avista's claims against BPA's construct for redressing overpayments under the REP. (*Id*.) Contrary to PPC's argument, however, the fact that one aspect of Avista's participation in the REP has been settled does not mean that it lacks value. To the contrary, as explained previously, Avista argues that its deemer balance should be eliminated or reduced much more significantly than the proposed Deemer Account Settlement. If Avista were to prevail in its legal challenge, it would not have to work off its deemer account balance (or would do so quickly), and therefore, would have a significantly lower Lookback repayment obligation. This, in turn, would mean that less Lookback Amount would be collected from Avista and returned to the preference customers. Thus, settlement of the deemer account balance, by itself, has real value to BPA and its customers.

Furthermore, PPC's suggestion that any settlement with Avista should require a broader waiver of Avista's claims against BPA for the manner in which it is recovering REP overpayments from IOUs confuses the relevant issues. As BPA recognized when establishing the Lookback in BPA's WP-07 Supplemental Rate Proceeding, deemer account balances were not resolved by the Lookback. *See* WP-07 Supplemental ROD at 218. Instead, deemer accounts are a part of the REP and BPA recognized that they would be resolved separately from the Lookback. *Id.* Thus, PPC's suggestion that settlement of the deemer issue only has value if it becomes part of a much larger settlement regarding the Lookback makes little sense. Furthermore, PPC is aware of the extensive efforts made by BPA and its customers and other interested parties to settle the Lookback. Despite significant efforts to settle disputes regarding such a massive subject, no settlement has been achieved.

PPC also argues that the proposed Deemer Account Settlement is problematic because it is not clear that it really settles for good Avista's liability for its deemer account. (PPC, ADS090004, at 2-3.) PPC states that if, for example, IPC prevailed on a claim that BPA is not entitled to offset future benefits with deemer balances, Avista may be able to argue that BPA cannot offset its benefits with its deemer account, even though the amount of that account would have been established by the settlement. (*Id*.) In response, PPC's argument is speculative and incorrect. First, PPC speculates that a party would argue, and prevail on appeal, that BPA is not entitled to offset future benefits with deemer balances. Such speculation is weak because BPA did exactly that from the inception of the REP through the deemer provisions in the 20-year 1981 RPSAs. The deemer concept is simply continued under the 2008 RPSAs. Second, PPC speculates that Avista would be able to argue that BPA cannot offset its benefits with its deemer account. However, the 2008 RPSAs govern the *prospective* implementation of the REP. The 2008 RPSAs include a deemer provision, and any deemer account balance accrued under that provision must be eliminated before a utility can receive prospective REP benefits. Avista, however, has a *pre-existing* deemer account balance. Even if a court found that the 2008 RPSAs could not *prospectively* preclude the payment of REP benefits until the deemer balance was eliminated (or "offset its benefits with its deemer account"), Avista would still have a pre-existing contractual obligation to BPA that must be satisfied. Section 5(c) of the proposed Deemer Account Settlement provides that if a court finds fault with the deemer provision in the 2008 RPSAs, Avista's RPSA will be amended consistent with such order. This, however, involves the *prospective* implementation of the REP, and does not preclude BPA from recovering the pre-existing deemer account balance.

If PPC's argument is that BPA would be precluded from implementing the Lookback for Avista because BPA would not be able to offset future benefits with deemer balances, this is also incorrect. Section 4 of the Deemer Account Settlement provides that BPA will incorporate Avista's deemer amount under the settlement into calculations of Avista's Definitive Benefit Amount, October 1, 2008, Balancing Account (deemer) balance and Lookback Amount in accordance with the WP-07 Supplemental ROD. Section 4(d) addresses what occurs under the Deemer Account Settlement in the event BPA must reconsider elements of the WP-07 Supplemental ROD after a successful challenge in court. Section 4(d) provides:

> (d) The definition in Section 2(c) and the provisions of this Section 4 are predicated upon BPA's implementation of the Lookback as adopted by the BPA Administrator in the WP-07 Supplemental ROD. The Parties hereby acknowledge that the decisions made in the WP-07 Supplemental ROD are currently being challenged in court. In the event that BPA is required to reconsider any aspect of its WP-07 Supplemental ROD as a result of a final, non-appealable order by a court of competent jurisdiction, the Parties hereby agree to cooperate in good faith to modify the Lookback Amount, if necessary, and implement the provisions of this Section 4 consistent with such order.

The use of a utility's deemer balance in determining a utility's Lookback Amount is different than the matter of implementing the deemer provision under the RPSA. In other words, even if a court held that BPA could not use a utility's deemer account balance to determine its Lookback Amount as provided in the WP-07 Supplemental ROD, this does not mean that the utility's pre-existing deemer balance would be eliminated. Instead, the pre-existing deemer balance would continue and would have to be worked off before a utility could receive prospective REP benefits under its RPSA. Even if a utility's Lookback Amount were reduced by the amount of the utility's deemer balance, the deemer balance would still have to be made up to BPA before BPA provided the utility any REP benefits.

WPAG argues that in return for providing Avista forgiveness of about a $50 million payment obligation owed to BPA's preference customers, BPA has obtained from Avista nothing of comparable value. (WPAG, ADS090005, at 2.) BPA has previously explained in the discussion of Issue 2 above how WPAG's characterization of BPA's alleged "forgiveness of $50 million" is inaccurate and grossly overstated and further addresses WPAG's $50 million assertion in the discussion of Issue 5 below. BPA will not repeat those arguments here.

WPAG also argues that Avista would agree to dismiss a pending petition for review of the Long-Term Regional Dialogue and the Bridge RPSAs, but this dismissal is of no value to BPA or its preference customers because there are at least eight petitions for review in the Ninth Circuit Court of Appeals, in addition to the one filed by Avista, filed by other IOUs and their state regulatory agencies that will remain on file and will likely be actively litigated. (*Id*.) WPAG argues the agreement by Avista to dismiss one of these petitions will in no way reduce the burden of litigation on the RPSAs, nor will it measurably reduce the amount of contention on these issues. (*Id*.)

WPAG's argument is misleading. First, the matter at issue in the proposed Deemer Account Settlement is Avista's deemer balance. The matter at issue in the context of the 2008 RPSAs is the continued deemer account provision, not the other RPSA provisions. In the development of the 2008 RPSAs, only two utilities had a significant interest in the prospective elimination of the deemer provision: IPC and Avista. These utilities were the only utilities with significant concerns about prospective deemer status. The only other interested party was the IPUC, which reviews and establishes Avista's and IPC's retail rates for the state of Idaho. Only IPC and the IPUC filed comments in the development of the 2008 RPSAs that advocated the prospective elimination of the deemer provision. Thus, there are only three parties actively pursuing the deemer account issue. The proposed Deemer Account Settlement would eliminate one of the *three* parties contesting the deemer provision. By eliminating one of the three parties pursuing the prospective deemer provision, BPA has significantly reduced the challenges to that provision.

In addition, IPC and the IPUC have encouraged BPA to conduct settlement negotiations regarding the prospective 2008 RPSA deemer provision. Because such discussions would involve a limited number of issues and affected parties, they would have a much higher chance of success than, for example, a global settlement of all WP-07 Supplemental ROD issues. Thus, although Avista's agreement not to challenge the 2008 RPSAs would not resolve all litigation regarding such Agreements, it would reduce the number of parties with an interest in challenging the prospective deemer provision and would facilitate the possible settlement of the issue. This has value to BPA and its customers because it increases the likelihood that BPA will succeed in sustaining the deemer provision for future application in the implementation of the REP. Absent a deemer provision (or other mechanism that performs the equivalent function of the deemer provision), exchanging utilities would receive positive REP benefits and have no decrement for what would otherwise be deemer periods.

WPAG argues that the agreement of Avista to not challenge BPA's use of the deemer accounts in the Lookback in the WP-07 Supplemental Rate Proceeding or the use in balancing accounts is likewise an empty commitment. (WPAG, ADS090005, at 2-3.) WPAG states there are 20 petitions for review in the Ninth Circuit Court of Appeals filed by other IOUs and their regulatory agencies challenging all aspects of the Lookback in the WP-07 Supplemental Rate Proceeding and under the Record of Decision for the Tiered Rate Methodology. (*Id*.) WPAG argues the forbearance by Avista will have no measurable impact on the amount of litigation confronted by BPA, nor will it remove from contention any of these issues. *(Id.)*

WPAG's alleged "facts" are once again misleading. First, petitions challenging BPA's proposed Tiered Rates Methodology are not challenges to the Lookback in BPA's WP-07 Supplemental Rate Proceeding. Second, only five IOUs and two state utility commissions have filed petitions challenging the Lookback methodology established in BPA's WP-07 Supplemental Rate Proceeding. In the WP-07 Supplemental Rate Proceeding, only two utilities had a significant interest in the manner in which deemer accounts were reflected in the Lookback: IPC and Avista. The only other interested party was the IPUC, which reviews and establishes Avista's and IPC's retail rates for the state of Idaho. Thus, there are only three parties actively pursuing the deemer account aspect of BPA's Lookback approach. Under the proposed Deemer Account Settlement, one of the IOUs, Avista, would not challenge the manner in which BPA uses utilities' deemer account balances to determine Lookback Amounts. By eliminating one of the *three* parties

pursuing the use of deemer accounts in the Lookback, BPA has significantly reduced the challenges to that aspect of the Lookback. Although Avista's agreement not to challenge the deemer application would not resolve all litigation regarding the Lookback, it would reduce the number of parties with an interest in challenging the manner in which deemer accounts were considered in the Lookback calculation. This has value to BPA and its customers because it would help to confirm one aspect of BPA's Lookback approach. The proposed Deemer Account Settlement, of course, was not intended to resolve all issues regarding BPA's Lookback approach. Instead, it was intended to help resolve challenges to one aspect of that approach. Thus, WPAG's notation that the proposed Deemer Account Settlement does not preclude all challenges to the Lookback is overreaching.

