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

FY 2012-2013 Power Rate Adjustment Proceeding	))	**BPA File No: BP-12**

Prehearing Statement of Legal Counsel of the Public Power Council

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January 21, 2011

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I. Introduction

The Public Power Council ("PPC") files this Statement of Legal Counsel pursuant to Bonneville Power Administration's ("BPA") *Rules of Procedure Governing Rate Hearings*, § 1010.13(a)-(b), 51 Fed. Reg. 7611 (1985) ("Rules of Procedure") and the schedule adopted by BPA in this proceeding. The sole purpose of this Statement of Legal Counsel is to provide certain legal conclusions that support the testimony submitted by PPC as part of its direct case. This Statement of Legal Counsel shall be separate and distinct from the initial legal brief that PPC will file later in this proceeding. PPC reserves for its initial brief a more detailed examination of the legal, factual and policy issues that it wishes the Administrator to resolve.

II. PPC Testimony to Which this Prehearing Brief Relates

This Statement of Legal Counsel supports the testimony of PPC witnesses Nancy Baker, Linda Finley, Kevin O'Meara, and Kayce Spear marked BP-12-E-PP-01. This PPC testimony regards BPA's Initial Proposal for determining the amount of Generation Inputs that Transmission Services will obtain from Power Services and the price for those Generation Inputs. Specifically, a portion of the PPC testimony is based on the

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following legal conclusions: First, the preference right enjoyed by BPA's preference customers attaches to "power," which includes both energy and capacity. Second, section 7(b)(1) of the Pacific Northwest Power Planning and Conservation Act ("Northwest Power Act") provides that, so long as Federal power is available to serve the general requirements of the preference customers, BPA may not allocate to its preference customers the costs of acquiring non-Federal power.[1] The foundation for these two legal conclusions is described below.

III. Issues to Be Addressed at Hearing

A. Generation Inputs Pricing

BP-12-E-PP-01 demonstrates that BPA has, or will within the next rate period, exhaust the Federal Columbia River Power System's ("FCRPS") ability to supply balancing reserves and other capacity products in sufficient amounts to satisfy the forecasted needs of both the general requirements of preference customers and the requests of non-Federal generators. As a result, BPA's preference customers will be in competition with non-Federal generators for the capacity of the FCRPS. Applicable statutory provisions

[1] 16 USC § 839e(b)(1).

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require that these competing demands must be reconciled in favor of the preference customers.

1. The Preference Laws Apply to All FCRPS Power, Which Includes Both Energy and Capacity

Public body and cooperative utilities in the Northwest have statutory preference to the federal "power" marketed by BPA. This preference was created, reaffirmed, and is further secured by the Bonneville Project Act,[2] the Northwest Power Act,[3] and the Flood Control Act of 1944.[4] These laws leave no doubt that the statutory preference to "power" includes both capacity and energy. The Northwest Power Act, for example, establishes a preference with respect to "[a]ll power sales" made by BPA,[5] and

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[2] "[T]he administrator shall at all times, in disposing of electric energy at said project, give preference and priority to public bodies and cooperatives." 16 U.S.C. § 832c(a).

[3] "All power sales under this chapter shall be subject at all times to the preference and priority provisions of the Bonneville Project Act of 1937." 16 U.S.C. § 839c(a).

[4] "Preference in the sale of such power and energy shall be given to public bodies and cooperatives." 16 U.S.C. § 825s.

[5] 16 U.S.C. § 839c(a). Preference under the Bonneville Project Act was preserved in the Northwest Power Act. 16 U.S.C. §§ 839c(a) and 839c(b)(2). Congress intended that preference customers would have the same priority over sales to other customers as they had under the Bonneville Project Act. House Rept. 96-976, Part II, Committee on Interior and Insular Affairs, p. 46; House Rept. 96-976, Part I, Committee on Interstate and Foreign Commerce, p. 34; Senate Report No. 96-272, Committee on Energy and Natural Resources, p. 26 (no inconsistencies between provisions of NWPA and preference clause).