WPAG argues that other provisions of the proposed Deemer Account Settlement strip whatever marginal value the commitments made by Avista in the area of litigation might have had. (WPAG, ADS090005, at 3.) WPAG states they do so by granting to Avista the benefit of any outcomes other IOUs and their regulatory agencies may achieve by pursuing the various petitions for review involving the 2008 RPSAs, the WP-07 Supplemental Rates and the Tiered Rate Methodology. (*Id*.) WPAG claims that Avista will have the best of both worlds; it will receive the forgiveness of a multi-million dollar contractual payment obligation for agreeing to forego certain litigation activities, but will retain the right to any and all benefits from the very same litigation activities being pursued by other IOUs. (*Id*.) Once again WPAG has failed to accurately describe the proposed Deemer Account Settlement. First, the Deemer Account Settlement is primarily intended to resolve disputes between BPA and Avista regarding Avista's deemer account balance by establishing the amount of such balance in the Lookback calculation and for prospective implementation of the REP. The primary purpose of the settlement is thus to avoid the substantial risk of litigation concerning Avista's deemer balance. This is what provides the primary benefit to BPA and its customers. In addition, Avista has agreed to waive challenges to the manner in which BPA uses utilities' deemer account balances to determine the Lookback Amounts and the 2008 RPSAs' prospective implementation of a deemer provision as part of the REP. Thus, although Avista's waivers do not resolve all litigation, they still provide value to BPA and its customers.

In addition, although WPAG claims Avista would benefit from challenges to BPA's Tiered Rates Methodology, the proposed Settlement does not even mention BPA's proposed Tiered Rates Methodology. Thus, it makes little sense to claim an impropriety in the event that BPA's Tiered Rates Methodology, as it may ultimately be adopted, is applied to Avista in the same manner as other BPA customers. Similarly, WPAG complains that Avista would benefit from any successful IOU challenges to the 2008 RPSAs and BPA's WP-07 Supplemental Rates. Again, however, the proposed Deemer Account Settlement is intended to address only deemer-related issues. The fact that non-deemer aspects of the 2008 RPSAs as finally established, or BPA's WP-07 Supplemental rates as finally established, would apply equally to Avista and all other exchanging utilities is not remarkable. Simply because a deemer account balance is settled with an exchanging utility does not mean that the exchanging utility should be treated differently from any other utility under the 2008 RPSAs or BPA's WP-07 rates.

WPAG argues that under the proposed Deemer Account Settlement, BPA will be agreeing to forego collection of a contractual obligation of Avista to pay millions of dollars. (WPAG,

ADS090005, at 3.) WPAG states this payment obligation would have directly benefitted BPA's preference customers by reducing the costs they must pay during a period of material economic distress, and when they are facing declining loads and a proposed double digit BPA wholesale power rate increase. (*Id*.)

WPAG's arguments are incorrect on several fronts. First, WPAG's claim that Avista has a specific and unquestionable deemer obligation to BPA is simply contrary to the facts. BPA previously explained that there are a number of factual and legal issues in dispute between BPA and Avista regarding Avista's deemer account balance. These have been previously documented and will not be repeated here. The proposed Settlement would resolve the legal risk associated with Avista's challenges to its deemer balance on reasonable terms, which benefits both BPA and its customers.

Second, WPAG's claim that a high deemer balance for Avista would reduce costs for BPA's preference customers ignores a number of facts. If Avista were successful in its challenge to BPA's calculation of its deemer balance, either all or a significant portion of its deemer balance would be eliminated. This would impose greater costs on BPA's preference customers than the settlement, not less. This is the purpose of a settlement: to analyze legal risk and reach a mutual agreement that significantly reduces such risk on reasonable terms. Also, settlements will occur at the time at which parties are able to reach a mutual agreement to resolve a dispute. The fact that a settlement may occur during a time of economic prosperity or decline does not mean that a settlement is inappropriate. Furthermore, viewed from another perspective, failure to implement a reasonable settlement would damage the parties that would otherwise benefit from the settlement. Such parties are experiencing the same economic difficulties facing BPA's preference customers.

Furthermore, WPAG's contention that preference customers are somehow being unfairly impacted by the Deemer Account Settlement is simply incorrect. BPA's preference customers did not pay the cost of Avista's initial REP benefits. Section 7 of the Northwest Power Act establishes BPA's ratemaking directives. Section 7(c)(1)(A) provides that:

> The rate or rates applicable to direct service industrial customers should be established—
>
> for the period prior to July 1, 1985, at a level which the Administrator estimates will be sufficient to recover the cost of resources the Administrator determines are required to serve such customers' load and the net costs incurred by the Administrator pursuant to section 839c(c) of this title, based upon the Administrator's projected ability to make power available to such customers pursuant to their contracts, to the extent that such costs are not recovered through rates applicable to other customers…

16 U.S.C. § 839e(c)(1)(A). Pursuant to this provision, BPA's DSI customers paid the cost of the REP during the period in which Avista received its initial benefits under the REP. Thus, the preference customers have no *quid pro quo* right to benefit from payment of Avista's deemer

balance based on a claim of having paid for Avista's early REP benefits. Even if they did, that would not diminish the Administrator's discretion to manage risk through settlements.

In summary, the proposed Deemer Account Settlement is a good deal for both BPA and the region. For BPA, the Deemer Account Settlement provides BPA with valuable consideration in that it ends Avista's decades-old claim regarding the validity and calculation of its deemer balance, while at the same time removing Avista from current challenges to BPA's deemer-related decisions in two key cases pending before the Ninth Circuit. For BPA's regional ratepayers, the Deemer Account Settlement also provides value because it secures BPA's right to $55 million in deemer payments from Avista without the cost, uncertainty, and delay of the legal process. For these reasons, the Administrator's decision to move forward with the Deemer Account Settlement is a sound business decision that is a proper exercise of his statutory authority to operate BPA in a manner consistent with "sound business principles."

Decision

BPA's proposed Deemer Account Settlement with Avista is based on and consistent with sound business judgment.

Issue 4

Whether BPA has inappropriately reviewed equitable considerations in deciding to resolve the deemer dispute with Avista.

Parties' Positions

Avista states that due to BPA's changes to BPA's 1981 ASCM, and Avista's inability to suspend or terminate the 1981 RPSA, the deemer provision had substantial unintended consequences. (Avista, ASD090010, at 2.) Avista states that although it received less than $7 million in total benefits for its customers under the 1981 RPSA, BPA calculated that, as of the end of 2001, Avista had accrued a deemer balance of more than $85 million. (*Id*.)

IPC states that the deemer provisions contained in the 1981 RPSAs have had consequences unintended in 1981 by the signatories to those agreements. (IPC, ASD090002, at 1-2.) IPC states that the effect of the deemer provision, when brought forward to a new RPSA taking into account BPA's changes to its ASC Methodology in 1984, is to disable hundreds of thousands of small farm and residential customers from the benefits of the REP for decades, if not forever. (*Id*.)

PacifiCorp and PGE state that the proposed Settlement provides some mitigation for the substantial inequities created by the deemer balance while at the same time fairly balancing a range of regional interests. (PacifiCorp, ASD090009, at 1; PGE, ADS090008, at 1.) PacifiCorp states the long-standing deemer disputes have accentuated this inequity. (*Id*.)

PPC argues no inequity has been imposed on Avista because the reason Avista acquired a deemer balance from 1983-1987 was because its ASCs were lower than BPA's rates. (PPC, ADS090004, at 2.)

BPA Staff's Position

BPA Staff believes equity is a legitimate consideration in the development of a settlement.

Evaluation of Positions

In its comments, Avista notes that its long-standing deemer dispute arises from a provision in a bilateral contract between BPA and The Washington Water Power Company ("WWP") (now Avista). (Avista, ADS090010, at 1-2.) Specifically, WWP's 1981 RPSA with BPA included a provision that allowed WWP to deem its ASC equal to the PF rate. (*Id*.) In the event WWP made such election, BPA debited to a separate account any net exchange payment to BPA, and credited to that separate account any net exchange payment to the utility, that would have been required if the utility had not made such election. (*Id*.) Any debit balance that existed at the time the 1981 RPSA was terminated would not be a cash obligation. (*Id*.) This provision of the 1981 RPSA is commonly referred to as the deemer provision. (*Id*.)

Avista notes that the deemer provision is clearly not a requirement of the Northwest Power Act and, consequently, has no statutory link to the REP; rather, the deemer provision is a purely contractual term created by BPA that was included as part of the 1981 RPSA. (Avista, ADS090010, at 2.) Avista states the parties intended the deemer provision to provide a mechanism to account for short-term fluctuations that may cause WWP's ASC to temporarily fall below the PF rate. (*Id*.) Although the deemer provision contemplated that deemer amounts would be carried forward to subsequent exchange agreements, the parties expected any such amounts to be small and for the deeming utility to quickly pay off such amounts from future positive REP benefits. (*Id*.) At the time the parties executed the 1981 RPSA, the parties did not expect, or intend, the deemer provision to cause WWP (and later Avista) to accrue substantial deemer amounts that would effectively wipe Avista out of the REP and require future generations of Avista's customers to forego benefits. (*Id*.)

Avista states that at the time that WWP entered into the 1981 RPSA, BPA used the 1981 ASCM to calculate the REP benefits that utilities would receive. (Avista, ADS090010, at 2.) In 1984, over WWP's and other IOUs' objections, BPA adopted a new 1984 ASCM, which eliminated some of the legitimate costs of WWP's, and other utilities' resources—costs commonly charged to wholesale and retail customers. (*Id*.) Two of those costs—return on equity and income taxes—pertained solely to IOUs. (*Id*.) The 1984 ASCM was challenged. (*Id*.) Avista claims the Ninth Circuit found that BPA's justifications had no logical support:

> Petitions correctly observe that there is no logical congruence which would support making interest payments on debt a proxy for equity return. There is, as well, an inconsistency in first disallowing equity return and then further disallowing the taxes on such profits.[12]

[12] *PacifiCorp v. FERC*, 795 F.2d 816, 823 (9th Cir. 1986).

(*Id*.) Avista states that, nevertheless, the Court deferred to BPA because BPA stated, in its experience, it needed to cap the cost of the overall program to reduce the risk that improper costs might be included in a utility's ASC through the return on equity component. (*Id*.) Although the Court deferred to BPA, it expressly stated that it did not sanction any permanent exclusion of those costs. (*Id*.)

Avista notes that in adopting the 1984 ASCM, BPA clearly stated that it was not its intent to "wipe out the exchange."[13] (Avista, ADS090010, at 2.) Avista asserts that the 1984 ASCM had precisely that effect on Avista. (*Id*.) As a direct result of the adoption of the 1984 ASCM, Avista claims that its customers were wiped out of the REP. (*Id*.) Moreover, because under the 1984 ASCM Avista's ASC was substantially less than the PF rate, Avista contends that it was forced to accrue a very significant deemer balance. (*Id*.) At the time the parties entered into the 1981 RPSA, Avista argues that the parties did not contemplate changes to the ASC Methodology like those adopted in the 1984 ASCM. (*Id*.) Accordingly, there was no mechanism for Avista to suspend or terminate its 1981 RPSA to avoid accruing a substantial deemer balance. (*Id*.) In 1987, Avista was finally able to suspend its 1981 RPSA, but not before accruing a significant deemer balance. (*Id*.) Avista terminated its 1981 RPSA in 1993. (*Id*.)

Avista states that due to the changes in the ASC Methodology, and Avista's inability to suspend or terminate the 1981 RPSA, the deemer provision had substantial unintended consequences. (Avista, ADS090010, at 3.) Specifically, although Avista received less than $7 million in total benefits for its customers under the 1981 RPSA, BPA calculated that, as of the end of 2001, Avista had accrued a deemer balance of more than $85 million. (*Id*.) The substantial disparity between the minimal amount of total benefits that Avista received for its customers and the enormous deemer balance that it accrued under the 1981 RPSA is demonstrative of the substantial inequities caused by the deemer provision in the 1981 RPSA. (*Id*.) Those inequities are magnified by the fact that, for approximately 12 years (1984-2001), Avista received no REP benefits for its customers, and by the fact that a new generation of customers—customers that received no REP benefits under the 1981 RPSA—are, in essence, required to pay back Avista's substantial deemer balance through the elimination of their REP benefits. (*Id*.)

IPC also states that the deemer provisions contained in the 1981 RPSAs have had consequences unintended in 1981 by the signatories to those agreements. (IPC, ADS090002, at 1-2.) IPC states the RPSAs were developed by BPA in an environment when BPA and qualifying utilities were highly motivated to enable widespread participation in the REP. (*Id*.) IPC notes the deemer provisions clearly were not intended by BPA to preclude significant numbers of the region's small farm and residential customers from participating in the long term in the benefits of the region's Federal hydroelectric system. (*Id*.) Instead, the deemer clauses were designed to address relatively minor variations in BPA's PF rate and exchanging utilities' ASCs. (*Id*.) However, the effect of these clauses, when brought forward to a new RPSA taking into account

[13] Hearings in the matter of: Proposed Methodology For Determining the Average System Cost of Resources for Electric Utilities Participating in the Residential Exchange Established by Section 5(c) of the Pacific Northwest Electric Power Planning and Conservation Act, Before the Bonneville Power Administration, April 20, 1984, p.7, lines 6-15 & p.8, lines 7-12 (introductory comments by Peter T. Johnson, Administrator, Bonneville Power Administration).

BPA's changes to its ASC Methodology in 1984, is to disable hundreds of thousands of small farm and residential customers from the benefits of the REP for decades, if not forever. (*Id*.) IPC concludes that a settlement rightly advances BPA's statutory role of insuring that those customers are able to participate in a full measure of REP benefits. (*Id*.)

PacifiCorp and PGE state that the proposed Settlement provides some mitigation for the substantial inequities created by the deemer balance while at the same time fairly balancing a range of regional interests. (PacifiCorp, ADS090009, at 1; PGE, ADS090008, at 1.) PacifiCorp and PGE note that BPA's implementation of the 1984 ASCM forced previously low-cost utilities that could potentially come in and out of the exchange to sink deeply into deemer status and, combined with the interest attributed, effectively deprived their customers of the ability to receive REP benefits. (*Id*.) In addition, PacifiCorp is concerned about the very low level of REP benefits that are currently allocated to the residential and small farm customers that reside in the state of Idaho. (PacifiCorp, ADS090009, at 1.) PacifiCorp states the long-standing deemer disputes have accentuated this inequity and PacifiCorp supports BPA's effort to settle these long-standing disputes. (*Id*.)

In contrast to the comments of Avista, IPC, PacifiCorp and PGE, PPC does not believe the deemer provision has been inequitable. PPC states that at a public meeting on February 11, 2009, BPA staff indicated that although settling ongoing legal disputes with Avista was one purpose of the proposed Settlement, it was also acknowledged that the real driver for BPA's support of the settlement was one of "equity." (PPC, ADS090004, at 2.) PPC has misunderstood BPA's statements at the public meeting. PPC correctly notes that BPA stated there were two primary purposes of the proposed Settlement: (1) to settle ongoing legal disputes that presented substantial legal risk to BPA and its customers, and (2) to address what has been an inequitable result to Avista from implementing the 1981 RPSA deemer provisions. The "real driver" of the settlement, however, is the resolution of legal risk, which has been thoroughly explained previously. Absent such risk, there would be no proposed Deemer Account Settlement.

BPA does not claim or disclaim that inequity, by itself and in the absence of legal risk, would be sufficient to support a settlement. In the instant case, however, a significant inequity has occurred. In simple terms and as noted previously, Avista executed an RPSA in 1981, which contained a deemer provision. An exchanging utility could be forced into deemer status under the 1981 RPSA if BPA's PF Exchange rate was revised and thereafter exceeded the utility's ASC. Similarly, an exchanging utility could be forced into deemer status if BPA revised the ASC Methodology in a manner that decreased the exchanging utility's ASC. The 1981 RPSAs incorporated BPA's 1981 ASCM, which was established in a separate consultation process with BPA's customers, state utility commissions, and other interested parties. *See* 16 U.S.C. § 839c(c)(7).

In 1984, however, BPA conducted a consultation proceeding in order to revise the 1981 ASCM and establish a revised 1984 ASCM. The 1984 ASCM made a number of changes in the calculation of ASC; for example, the 1984 ASCM excluded return on equity and income taxes from ASC. The 1984 ASCM thereby had the effect of reducing Avista's ASC lower than it was under the 1981 ASCM. Consequently, Avista was accumulating a substantial addition to a deemer balance.

Although the 1981 RPSA allowed an exchanging utility to terminate its participation in the REP if the section 7(b)(2) rate test triggered and the PF Exchange rate became higher than the utility's ASC, there was no similar termination ability if the ASC Methodology was revised to reduce ASCs below the PF Exchange rate. Consequently, Avista accumulated a $39.3 million deemer balance before it could terminate or stay its participation in the REP in 1987. This, however, was only the start of the problem.

In 1987, BPA and Avista executed the Suspension Agreement. The Suspension Agreement had a two-fold impact on Avista's deemer balance. First, it suspended Avista's participation in the REP. Although this suspension stopped Avista from accruing further deemer balances as a result of its ASC, it did not stay the accumulation of interest on Avista's outstanding deemer balance. The Suspension Agreement used the "prime rate values published in the Federal Reserve Bulletin . . .[.]" Suspension Agreement Between BPA and WWP at § 4. Prime interest rates reached surprisingly high levels during the period of the Suspension Agreement, averaging 8.6 percent a year. Because Avista was not participating in the REP and because its ASC continued to be below BPA's PF Exchange rate, Avista could do very little to stem the continued accumulation of interest. This pattern would continue for the next eight years with the result that Avista's deemer balance grew to approximately $85 million by 2001.[14] Thus, of BPA's total outstanding deemer balance claim against Avista, approximately 53 percent (roughly $45.7 million) of the balance stems solely from interest accrued under the Suspension Agreement. Consequently, before Avista's residential and small farm customers could receive REP benefits, Avista would have to work off a massive deemer balance that is primarily composed of the interest calculated from the Suspension Agreement.

Learning from this experience, when BPA developed its 2008 RPSAs it adopted a revised deemer provision that only applied the Consumer Price Index ("CPI") to deemer account balances. As BPA noted in the 2008 RPSA ROD, at 20:

> BPA continues to believe that adjusting the amounts in the balancing account based on the CPI (1) more accurately measures the cost to other BPA customers of the deferred "repayment" of such amounts, and is therefore fairer to both those customers and to the residential and small
> farm consumers of exchanging utilities, and (2) is easier to apply. First, for reasons explained in Issue 2 below, amounts in the balancing account are not cash obligations of the exchanging utility, but rather non-cash deferred obligations. The Agreements contemplate – consistent with the 1981 RPSA – that this non-cash obligation will be discharged through an offset by BPA to future REP benefits. Using offsets to future REP benefit payments as the default mechanism for amortizing deemer balances is consistent with the fact that these deferred obligations, like the REP benefits paid by BPA, are more accurately attributable to the residential and small farm consumers of the exchanging utilities than to the utilities themselves, which receive no monetary benefits whatsoever from the REP. Absent a contractual obligation to make a cash repayment on a fixed schedule, applying an interest rate of prime plus four percent to outstanding

[14] As noted in the discussion of Issue 2, Avista contests that interest continued to accrue during this period.