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specifically defines "electric power" to include "electric peaking capacity, or electric energy, or both."[6]

BPA agrees with this basic proposition. For example, BPA states in its Generation Inputs Policy testimony that:

> BPA Staff believes that the preference and priority provisions under a number of BPA statutes provide the first right to use the resources of the FCRPS to BPA's public customers for load service and the provision of balancing reserve capacity.[7]

BPA is correct that the preference provisions apply to "power," which expressly includes capacity as well as energy.

2. The Consequences of Public Bodies' Capacity Preference Rights

But what does it mean for preference customers to have a statutory preference right to capacity? Stated simply, it means that whenever preference customers and non-Federal generators make competing requests for the power of the FCRPS, BPA is required by law to use or preserve that power for the benefit of the general requirements of its preference customers. This means that BPA may not allocate power, whether by contract or otherwise, in a way that would give competing non-Federal

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[6] 16 U.S.C. § 839a(9). *See also* Flood Control Act of 1944, 16 U.S.C. § 825s (ensuring preference to "electric energy and power"). The PPC is aware of no case that has ever held that preference applies to anything other than the entire output and capability of the federal power system.

[7] BP 12-E-BPA-23, p. 28 ln 22, - p. 29, ln 3.

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generators access to FCRPS power before it is made available to preference customers.

PPC is concerned that the BPA staff proposal regarding the use of FCRPS power to meet competing demands for system capacity, although generally correct, may be misinterpreted in an manner that is contrary to applicable preference laws. Specifically, BPA's testimony states:

> As the need to use the FCRPS to provide load service increases under BPA's requirements power sales contracts, BPA will reduce, if necessary, the balancing reserve capacity provided by the FCRPS and replace that balancing reserve capacity with non-Federal sources of balancing reserve capacity.[8]

PPC believes that BPA's statement, when properly interpreted, is accurate. PPC's concern, however, is that this statement might be misunderstood or misquoted so as to imply that non-Federal generators have a *de facto* preference right, or are on the same footing as preference customers, with respect to any FCRPS power resources.

The forgoing statement would be more precise if it were to read as follows:

> As the need to use the FCRPS to **[satisfy the general requirements of preference customers]** increases under BPA's requirements power sales contracts **or otherwise**, BPA

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[8] *Id.*

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> will reduce, if necessary, the balancing reserve capacity provided **to non-Federal generators** by the FCRPS and replace that balancing reserve capacity **provided to such non-Federal generators** with non-Federal sources of balancing reserve capacity.

Restating this proposition in this manner clarifies that BPA does not intend to reduce the FCRPS power used and needed by BPA's preference customers to meet their general requirements while continuing to provide FCRPS power to competing non-Federal generators. PPC believes that this was the intent of BPA's testimony and, for the reasons stated below, this outcome is compelled as a matter of law.

a. Treatment of Competing Requests

Where there are "conflicting or competing" applications for electric power (including energy and capacity), preference customers must be given priority over other would-be consumers of that power.[9] Although preference may not apply to electric power sales specifically directed by statute, such as the initial sales to Direct-Service Industrial ("DSI") customers, it does apply

[9] *Aluminum Co. of Am. v. Bonneville Power Admin.*, 467 U.S. 380, 384, 393 (1984).

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whenever the Administrator allocates electric power through the exercise of discretion.[10]

As applied in this context, all of BPA's preference customers have signed power supply contracts that obligate BPA to meet their net requirements under §5(b) of the Northwest Power Act.[11] Many preference customers also purchase FCRPS power from BPA in the form of ancillary and control area services, such as Regulation and Frequency Response service, Operating Reserves, Variable Energy Resource Balancing Service, Dispatchable Energy Resource Balancing Service, and Energy and Generation Imbalance services.

Non-preference customers, specifically including non-Federal generators, may also use any *available* FCRPS power by purchasing and paying for analogous ancillary and control area services. Any time BPA receives a request for such FCRPS power from a non-Federal generator that competes or conflicts with the general requirements of BPA's preference

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[10] *See Alcoa v. Cent. Lincoln Util. Dist.*, 467 U.S. 380, 393 (1984) (explaining that preference applies to power that the Administrator allocates administratively, as opposed to power allocated by statute).

[11] 16 U.S.C. § 839c(b). The "net requirements" of preference customers is the difference between their firm loads and the non-federal peaking and energy resources committed to meeting their loads.

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customers, however, the statutory preference provisions direct BPA to fulfill preference customers' general requirements first.[12]

b. BPA Must Reserve Power for Preference Customers' Reasonably Anticipated Future Load Service Needs

The applicable preference provisions also require that BPA reserve FCRPS power to meet the foreseeable general requirements of its preference customers.[13] BPA may not deprive its preference customers of FCRPS power that will be needed to serve their general requirements by making discretionary forward sales to non-Federal generators. PPC's testimony demonstrates that it is now reasonably foreseeable that providing unconstrained balancing services or other integration services to non-Federal generators will consume FCRPS power resources that will be needed to meet the forecasted general requirements of its preference customers.[14] BPA must therefore take whatever steps are necessary and appropriate to reserve

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[12] *See, e.g.*, 16 U.S.C. §§ 832c(a) and 839c(a), both of which require preference to apply "*at all times*" (emphasis added).

[13] *See, e.g.*, 16 U.S.C. § 832d(a), which requires BPA to cancel contracts with non-preference customers on five years' notice if "any part of the electric energy purchased under such contract is likely to be needed to satisfy the requirements" of preference customers, and further provides that "such cancellation may be with respect to all or any part of the electric energy so purchased under said [non-preference] contract to the end that the preferential rights and priorities accorded public bodies and cooperatives under this chapter shall at all times be preserved."

[14] BP-12-E-PP-01

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sufficient FCRPS power so as to be able to continue to meet the general requirements of its preference customers.[15]

Even existing non-Federal uses of FCRPS power cannot displace or subordinate subsequent preference requests. Should FCRPS power resources—including the capacity products associated with such resources—previously allocated to non-Federal generators be required by preference customers in order to meet their general requirements, BPA must withdraw that FCRPS power from any non-preference uses.[16]

c. The Preference Laws Prohibits BPA from Granting Access to FCRPS Power to Non-Preference Customers Before It Is Made Available to Preference Customers.

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[15] As stated in the legislative history:

> The original Bonneville Project Act, like other Federal power marketing laws, contains a "preference clause." This clause requires that BPA, although statutorily authorized to sell power to all types of customers, must give first right and priority to that power to "public bodies and cooperatives." "Public bodies" are defined to include "States, public power districts, counties, and municipalities, including agencies or subdivisions of any thereof." If a shortage of power is *contemplated*, BPA's other customers must do without, in order that "public bodies and cooperatives" continue to receive the Federal power to which they are entitled. House Rept. 96-976, Part II, Committee on Interior and Insular Affairs, p. 27 (emphasis added).

[16] The Northwest Power Act replicates the reservation requirements contained in the Bonneville Project Act and the Regional Preference Act by requiring the Administrator to include in power contracts offered under §5 the ability to restrict power deliveries if the Administrator cannot be assured of acquiring sufficient resources to meet his load service obligations. These provisions preserve the full capability of the federal power system resources for preference customer load service even during a shortage. 16 U.S.C. §839c(b)(5) and (6). These provisions also show that Congress intended that preference have applicability even after BPA obtained the broad resource acquisition authority under the Northwest Power Act, such that preference customers retained their rights of first access to BPA's low-cost resources.

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The applicable statutory preference provisions also require BPA to ensure that the discretionary contracts through which it might allocate any FCRPS power to non-Federal generators adequately protect preference customers' rights to purchase such power to meet their general requirements.