> account balances, as proposed by Snohomish, is excessive in relation to the nature of the obligation, and would arguably overcompensate BPA's other customers compared to applying an inflation rate, which, using the CPI based on the last 10 years, would be in the 2 to 5 percent range.
>
> Second, the date by which amounts in the balancing account would be "repaid" by offset is unknowable and largely, if not wholly, outside the control of an exchanging utility. As such, it would be difficult to choose the appropriate interest rate to apply to such amounts, because the rate of interest is determined in large part by the duration of the "loan." Again, in this respect adjusting the amount in the balancing account based on an inflation rate provides a fair surrogate that should make BPA's customers "whole" in the context of the obligation owed to them, and does not unfairly penalize the residential and small farm consumers of the exchanging utilities by using an interest rate that could be excessive in light of the nature and duration of the outstanding obligation.

Thus, BPA recognized that the previous application of an interest rate to deemer account balances under the Suspension Agreement produced an unanticipated and significant penalty to deeming utilities. Application of the previous interest rate, despite small initial deemer balances, could and did produce enormous balances that would preclude exchanging utilities from receiving REP benefits for their residential and small farm customers until the deemer balance was worked off.

PPC claims that BPA believes it is unfair that Avista had received a modest amount of exchange benefits immediately after the passage of the Northwest Power Act, and then had acquired a significant level of deemer liabilities, in accordance with the provisions of the contract that Avista and BPA had voluntarily signed. (PPC, ADS090004, at 2.) PPC has mischaracterized BPA's position. PPC correctly notes that Avista received only a small amount of REP benefits under the REP before it went into deemer status, and its deemer balance was exacerbated by BPA's revision of the 1981 ASCM. BPA is not saying that its actions were unfair (although the IOUs' comments on the proposed Deemer Account Settlement directly make such a claim), but BPA must acknowledge that its actions had a significant deleterious impact on the REP benefits received by exchanging utilities and particularly on deeming utilities. BPA, however, is saying that where a utility has accumulated only a small deemer account balance and then cannot reenter the REP to receive benefits to work off the deemer account balance for an extended period of years, the application of a high interest rate can cause a massive increase in the deemer account balance unrelated to the substantive incurrence of that balance. BPA believes this can reasonably be characterized as an unfair result.

PPC does not believe that enforcing the terms of the contracts with Avista is inequitable. (PPC, ADS090004, at 2.) PPC argues the reason Avista acquired a deemer balance from 1983-1987 was because its ASCs were lower than BPA's rates. (*Id*.) PPC states that during and after this period, consumer-owned utilities served by BPA adjacent to Avista generally had higher residential rates than Avista did, a disparity that became markedly wider when BPA's rates increased massively during the energy crisis. (*Id*.) At that time, BPA did not express equity concerns regarding the residential rate disparity between Avista and neighboring consumer-

owned utilities. (*Id*.) To now say that it is inequitable that Avista be prevented from receiving REP benefits only recognizes one side of the story. (*Id*.) In response, as noted previously, BPA does not believe it is inequitable for an exchanging utility to develop a deemer balance under the terms of its RPSA. The inequity in this case is primarily related to the accumulation of interest on the deemer account balances. The fact that IOUs' and preference customers' retail rates may be higher or lower than each other does not mean BPA will make any statement about whether the levels of such rates are reasonable.

PPC argues that preference customers have paid (and are projected to pay in the future) money to Avista to offset its system costs when Avista has had lower costs than BPA's. (PPC, ADS090004, at 2.) PPC's first assertion is not accurate. As noted previously, during the period from 1981 to 2001, Avista received positive REP benefits only during the initial years of its 1981 RPSA. Avista went into deemer status in 1983. For the period prior to July 1, 1985, BPA's DSI customers paid the cost of the REP, including the REP benefits paid to Avista. Thus, BPA's preference customers did not pay money to Avista to offset its system costs during the period to which the Deemer Account Settlement applies. PPC therefore argues that even though preference customers did not pay for Avista's REP benefits, they should receive benefits from Avista's deemer balance. This reasoning is not persuasive.

BPA acknowledges that Avista has been inequitably harmed by the application of interest in the implementation of the deemer provision in its Suspension Agreement. In considering whether to settle Avista's deemer balance dispute, BPA does not believe it is improper to consider the equities of the case in deciding whether to go forward with the proposed Deemer Account Settlement. Indeed, the Northwest Power Act does not require the Administrator to approach every dispute raised by a BPA customer as an automaton and thereby ignore customers' claims that BPA has acted improperly or unfairly. Rather, BPA's organic statutes empower the Administrator to "compromise or . . . settle[ ] . . . any claim . . . upon such terms and condition and in such manner as he may deem necessary." 16 U.S.C. § 832a(f). BPA was given this wide settlement authority because it would be the most familiar with the particular facts which led to the pending claim, and therefore, was in the best position to reach an advantageous settlement with the disputing party in a timely fashion. As noted in the legislative history of the Act:

> The section also permits the Administrator to compromise claims arising out of contracts he has executed. The Administrator is a responsible officer of the Government and is the one who is most familiar with the claim and the facts out of which it arose. The discretion to compromise and settle it should be a part of Bonneville's business operations. It should not be compelled to lose, or run the risk of losing, advantageous settlements because of the delays involved in sending offers back and forth across the continent for consideration by a number of agencies before acceptance is possible.

See H.R. Rep. No. 777, 79th Cong., 1st Sess. (1945), *reprinted at* 1945 U.S. Code Cong. Service 874, 875.

In determining whether to "compromise" or "settle" a claim, there is nothing in the Northwest Power Act that precludes BPA from *considering* the equities of the situation. Indeed, courts

have affirmed the ability of Federal agencies to consider equity like a court when considering the appropriate action to take. As noted by one court:

> The principles of equity are not to be isolated as a special province of the courts. They are rather to be welcomed as reflecting fundamental principles of justice that properly enlighten administrative agencies under law. The courts may not rightly treat administrative agencies as alien intruders poaching on the court's private preserves of justice. Courts and agencies properly take cognizance of one another as sharing responsibility for achieving the necessities of control in an increasingly complex society without sacrifice of fundamental principles of fairness and justice.

Niagara Mohawk Power Corp. v. FPC, 379 F.2d 153, 160 (D.C. Cir. 1967). BPA's decision to settle with Avista, which considers the equities that created Avista's deemer balance, is no different. Indeed, an agency's failure to review its actions for possible inequity in determining whether to settle a claim would be myopic and irresponsible.

In conclusion, BPA has not improperly relied upon equity to reach its decision to settle Avista's deemer balance dispute. Rather, the equitable considerations of this case were simply one of a number of factors BPA considered in deciding to settle this matter with Avista. After reviewing the equities surrounding Avista's deemer balance, BPA firmly believes the proposed Settlement results in a fair resolution of the outstanding dispute between BPA and Avista. Influencing BPA's decision in this regard is the fact that Avista's received a relatively small amount of REP benefits, less than $7 million, from 1981 to 1983. In return, Avista accumulated $39.3 million in a deemer balance under the terms of its 1981 RPSA by 1987. In an effort to get out of the never-ending accumulation of its deemer balance, Avista executed a Suspension Agreement that allowed for interest to be charged on Avista's deemer balance at the prime rate. This resulted in the accumulation of an additional $45.7 million in Avista's deemer balance solely because of interest. In light of these facts, BPA believes that the Deemer Account Settlement, which secures $55 million for BPA, strikes the proper balance between preserving value for the region while at the same time recognizing the particular circumstances that led Avista to accumulate its disputed deemer balance.

Decision

BPA appropriately reviewed equitable considerations in deciding to resolve its deemer dispute with Avista.

Issue 5

Whether settlement of Avista's deemer balance will have a significant impact on BPA's power rates relative to no settlement, and whether the costs are equitably allocated between Slice and non-Slice customers.

Parties' Positions

Inland does not support the proposed Settlement, arguing that the deemer dispute involves tens of millions of dollars and the resolution of the dispute will have significant impacts on BPA's power rates. (Inland, ADS090001, at 1.)

NRU objects to the Settlement because it will cause the rates of BPA's public power customers to be higher than they would otherwise be. (NRU, ADS090003, at 2.) NRU states that BPA has up to this point been unable to demonstrate the rate impact of this proposal, but because $30 million is at play here that it expects that BPA's public power ratepayers will find their rates higher as a result of this proposed Settlement. (*Id*.) It also states that BPA and the region are now facing considerable economic uncertainty. (*Id*.) NRU argues that whatever the added cost of this Settlement, they will only add to BPA's costs. (*Id.*)

NRU also expresses concern about the allocation of costs among customers, stating that the distribution of these added costs among public power ratepayers is also in question. (*Id.*) At the February 11th clarification session, it was unclear whether the burden of the Settlement will be fairly spread over BPA's Slice and Non-Slice customers. (*Id.*) NRU states that an inequitable allocation of these costs to the Non-Slice customers will only add insult to injury. (*Id.*)

WPAG states that the Settlement reduces the repayment obligation of Avista by about $30 million through FY 2002 and by about $50 million through the present. (WPAG, ADS090005, at 2.) WPAG argues that BPA is proposing to forego repayment by Avista of about $50 million, and thereby increase the costs borne by its preference customers by an equal amount. (*Id.*)

PNGC states that the Settlement will have the effect of increasing the rates that BPA charges to PNGC for requirements service to PNGC's members. (PNGC, ADS090006, at 1-2.)

APAC states that the deemer balances represent real costs that BPA was deemed to incur in supplying power to serve Avista's loads. (APAC, ADS090007, at 1.) Those additional costs may have impacted the rates paid by all preference customers depending on the interaction of the 7(b)(2) rate test and the level of ASCs. (*Id*.) APAC argues BPA owes a duty to those preference customers to enforce Avista's contractual obligations and return full value to BPA. (*Id*.)

BPA Staff's Position

The rate impacts associated with the Deemer Account Settlement cannot be finally determined at this time. BPA anticipates that the proposed Settlement will have a very small impact on the overall level of BPA's rates, considering that one likely alternative to settlement is a deemer balance established through litigation that is similar to the proposed Settlement amount and that the balance established through litigation could be lower than the proposed Settlement amount.

The costs of settling the Avista deemer dispute are not borne exclusively by BPA customers paying the Priority Firm (PF) rate, as appears implicit in the comments of parties. In fact, the costs are borne by all BPA rate payers, including DSIs purchasing at the IP rate and exchanging utilities "purchasing" at the PF Exchange rate. This means that the costs are effectively spread

over substantially more megawatt hours of sales than the commenting parties appear to be assuming.

Evaluation of Positions

Inland, NRU, WPAG, PNGC and APAC express concern that the proposed Deemer Account Settlement would result in higher BPA power rates charged to preference customers or higher costs borne generally by preference customers. In fact, however, the Deemer Account Settlement will have, at most, an insignificant impact on BPA's PF Preference rate in FY 2010-2011. This counterintuitive result is due to a combination of several factors, explained more fully below. Before discussing the expected rate impacts of the Deemer Account Settlement, however, BPA must emphasize that this Record of Decision is not finally establishing the cost allocation or rate impacts of the proposed Settlement for FY 2010-2011. Rather, the discussion below simply provides an overview of the expected treatment of the Deemer Account Settlement. Concerns with the rate treatment of the Deemer Account Settlement must be raised in the WP-10 rate proceeding.

First, BPA is not re-setting FY 2009 or earlier power rates. Therefore, there is no impact on current rates. Second, with or without settlement, Avista will have extinguished its deemer account balance by the beginning of FY 2010. This means that the REP costs recovered in BPA's WP-10 and future power rates are the same with or without settlement. Third, BPA recently secured a U.S. Treasury liquidity facility that changes how reductions in net revenues and beginning of rate period financial reserves impact power rates. Specifically, with the proposed Settlement, BPA's financial accounting treatment will include a reduction in FY 2009 net revenues of approximately $33 million. BPA will make additional payments to Avista for FY 2009 REP benefits of approximately $8 million and additional payments to preference customers for the return of part of Avista's Lookback Amount of approximately $13 million. The combined effect is that BPA's ending FY 2009 financial reserves will be approximately $21 million lower than without settlement. The remaining $12 million remains in reserves pending resolution of legal challenges and the payment to Avista of the Interim Agreement true-up.

The availability of the new Treasury liquidity facility combined with BPA's current expected end of year financial reserves means that BPA will likely not need to include Planned Net Revenues for Risk in its FY 2010-2011 final rates, even with the proposed Settlement. Given this, BPA expects that the FY 2010-2011 rate impact of the Settlement is only lower interest earned on financial reserves. The $21 million of lower financial reserves translates into approximately $1 million per year in higher net interest expense for FY 2010-2011 rates. This is expected to result in less than a 0.02 mills per kWh increase in the FY 2010-2011 non-Slice PF Preference rate, an extremely small increase, and commensurate small increases in the Slice PF rate, the IP rate, and the PF Exchange rate.

This minor impact on rates will be felt even less by preference customers that receive Lookback Amount payments from BPA. The above-noted calculation of the Settlement's PF Preference rate impact states the approximate impact on the WP-10 PF Preference rate. The majority of BPA's preference customers, specifically those that paid the WP-02 PF Preference rates and incurred overcharges due to the 2000 REP Settlement Agreements, will receive a one-time return

of an additional $13 million of Avista's Lookback Amount in late FY 2009. This one-time credit means that the net financial impact of the Settlement for these customers is less than the impact due to the PF Preference rate alone.

Inland, NRU, WPAG, PNGC and APAC express concern that the proposed Deemer Account Settlement would result in higher BPA power rates charged to preference customers or higher costs borne generally by preference customers. This view of the impacts of the Settlement, however, is incorrect because it erroneously assumes that the deemer balance assumptions BPA used in setting FY 2009 rates were fixed for all time. As noted earlier, BPA assumed in the WP-07 Supplemental Rate Proceeding that, as of FY 2002, Avista's deemer balance was $85.6 million. In taking this position, BPA was clear that the $85.6 million deemer balance was only an *assumption*. *See* WP-07 Supplemental ROD, WP-07-A-05, at 218-219. BPA noted that this assumption was in dispute and could be replaced if the disputes regarding Avista's deemer balance were finally resolved through litigation or a settlement. *Id.* In the instant case, BPA has reached a proposed settlement with Avista that replaces the disputed balance of $85.6 million with an agreed-to balance of $55 million. Consistent with the statements BPA made in the WP-07 Supplemental ROD, BPA's rate case assumptions must now be updated to reflect the proposed Settlement.

Moreover, the potential negative impacts to BPA's rates is diminished under the Settlement compared to BPA retaining its higher, but disputed, claim for $85.6 million. As noted before, Avista strongly objected to BPA's deemer balance claim of $85.6 million. If Avista succeeded in discharging its deemer balance through litigation, BPA would have to increase its rates in subsequent cases to recover the REP benefits that had been improperly withheld from Avista. This result would cause more rate volatility, and would have a greater impact on BPA's rates, than the small impact noted above caused by the Settlement. Viewed in this context, the Settlement is better for BPA's ratepayers because it eliminates risk and creates certainty.

BPA acknowledges that circumstances in future rate cases could mean that the lower ending FY 2009 financial reserves resulting from the Settlement might result in a somewhat higher PF Preference rate. If this were to occur, however, it would not only be the PF Preference ratepayers that would incur the additional costs of the Settlement. A portion of the costs would also be recovered by sales at BPA's PF Exchange and IP rates. In light of the foregoing considerations, BPA believes that the impact of the Settlement on the PF Preference rates is not sufficient to conclude that the Settlement should not be offered.

NRU expresses concern regarding possible inequitable allocation of the costs of the Settlement between BPA's Slice and non-Slice customers. (NRU, ADS090003, at 2.) PNGC expresses concern about the costs incurred by its members, presumably through both Slice and non-Slice PF Preference rates. (PNGC, ADS090006, at 2.) Slice customers experience the impacts of changes in BPA's costs or net revenues during a rate period differently than customers paying the non-Slice PF rate. Generally speaking, Slice customers are collectively responsible for 22.6278 percent of certain specified BPA actual costs. Like the non-Slice rates, the Slice rate is set prospectively for the rate period based on projected costs and revenues in the Slice Revenue Requirement; but unlike the non-Slice rates, amounts paid by Slice customers include an annual Slice True-Up Adjustment Charge, whereby the difference between projected costs and revenue

credits in the Slice Revenue Requirement and actual costs and revenue credits for the contract year is calculated and becomes the basis for the annual Slice True-Up Adjustment Charge. The end result is that Slice customers pay their share of Power Services' actual expenses and receive their share of actual revenue credits applicable to the Slice Revenue Requirement annually.

Slice customers will see an increase in their FY 2009 Slice True-Up Adjustment Charge, equal to 22.6278 percent of a $20 million net increase in the IOU Residential Exchange Program expense. In addition, Slice customers will receive 22.6278 percent of the $13 million in additional Lookback amounts recovered from Avista and returned to preference customers. The $20 million net increase in the IOU REP expense reflects the $13 million in additional Lookback amounts recovered from Avista. This results in a $4.5 million net cost to the Slice customers in FY 2009 through their Slice True-Up Adjustment Charge. However, if BPA decides to make payments or bill credits to Slice customers for their share of the $13 million Lookback recovered from Avista outside of their Slice True-Up Adjustment Charge, BPA will then need to add back their share of the $13 million in the calculation of the Slice True-Up Adjustment Charge so that Slice customers do not get compensated twice, once through payments or bill credits, and a second time through the Annual Slice True-Up Adjustment Charge for their share of the $13 million Lookback recovered from Avista.

The foregoing description of financial impacts and associated conclusions reflects information available in early June, 2009. Some elements that determine the precise financial consequences of the Settlement are not currently known with certainty. These include: (1) certain issues that will be decided in the upcoming WP-10 Final ROD and Final Rates Proposal, most notably the level, if any, of Planned Net Revenues for Risk included in BPA's FY 2010-2011 power rates; (2) all financial accounting treatment is subject to audit and could be revised; (3) the Final FY 2009 ASCs that are to be issued on or about June 19, 2009; and (4) Avista's actual FY 2009 qualifying exchange loads, which determine the actual amounts of FY 2009 REP payments to Avista. These and other factors notwithstanding, BPA believes the likelihood of financial and rate consequences of Settlement differing materially from those described herein is very small.