In *Cen. Lincoln Util. Dist. v. BPA*,[17] for example, the Ninth Circuit held that contracts offered to DSIs violated the Northwest Power Act's preference clause by offering a portion of its non-firm FCRPS energy to the DSIs *before* offering it to the preference customers.[18] The Court found that BPA's agreement was counter to "the longstanding preference given to public bodies in the sale of federal power."[19] The Court did not demand that preference customers demonstrate that an actual shortage had occurred. Instead, the Court found that BPA had violated preference by agreeing to a disposition of FCRPS power in the wrong order, *i.e.* an order that conflicted with the priority accorded preference customers in the event of a shortage.[20]

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[17] 686 F.2d 708 (9th Cir. 1982).

[18] *Id*. at 710.

[19] *Id*. at 715.

[20] Although the Ninth Circuit's opinion in *Cen. Lincoln* was ultimately reversed by the Supreme Court, this reversal was not on the grounds that the preference clause does not require an "ordering" of power allocations first to preference customers. Rather, the Supreme Court held that the original DSI contracts under the Northwest Power Act were statutorily *mandated*, and thus not subject to preference. In other words, the Supreme Court held that preference would apply only if the allocation to the DSIs had been done "administratively." Nothing in the Supreme Court's opinion found that the

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d. Transmission Service to Non-Federal Generators Does Not Trump Preference Rights.

i. Historical Accounting Practices Do Not Support an Exception to Preference Provisions

BPA has made discretionary sales of FCRPS power to integrate non-Federal intermittent resources onto the BPA transmission system. Historically, the FCRPS produced sufficient power to meet competing demands. As a result, BPA did not need to account for the uses of FCRPS power to balance preference loads and generation on the system. Adhering to this practice in the face of competing demands for FCRPS power would, however, have the effect of reducing preference rights to whatever portion of the FCRPS power remains after the capacity needed to integrate non-Federal generators has been deducted. Such an "off-the-top" approach might be appropriate with respect to capacity needed to integrate *federal* projects into BPA's transmission system.[21] But the law does not support granting such

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Ninth Circuit erred by interpreting preference as prohibiting an allocation of power to a non-preference entity ahead of a preference customer.

[21] Federal statutes authorizing the construction and operation of hydroelectric projects on the Columbia River expressly provide that the operating entity is to obtain the power needed for the operation of the particular project before making the remaining power available to BPA, and thereby reducing the amount of power available for BPA to market. *See*, 16 U.S.C. §§832, 832a; 838f. These statutory provisions cannot reasonably be read to require a comparable deduction of capacity needed to integrate non-federal intermittent resources onto the federal transmission system. Indeed, the very fact that BPA elects to treat the transmission system integration needs as off-the-top obligations (and charges BPA Transmission for this discretionary sale of capacity) confirms that this allocation of federal power

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"priority" access to FCRPS power for integrating *non-Federal* projects over service to preference customer loads.

ii. BPA's Other Obligations Do Not Override Statutory Preference Rights

BPA has no statutory obligation to provide ancillary and control area services, such as balancing services, to non-Federal generators.[22] BPA's practice of providing such services to non-Federal generators stems from a discretionary decision to comply with FERC's *pro forma* Open Access Transmission Tariff ("OATT"). Accordingly, any resulting allocation of FCRPS power to integrate non-Federal generators is an exercise of administrative discretion. As stated above, Congress has directed BPA to comply with the statutory preference provisions first, before making any discretionary sales or uses of FCRPS power.[23]

3. Section 7(b)(1) Of the Northwest Power Act

Not only do the applicable statutes grant preference customers priority access to FCRPS power as needed to meet their reasonably forecasted general requirements, they also include rate protections to ensure, among

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system capacity to BPA Transmission is an administrative allocation outside the ambit of express statutory directives.

[22] *See, e.g.,* FERC Order 2003-A at ¶ 517 (explaining that a customer obtaining interconnection service from a transmission provider "must arrange separately for delivery service").

[23] *Alcoa v. Cent. Lincoln Util. Dist*., 467 U.S. at 393.