WPAG states that the proposed Settlement reduces the repayment obligation of Avista by about $30 million through FY 2002 and by about $50 million through the present. (WPAG, ADS090005, at 2.) As noted above in the discussion of Issue 2, WPAG's claims are simply incorrect. At most, the Deemer Account Settlement results in a $30 million reduction through FY 2002. BPA can find no basis for the $50 million amount. BPA calculates that the reduction in Avista's repayment obligation is the $33 million number cited above. BPA arrived at this number by substituting a beginning FY 2002 deemer balance for Avista of $55 million for the $85.6 million balance assumed in the WP-07 Supplemental Power Rate Case Final Proposal FY 2002-2008 Lookback Study, Table 15.2, WP-07-FS-BPA-08 at 267, and re-running the Lookback model with all other assumptions, including the prime interest rates used and simple interest calculations, unchanged. BPA believes WPAG simply erred in its calculation that arrived at the $50 million amount or it assumed some substantially higher interest rate than the prime rate for the period 2002 through 2008. Either way, WPAG's assertion that the settlement reduces the repayment obligation of Avista by about $50 million through the present overstates the reduction in Avista's payment obligation by over 50 percent and is simply incorrect.

APAC states that deemer balances represent real costs that BPA was deemed to incur in supplying power to serve Avista's loads. (APAC, ADS090007, at 1.) APAC does not provide additional information or rationale that would assist in better understanding the basis for this statement. Although BPA suspects that APAC is referring in some manner to what might be an opportunity cost or a stream of payments from Avista to BPA that might have occurred absent the deemer construct, without more information BPA must view this statement literally.

The Avista deemer balance is not the result of any BPA direct cost *per se*, real or otherwise, and does not arise through any deeming of costs BPA incurred in supplying power to serve Avista's loads. It arose initially because Avista elected to "deem" its ASC equal to BPA's PF Exchange rate pursuant to the deemer provisions of its 1981 RPSA with BPA. The accumulation of the deemer principal balance was a function of Avista's exchange load multiplied by the difference between Avista's ASC and the PF Exchange rate. Although the PF Exchange rate is determined in part by BPA's costs, these costs are not "costs BPA incurred in supplying power to serve Avista's loads," and even if they were, other factors are material to the determination of the PF Exchange rate. Avista's ASC, the other half of the cost difference calculation used to determine the deemer principal balance, has no relation to BPA's costs.

Even if one assumed some relationship between Avista's deemer principal balance and costs BPA "incurred in supplying power to serve Avista's loads," Avista's deemer balance as of 2002 has a material interest component that has no direct relationship whatsoever to BPA's costs. Avista's deemer principal balance was accumulated from 1983 through 1987 and totals $33 million. The difference between this number and the $85.6 million beginning FY 2002 deemer balance assumed in the WP-07 Supplemental Power Rate Case Final Proposal (*see* FY 2002-2008 Lookback Study, Table 15.2, WP-07-FS-BPA-08 at 267) is almost $53 million of accumulated interest. The corresponding interest component in the proposed Settlement FY 2002 deemer balance of $55 million is $22 million. Stated in percentage terms, 62 percent of the WP-07 Supplemental deemer balance assumption and 40 percent of the Settlement deemer balance is interest accumulated on a principal balance as of 1987.

Because the factors that gave rise to Avista's deemer principal balance have at best a partial and very indirect relationship to BPA's costs, and the interest component of the deemer balance has no relationship whatsoever to BPA costs, BPA believes APAC's assertion that the deemer balance constitutes real costs that BPA was deemed to incur in supplying power to serve Avista's loads is without merit.

Decision

BPA cannot dispositively determine at this time the rate impacts associated with the Deemer Account Settlement. The rate implications of the Settlement must be addressed in BPA's rate cases. As a general matter, however, BPA does not anticipate that the Settlement will have a significant impact on BPA's power rates. BPA's Slice and non-Slice customers experience the costs of the Settlement differently due to the differences in the pricing constructs of the two products. Such differences do not mean that the Settlement or the allocation of costs between Slice and non-Slice customers is inequitable. BPA will apply a treatment of the Settlement

credits to Slice customers that ensures a double-counting or over-compensation of their share of credits does not occur.

Issue 6

Whether the proposed Settlement will impact settlement discussions in the WP-07 Supplemental Rate Proceeding litigation.

Parties' Positions

PPC argues that it may be unwise to settle Avista's deemer account at this time because parties to Ninth Circuit litigation of the Residential Exchange Program are currently involved in a settlement effort. (PPC, ADS090004, at 1, 3.)

BPA Staff's Position

BPA Staff does not believe the proposed Deemer Account Settlement should have a material impact on WP-07 Supplemental Rate Proceeding litigation settlement discussions.

Evaluation of Positions

PPC states that it may be unwise to settle Avista's deemer account at this time due to the fact that parties to the Ninth Circuit litigation of the REP are currently involved in a settlement effort and the amount of Avista's deemer balance could be relevant in parties' assessment of whether an overall settlement of the issues is workable. (PPC, ADS090004 at 3.)

There are many parties involved in the WP-07 Supplemental Rate Proceeding litigation, including almost all of the parties that have commented on this proposed Settlement of the Avista deemer dispute. Involved parties have widely differing views on the broader WP-07 Supplemental issues and presumably would apply very different valuations on any particular element of a proposed settlement of these broader issues. These broader issues in a number of cases have financial consequences in the hundreds of millions of dollars. For some, settlement of the Avista deemer dispute could be a factor that could enter in to their assessment of the overall merits of a broader settlement. Given the magnitude of the broader issues, however, BPA believes the Avista Deemer Settlement should not be a significant factor one way or the other in an objective assessment of the merits of settling the WP-07 Supplemental Rate Proceeding litigation. In fact, PPC fairly conveys in its comments the speculative and uncertain nature of the impact, if any, that settling the Avista deemer dispute might have on a broader settlement of the WP-07 Supplemental Rate Proceeding litigation. BPA does not believe the *possibility* of including the deemer issue in a broader settlement and the *possibility* that such inclusion would materially affect some parties' assessment of the merits of the broader settlement presents a sufficient reason to abandon or postpone the proposed Settlement of the Avista deemer dispute.

Decision

The possibility that the Settlement could impair parties' efforts to reach settlement in the cases challenging BPA's WP-07 Supplemental Rate Proceeding is not a compelling reason to abandon or postpone settlement of the Avista deemer dispute.

Issue 7

Whether BPA is setting a bad precedent by resolving the deemer dispute with Avista.

Parties' Positions

NRU expresses concern in its comments that BPA is setting a bad precedent by settling Avista's deemer balance dispute. (NRU, ADS090003, at 2.) NRU is concerned that BPA is not following the terms of the RPSA and Suspension Agreement Avista signed, and as such, is setting a bad precedent for NRU members that have just entered into 20-year long power supply contracts. (NRU, ADS090003, at 2.)

PPC raises a similar concern. (PPC, ADS090004, at 1-2.) PPC states BPA is setting a bad precedent by not enforcing long-term obligations based on "equitable" grounds. (*Id.*) PPC also argues that if BPA does not recover all claimed deemer balance amounts from Avista, the preference customers will have even less assurance that BPA will enforce its "Lookback" construct, which similarly involves recovering a past obligation from the IOUs over a long-term period. (*Id.* at 2.)

APAC notes that BPA's settlement with Avista seems to be rewarding Avista for not responding to BPA's October 19, 1993, setting conditions for Avista's termination. (APAC, ADS090007, at 1.)

WPAG argues that the deemer account approach was agreed to in reliance on the expectation the BPA would be the custodian of the deemer accounts, and could be trusted to protect the preference customers' financial interest by enforcing these agreements. (WPAG, ADS090005, at 1.)

BPA Staff's Position

BPA would not be setting a bad precedent by entering into the proposed Deemer Account Settlement. The Settlement would resolve a long-standing contractual dispute between BPA and Avista in a manner that allows BPA to substantially recover the balance without complicated and time-consuming litigation.

Evaluation of Positions

Contrary to the sentiments expressed in the public agency parties' comments, BPA does not believe that settling a long-standing and highly contentious dispute over a 27-year old

contractual provision sets a bad precedent. Indeed, after careful consideration of the legal, factual, and equitable issues that led to Avista's deemer balance, BPA believes locking in $55 million of the alleged $85.6 million outstanding balance, roughly 64 percent of the claimed amount, is very reasonable. BPA believes that the settlement value of $55 million is particularly appropriate when considering the specific legal and equitable circumstances of this case.

As noted in the discussion in Issue 2, BPA's claim for the $85.6 million in a deemer balance from Avista is subject to legal risk. BPA's case for applying interest to the deemer balance relies on an unanswered letter and the vague terms of two expired contracts. Furthermore, Avista has several other contractual and statutory claims against BPA's calculation and determination of the deemer balance that could threaten the validity of the underlying balances. In terms of precedent, BPA believes that the Settlement is setting a good precedent because it secures $55 million of value for BPA without incurring the cost and uncertainty of litigation. As such, BPA is not simply walking away from the disagreement without receiving any value. To the contrary, considering the significant risks noted above, the Settlement with Avista is very reasonable.

In addition, as noted in Issue 4, BPA believes it is setting the right precedent by also considering the equitable side of Avista's deemer dispute. To be clear, equitable considerations were only one factor in many considered by BPA in reaching the decision to settle the deemer balance issue with Avista. BPA believes that reviewing the equities, in addition to the legal concerns, is the right way of approaching settlements in cases such as this. Here, the impact to Avista's deemer balance caused by the 1984 ASCM is stark. Once the 1984 ASCM was put in place, Avista's deemer balance grew by more than *500 percent*, from $6.8 million to over $39.3 million in a 3-year time period. To stay the accumulation, BPA and Avista entered into a Suspension Agreement in 1987. Although this arrangement solved Avista's short-term problem by staying further accumulation of the principal amounts of Avista's deemer balance, it exacerbated Avista's long-term deemer problems by locking Avista into paying interest on a balance it could not reasonably reduce. As further noted in Issue 4, by the close of 2001, Avista's (disputed) deemer balance grew to over $85 million, 53 percent of which (roughly $45.7 million) stemmed solely from interest accrued under the Suspension Agreement. Although BPA believes it had both the right and the authority to take these actions and require these provisions, the impact that these changes have had on Avista's deemer balance is not lost on BPA. Indeed, learning from this experience, when BPA developed its 2008 RPSAs, it adopted a revised deemer provision that only applied the Consumer Price Index ("CPI") to deemer account balances.

NRU and PPC express concern that the Settlement will undermine BPA's commitment to enforcing long-term agreements. NRU argues that the settlement is not consistent with the signed RPSA and the Suspension Agreement. (NRU, ADS090003, at 2.) NRU expresses worry about the precedent this sets especially since NRU members have just entered into contracts for power supply for the next 20 years. (*Id.*) PPC raises a similar concern. (PPC, ADS090004, at 1.) PPC opposes the proposed Settlement because, in its view, it sets a bad precedent that BPA will not "enforce long-term obligations." (*Id.*) PPC notes that it is "particularly disturbing" that BPA believes that the main source of the "inequity" was the use of the prime rate in calculating the interest on deemer amounts. (*Id.*) PPC contends that the use of simple interest at the prime rate was explicitly agreed to by BPA and Avista, and arguably Avista assented to compound interest starting in 1993. (*Id.*) To decide later that even simple interest is excessive and

inequitable undercuts preference customer confidence that BPA can be counted on to enforce long-term agreements. (*Id.* at 2.)

NRU's and PPC's worries and concerns are misplaced because they gloss over the substantial legal uncertainty regarding whether BPA had a right to assess interest against Avista's deemer balance after 1993. As discussed in Issue 2 above, BPA's case for interest on Avista's deemer balance is subject to significant legal risk. BPA's claim for interest relies on the silence of Avista to one letter and the ambiguity of two expired contracts. BPA does not agree that under these facts its decision to settle out a decades-old *claim* for a deemer balance in any way threatens or undermines BPA's commitment to enforcing other "long-term agreements."

Furthermore, BPA fails to see how settlement of Avista's 20-year old deemer dispute would adversely affect NRU's or PPC's members that have recently executed new long-term power sales contracts. If BPA's decision to settle with Avista shows anything, it demonstrates BPA's sincere desire to resolve, in good faith, any and all outstanding disputes with its customers. BPA would expect members of NRU and PPC to advocate that BPA adopt this same course of action if they have unresolved contract-related disputes with BPA at the end of their long-term contracts. Thus, to the extent any precedent is being set by BPA's actions, it is a precedent that shows that BPA is willing to work with its customers to resolve long-standing disputes without costly and counterproductive litigation. This type of precedent should be a comfort, rather than a concern, to PPC's and NRU's members.

PPC also argues that the settlement comes at a particularly bad time, given that BPA has just presented to preference customers that it will compensate them for past overcharges of the REP through offsetting "Lookback" amounts against future payments to the IOUs. (PPC, ADS090004, at 2.) PPC contends that if customers cannot be sure that BPA will in fact enforce that construct, which also involves recognizing a past obligation over a long-term period, they have less reason to believe that BPA's construct actually will recover those amounts. (*Id.*)

PPC's concern that the Settlement will somehow diminish BPA's resolve to return the Lookback Amounts to preference customers is unfounded. The Lookback construct stands in a totally different position than Avista's long-standing deemer balance dispute. For one, several cases are currently pending before the Ninth Circuit challenging BPA's decisions over the determination, calculation, and return of the Lookback Amounts to preference customers. BPA anticipates that more cases will be filed once BPA's rates are finally approved by FERC. Thus, unlike the deemer account balance disputes that have remained unresolved for decades, the legal questions surrounding the validity and calculation of the Lookback Amounts are on a course to be determined by the Court. There is also a possibility that these cases will reach settlement. In either event, BPA is confident that through these cases the Lookback issues will reach a final resolution that will provide PPC and BPA certainty as to what amounts, if any, that BPA should be returning to preference customers. If PPC finds BPA taking a course of action that PPC considers inconsistent with the holdings of the Court or terms of any settlement after these issues are resolved, it will have ample opportunities to bring that fact to the Court's attention. Thus, PPC's concern that BPA's decision to settle with Avista will somehow endanger preference customers' rights to the Lookback Amount is not persuasive.

APAC complains that while BPA gives up all of its contentions regarding the appropriate interest rate, Avista seems to be rewarded for not having responded to BPA's October 19, 1993, letter setting conditions for Avista's termination of its RPSA. (APAC, ADS090007, at 1.) BPA disagrees. BPA does not view a settlement that requires Avista to agree to a $55 million deemer balance, release BPA from all claims related to Avista's deemer balance, and forgo certain claims at the Ninth Circuit as "rewarding" Avista's decision to not respond to BPA's October 19, 1993, letter. Rather, the Settlement is the product of careful consideration of the legal, factual, and equitable issues presented in this case. BPA and Avista held differing views on what was required under the Suspension Agreement and the RPSA. These differences of opinion led BPA to include language in its October 19, 1993, letter which Avista would not acknowledge. Instead of resolving these issues at the time of BPA's October letter, both parties chose to leave the issue unsettled, which is where the issue remained for the ensuing 15 years. BPA and Avista are now at a point where the parties must decide whether to litigate this issue to its conclusion or find a resolution that works for both parties. After extensive negotiations, BPA believes it has reached a compromise that settles the long-standing deemer dispute with Avista in a manner that preserves the value of the deemer balance for BPA's regional ratepayers. BPA does not see this type of settlement as "rewarding" or "punishing" any particular behavior; rather, it puts an end to a dispute that has been lingering for long enough between Avista and BPA.

WPAG argues that preference customers were willing to agree to a deemer account approach rather than immediate cash payments, in part, in reliance on their expectation that BPA would be the custodian of these deemer accounts, and could be trusted to protect their financial interest by enforcing these contract provisions over the course of multiple RPSAs. (WPAG, AS090005, at 1.) WPAG claims that this settlement is not consonant with BPA's custodial duties that preference customers relied upon when they agreed to the deemer account approach. (*Id.* at 3.) In response, however, BPA has properly enforced the provisions of the RPSAs and continues to do so with the proposed Settlement. Contrary to the public agencies' assertions, the instant case does not involve clear contractual terms or facts, or BPA's failure to enforce such terms. Instead, BPA is insisting on repayment of the principal deemer balance accrued under Avista's 1981 RPSA. Given the contractual and factual context previously described, BPA has been able to reach a reasonable settlement regarding the application of interest to the deemer balance despite significant legal risks arising from the contracts and facts. As such, through the proposed Settlement, BPA is acting intelligently with regard to its financial interest as well as the interests of its preference customers.

Also, contrary to WPAG's arguments, BPA's approach to the calculation of the deemer value in the Settlement is consistent with the parties' intent underlying the deemer provision. First, in developing and implementing the deemer provision, there is nothing in the contract record created during the negotiations of this provision to suggest that BPA took on the mantle of "custodian" of the deemer balance for the benefit of preference customers. Certainly, BPA is responsible for properly administering the REP, including deemer accounts. However, as noted in BPA's 1981 Staff Evaluation of Comments, the purpose of the deemer provision was to keep a utility from receiving payments under the REP until "it has foregone [*sic*] economic benefits equal to the cost it would have paid had the utility's average system cost not been deemed equal to BPA's Firm Power rate." 1981 Staff Evaluation of Comments, Contract Administrative Record at 002681. In other words, the intent behind the deemer provision was to require a utility

to forgo REP benefits in an amount equal to the payments that the utility would have had to make to BPA under the 1981 RPSA had the utility not deemed its ASC equal to BPA's PF Exchange rate. This "forgoing the economic benefits" approach to the deemer balance provision was a "compromise embraced by all BPA customer groups." *Id.*

The proposed Settlement is completely consistent with this intent because BPA will recover the entirety of the deemer balance that Avista accrued under its 1981 RPSA. As noted before, that balance was $39.3 million. In addition, under the Settlement, Avista must pay inflation on this amount for the period from 1987 until 2001. This brings the total amount of the deemer balance Avista pays back to BPA to $55 million as of October 1, 2001. Avista also agrees to the treatment of its restated deemer balance during the FY 2002-2008 period, which includes accumulation of interest at the prime rate. This means that Avista pays $13.3 million in interest in addition to the $55 million for a total deemer payment of $68.3 million. Taken together, then, the Settlement requires Avista to give up REP benefits in an amount equal to the inflation adjusted value of the deemer balance it accrued under its 1981 RPSA. This result is consonant with the intent behind the deemer provision, which was to require utilities to forgo REP benefits "equal to the cost it would have paid had the utility's [ASC] not been deemed equal to BPA's Firm Power Rate." 1981 Staff Evaluation of Comments, Contract Administrative Record at 002681. Therefore, WPAG's complaints that the proposed Settlement is not remaining true to the objectives of the parties in agreeing to the deemer construct are not persuasive.

Decision

BPA's decision to settle Avista's long-standing deemer balance dispute does not set a bad precedent because BPA has properly considered and weighed the factual, legal, and equitable circumstances surrounding Avista's dispute.

Issue 8

Whether settlement of Avista's deemer balance will have implications for other utilities that have deemer balances.