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other things, that the rates paid by preference customers are not being used to subsidize non-Federal generators. Under section 7(b)(1) of the Northwest Power Act, for example, rates "for electric power sold to meet the general requirements of [preference customers] * * * shall recover the costs of that portion of the Federal base system resources needed to supply such load until such sales exceed the Federal base system resources."[24]

On its face, section 7(b)(1) provides that any FCRPS power sold to preference customers (on a priority basis) shall be priced at the melded cost of the FCRPS power resources used to serve such preference customers. The only circumstance in which section 7(b)(1) permits BPA to charge its preference customers for the costs of acquiring additional power is when BPA's sales of FCRPS power to meet the general requirements of the preference customers exceed the FCRPS resources.

The Ninth Circuit has expressly interpreted section 7(b)(1) as precluding BPA from charging preference customers for the costs of acquiring additional, non-Federal power resources that may be needed to serve non-preference customers—including non-Federal generators. In

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[24] 16 USC § 839e(b)(1).

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Golden Northwest Aluminum, Inc. v. BPA,[25] the Court interpreted BPA's obligations under section 7(b)(1) as follows: "[I]f FBS resources, including replacement resources, are not sufficient to satisfy BPA's contractual obligations to its non-preference customers, **BPA may not allocate to its preference customers the costs of acquiring non-FBS power**." (Emphasis added).

The *Golden Northwest* Court further explained that BPA may charge preference customers for "replacement resources" needed when FCRPS power is insufficient to meet the general requirements of its preference customers and the needs of other customers that have a right under the Northwest Power Act to purchase FCRPS power.[26] Specifically, the Court defined "replacement resources" so as to include power acquired by BPA to serve certain DSI contracts.[27]

Such "replacement resources" do not include, however, non-Federal power resources acquired by BPA to serve discretionary allocations of power that are not mandated by the Northwest Power Act. As explained

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[25] 501 F.3d 1037, 1047 (2007).

[26] *Id.*

[27] *Id. See also Cen. Lincoln Util. Dist. v. BPA*, 467 U.S. at 393 (describing the initial statutory right of DSIs to Federal power under the Northwest Power Act). Nothing in this Statement of Legal Counsel is intended to admit or imply that the DSIs have an ongoing statutory right to acquire FCRPS power.

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above, BPA is under no statutory or regulatory mandate to provide FCRPS power to non-Federal generators, and any available FCRPS power allocated to such non-Federal generators is done on a discretionary basis. Thus, any additional power acquired by BPA to serve non-Federal generators is not "replacement power," it is "non-Federal power." The Ninth Circuit could not be any clearer in stating that the costs of acquiring such non-Federal power may not be allocated to BPA's preference customers.[28]

This is not to suggest that section 7(b)(1) precludes BPA from acquiring non-Federal power resources in support of a discretionary policy decision to integrate non-Federal generation. What section 7(b)(1) does require, however, is that the costs of such non-Federal power resources acquired for the benefit of non-Federal generators must be paid by the benefiting non-Federal generators and may not be allocated to preference customers, whether directly or indirectly.

4. Conclusion

The PPC has submitted testimony regarding BPA's Initial Proposal for determining the amount of Generation Inputs that Transmission Services will obtain from Power Services and the price for those Generation Inputs.

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[28] *Golden Northwest Aluminum, Inc. v. BPA*, 501 F.3d at 1047.

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Certain aspects of this testimony presume legal conclusions that are expressed in this Statement of Legal Counsel. The foundation for these legal conclusions is that, when taken together, the applicable statutory preference and rate provisions require BPA to provide preference customers with sufficient FCRPS power, including both energy and capacity, as needed to meet their general requirements. BPA may not use FCRPS power for any other competing purpose to the detriment or expense of its preference customers. Furthermore, the rates charged by BPA for such preference power must reflect the costs of the FCRPS power resources, and may not include costs incurred by BPA to acquire non-Federal power resources.

Dated: January 21, 2011

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CERTIFICATE OF SERVICE

I hereby certify that on January 21, 2011, I served via efiling with the Bonneville Power Administration the PREHEARING STATEMENT OF LEGAL COUNSEL OF PUBLIC POWER COUNCIL upon each person designated on the official service list compiled by BPA in Docket BP-12.

DATED this 21st day of January 2011.

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