Parties' Positions

Inland and NRU express concern that the settlement of Avista's deemer balance will establish a precedent that will be used to settle deemer account balances with other utilities, such as IPC, with potentially even larger impacts on BPA's rates. (Inland, ADS090001, at 1; NRU, ADS090003, at 2.)

BPA Staff's Position

The Deemer Account Settlement was designed to address the specific facts and circumstances surrounding Avista's deemer balance. BPA cannot determine at this time whether this Settlement would be offered to other utilities with deemer balances, such as IPC.

Evaluation of Positions

The proposed Settlement was developed in response to the particular factual, legal, and equitable issues related to the validity and calculation of Avista's deemer balance. As noted previously, Avista has certain legal claims related to the merits of the underlying deemer balance Avista accrued under its 1981 RPSA. Avista also challenges BPA's determination of the interest that is applicable to the outstanding balance. In its assessment of legal risk, BPA believes there is legal risk regarding its claim for interest on Avista's deemer balance beyond the early 1990s. As noted previously, BPA is not blind to the equities that led to Avista's current deemer balance, which concern both BPA's revision of the 1981 ASCM (which raised Avista's deemer from $6.8 million to over $39 million in less than three years) and the application of interest to the principal amount. Taken together, BPA believes that the proposed Settlement properly responds to these particular facts in a reasonable and sound business manner.

In its comments, Inland argues that the disposition of the deemer dispute between BPA and Avista is likely to have implications for other "deemer account balance" issues with potentially even larger impacts on BPA's rates. (Inland, ADS090001, at 1.) Inland, therefore, recommends that BPA settle the dispute with Avista "via the court system (Ninth Circuit Court)." (*Id.*) NRU raises a similar concern in its comments. (NRU, ADS090003, at 2.) NRU notes that IPC has a deemer balance that is much larger than Avista's. (*Id.*) NRU explains that it is very concerned that the settlement of this issue along the lines proposed here for Avista could set a precedent for a settlement with IPC. (*Id.*)

BPA understands the concerns raised by Inland and NRU. IPC, the only other utility with an outstanding deemer balance, has a disputed deemer balance that has many similarities to Avista's dispute. IPC received a relatively small amount of REP benefits under the REP in relation to the deemer balance that it ultimately accumulated. IPC's deemer balance also grew substantially after BPA changed the ASC Methodology in 1984, from $1.5 million at the end of 1984 to $32.3 million at the end of 1987. Like Avista, IPC executed a Suspension Agreement. Finally, IPC has disputed the validity and the calculation of its deemer balance. BPA appreciates the parties' concerns that BPA may be setting a precedent, given the similarities between Avista and IPC; however, BPA considers the legal risk associated with each utility's claims on a case-by-case basis and will not speculate whether BPA would consider settlement of IPC's deemer balance on the same or similar terms.

Even assuming for the sake of argument that BPA decides it is reasonable to settle with IPC, it does not follow that the proposed Settlement will in some way establish an immovable precedent that restricts BPA's ability to negotiate reasonable terms with IPC. The similarities between the two cases do not, in BPA's view, mean perforce that IPC and BPA will reach the exact same settlement, if any at all. Unlike Avista's case, BPA has not conducted an in-depth review of the relevant factual and legal background that created IPC's current disputed deemer balance. BPA would have to review this information and discuss this matter further with IPC before considering any such settlement. BPA would also commence a public process to receive public input as well. Whether as a result of such negotiations and comments the same or similar settlement would be reached cannot be determined at this point. BPA, of course, is not foreclosing the possibility that BPA and IPC could reach a similar result. However, whatever the

outcome, any settlement would be the product of the specific factual, legal, and equitable circumstances of IPC's deemer balance, and not simply because it is the "same deal" that BPA offered Avista. Because BPA has not done the requisite analysis, it is too early to tell whether the proposed Settlement would have any import for a settlement with IPC.

Decision

The proposed Settlement properly balances the factual, legal, and equitable grounds surrounding Avista's deemer dispute. Whether a similar settlement would be appropriate for IPC's deemer balance cannot be determined at this time.

Issue 9

Whether BPA should use the GDP Price Deflator as the rate of inflation when escalating Avista's deemer balance from 1987 through 2001.

Parties' Positions

Avista states that the use of the GDP deflator is appropriate. (Avista, ADS090010, at 6.)

BPA Staff's Position

BPA believes that the GDP deflator is an appropriate mechanism for escalating the 1987 value of Avista's deemer balance to FY 2002 dollars.

Evaluation of Positions

Avista states that in the overview of the proposed Settlement issued on January 28, 2009, BPA stated that:

> [w]hen BPA and Avista entered into an REP suspension agreement in 1987, Avista's deemer balance stood at $39.3 million. Instead of applying the prime rate to the $39.3 million deemer balance established in the 1987 suspension agreement to arrive at the beginning of FY 2002 deemer balance, BPA escalated the $39.3 million using the consumer price index. The result is an outstanding balance of $55 million at the beginning of FY 2002.

(Avista, ADS090010, at 6.)

BPA's statement that it used the Consumer Price Index ("CPI") to escalate the $39.3 million was incorrect. (*Id*.) Avista goes on to state that, in fact, BPA used the GDP deflator to escalate the $39.3 million and not the CPI, and that BPA corrected this misstatement by pointing out in a public meeting held on the proposed Settlement on February 11, 2009, that it had in fact used the GDP deflator. (*Id*.) BPA concurs with Avista's description of the overview of the proposed Settlement and of the February 11, 2009, public meeting.

Avista contends that the use of the GDP deflator is an appropriate compromise of the dispute regarding the calculation and interest rate to be applied to the deemer balance. (*Id.*) In Avista's view, what is important in this matter is that BPA and Avista agreed to base a settlement on the suspension balance of $39.3 million and agreed to escalate the balance by inflation instead of the prime rate. (*Id*.) Avista also states that the parties agreed that the settlement balance, inflated from the suspension balance, would be $55 million and that the use of the GDP deflator produced the proposed Settlement balance of $55 million. (*Id.*) BPA agrees with Avista that the proposed Settlement balance of $55 million was derived by inflating the Suspension Agreement balance using the GDP Deflator.

Avista also notes that because the proposed Settlement is a compromise of issues and risks, the parties could have agreed to a range of treatments of the suspension balance, ranging from no escalation at all to the use of CPI or some other inflator. (*Id.*) Avista states it did not agree to a particular interest rate in 1993 when it terminated the 1981 RPSA and contended that no interest should have accrued during the period that the deemer balance was held in abeyance. (*Id.*) Avista concludes that use of the GDP deflator to escalate Avista's deemer balance is consistent with the compromise reflected in the proposed Settlement and strikes a balance that recognizes both the time value of money and Avista's disputes regarding the accrual of interest and the calculation of the deemer balance. (*Id.*)

BPA acknowledges that the focus of the deemer dispute negotiations between BPA and Avista was determining a settlement amount that was based on the $39.3 million Suspension Agreement and included an upward adjustment for inflation from FY 1993 through FY 2002. BPA also acknowledges that the parties agreed to a proposed settlement whereby Avista's beginning FY 2002 deemer balance would be set to $55 million. BPA agrees that the Settlement reflects a compromise between parties based on a number of complex issues and risks that are difficult to assess. As Avista correctly notes, different escalators could reasonably be used in arriving at a settlement number that parties find acceptable. Both the GDP deflator and the CPI are recognized measures of inflation and both measures, among others, are commonly used for inflation adjustments.

Although BPA believed it was using the CPI in arriving at the $55 million amount, BPA was in fact using the GDP deflator. BPA referenced use of the CPI as the means to inflate the $39.3 million starting balance to a FY 2002 balance during the negotiation sessions where the parties agreed to the $55 million amount. Based on the negotiations between Avista and BPA that resulted in the $55 million amount and the comments received regarding the proposed Avista Deemer Settlement, BPA does not find a compelling reason to replace the $55 million settlement amount with a higher amount that would result from use of the CPI.

Decision

BPA will use the GDP Price Deflator as the rate of inflation when escalating Avista's deemer balance from 1987 through 2001, leaving the proposed $55 million beginning FY 2002 settlement deemer balance unchanged.

V. ENVIRONMENTAL CONSIDERATIONS

BPA has evaluated the potential for environmental effects related to the proposed Deemer Account Settlement Agreement with Avista Corporation, consistent with the National Environmental Policy Act (NEPA). 42 U.S.C. § 4321 *et seq*. The proposed Settlement is intended to resolve long-standing disputes regarding the amount of Avista's deemer account balance through the establishment of a substantive account balance effective in 1987 and adjustment for inflation as measured by the GDP Deflator through 2001. These actions are administrative and financial in nature and accordingly would not be expected to result in environmental effects. In addition, it is expected that there would be no substantial change in consumer or utility behavior because there would be no resource or transmission development that would result from implementation of the Agreement. Under the Agreement, Avista would continue to participate in the REP under its existing RPSA. Because the Agreement provides value to the region and removes uncertainty concerning Avista's deemer account, the Agreement is consistent with the Market-Driven approach contained in BPA's Business Plan Environmental Impact Statement (DOE/EIS-0183, June 1995), and adopted by BPA in its Business Plan ROD (August 15, 1995).

VI. CONCLUSION

Based upon the foregoing discussion, the record compiled in this proceeding, and all requirements of law, I hereby determine that BPA should execute the Deemer Account Settlement Agreement with Avista Corporation.

Issued at Portland, Oregon, on this 22nd day of June, 2009.

UNITED STATES OF AMERICA
Department of Energy
Bonneville Power Administration

By _*/s/ Stephen J. Wright*_____

Name Stephen J. Wright_____

Title Administrator and CEO_____