

**To:** Congressional Budget Office  
**From:** Northwest Senate Delegation Offices  
**Re:** OMB proposal to increase electric rates of Bonneville Power Administration  
**Date:** March 1, 2006

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**Summary:** The Administration in its Fiscal Year 2007 budget has proposed that the Bonneville Power Administration (BPA) redirect any net secondary revenues exceeding \$500 million annually from its power rate base to the U.S. Treasury. The Administration estimates that this budget proposal reflects \$924 million in revenue for the U.S. Treasury in the next 10 years. The Administration also asserts that this budget proposal can be accomplished administratively through a BPA power rate case.

We disagree with the Administration's assertion that this budget proposal can be implemented administratively and assert that for the following reasons, this budget proposal – which requires a change in the manner in which BPA sets rates - must be authorized by law. Additionally, this budget proposal faces uncertain regulatory approval by the Federal Energy Regulatory Commission (FERC), a quasi-judicial independent agency subject to its own laws and precedents.

Any attempt to administratively implement this budget proposal will be subject to significant delay due to legal challenges by BPA's power customers. BPA customers may also challenge this budget proposal through the FERC's regulatory process, adding to the delay in implementation.

Finally, this budget proposal will not represent receipts to the U.S. Treasury in Fiscal Year 2007 (FY07). Additionally, the revenue assigned to this budget proposal is based upon outdated estimates of West Coast oil and natural gas markets, and therefore, can only be characterized as speculative.

**I. This budget proposal must be authorized by law.**

The Administration's budget proposal attempts to modify decades of law governing the manner in which the BPA Administrator establishes power rates. BPA's authority to set rates is provided for in several federal statutes including the Bonneville Project Act of 1937, the Flood Control Act of 1944, the Federal Columbia River Transmission System Act of 1974 (Transmission System Act), and the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (Northwest Power Act).

These statutes direct that the BPA Administrator “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 (emphasis added). Equally important is the direction that BPA rates “shall be drawn having regard to the recovery . . . of the cost of producing and transmitting such electric energy, including *the amortization of the capital investment over a reasonable period of years.*” 16 U.S.C 832f (emphasis added). The Transmission System Act of 1974 and the

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Northwest Power Act reaffirm the congressional direction to “set the lowest possible rates consistent with sound business principles” and to include in rates “amortization of the capital investment over a reasonable period of years.”

Congress intended that the BPA rates reflect the fact that the projects are multi-purpose and that power is a low-cost by-product of these multi-purpose projects. The U.S. Treasury was to be repaid over a "reasonable period of years." BPA has consistently interpreted this congressional direction to mean repayment occurs over the period that Congress specified in an appropriations bill or in the term for the bonds used to finance the project. Combined with the "lowest possible rates consistent with sound business principles" standard, this means that the rates should be no lower, nor higher than necessary to repay the rates in the period specified. The "sound business principles" standard means repayment on the scheduled repayment date, and does not mean prepayment of long-term debt. Otherwise the "lowest possible" portion of the equation would be violated. Using a home mortgage as an example, the payments can only be lowest possible if they are match the actual period of the mortgage. Prepayment of the mortgage may result in earlier retirement of the mortgage--but it doesn't result in the lowest payments.

BPA has consistently interpreted its statutory direction in manner that is inconsistent with this budget proposal. As such, this budget proposal represents a *de facto* change in BPA’s organic statutes and repayment procedures. Agencies are entitled to deference when they interpret statutes initially. The ability to change well settled agency interpretations without a change in the underlying statutes, however, is disfavored by the courts. (The U.S. Supreme Court recently reaffirmed this legal precedent in *Gonzales v. Oregon* on a 6-3 vote [Docket No. 04-623]). In a 1983 letter and accompanying memorandum of law between Energy Secretary Hodel and OMB Director Stockman, Hodel summarized an interpretation and agreement between the two offices: “. . . it is our belief that *Congress would have to approve any shortening of the amortization period on existing projects.*” (Emphasis added)

In this instance, Congress has not acted to effect a modification of BPA’s organic statutes and no deference is due the BPA Administrator’s attempt to implement this budget proposal administratively. Legislation is necessary to authorize the change in the manner in which BPA establishes its power rates.

## **II. Administrative implementation of this proposal will be subject to significant delay.**

The budget proposal would represent an increase in the level of BPA’s power rates. BPA power customers would be able to challenge any attempt to implement this proposal administratively in federal court. Challenges to the BPA Administrator’s interpretation of statute or exercise of discretion are typically filed with the 9<sup>th</sup> Circuit Court of Appeals. 16 U.S.C. 839f(e)(5). On average, judicial review in the 9<sup>th</sup> Circuit Court of Appeals takes 2 years.

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Additionally, all BPA rates must be reviewed and finally approved by the Federal Energy Regulatory Commission (FERC). 16 U.S.C. 839e(a)(2). FERC reviews BPA's rates to ensure that the rates are sufficient to assure repayment of BPA's long-term debt over "a reasonable period of years after first meeting the Administrator's other costs, and are based upon the Administrator's total system costs. . ." 16 U.S.C. 839e(a)(2)(A) and (B). The FERC process itself is subject protest by BPA customers, which represents additional delay.

**III. The proposal does not represent revenue to the Treasury in FY 2007 and any estimated revenue in subsequent years is highly speculative.**

The budget proposal would not increase revenue for the U.S. Treasury in FY07. As proposed, BPA would impose a new rate on its customers, effective October 1, 2006. That new rate would redirect any net secondary revenue earned during FY07 that exceeds \$500 million to the U.S. Treasury. If BPA does in fact collect secondary revenue over \$500 million—a highly speculative proposition—it will not know this until late in FY'07. According to current BPA rate setting methodology, that net secondary revenue does not impact power rates until the following fiscal year, when BPA would adjust its annual power rate to reflect any secondary revenue earned in the preceding fiscal year. In other words, BPA would not transfer to Treasury any secondary revenue above \$500 million until October 1, 2008.

Additionally, the Administration's budget estimates that this proposal will increase revenue to the U.S. Treasury by \$924 million over the next ten years. This cumulative estimate and the annual estimates included in the Administration's budget proposal are based upon speculative West Coast energy markets. In order to determine when and if BPA's secondary sales will result in revenue exceeding \$500 million, OMB presumably needed to look at forecast of natural gas and oil prices on the West Coast. BPA sells its secondary power (or surplus power, meaning electric power marketed by BPA that is not needed to meet the needs of statutory customers) on the market, consistent with statutory direction. This means that if West Coast energy markets are high, BPA will receive a higher price for its secondary power. If West Coast energy markets are low, BPA will earn less in secondary revenue.

We find it highly unlikely that implementation of OMB's proposal would result in \$924 million in additional revenues for the U.S. Treasury over the next ten years. BPA has only exceeded \$500 million in net secondary revenues one time in its history. Nevertheless, OMB has estimated that BPA will collect net secondary revenue of \$668 million in FY07, \$588 million in FY08, and \$580 million annually for the next 8 years. The assumptions included in the energy price forecasts on which OMB has based these projections have not been disclosed. However, it is worth noting that natural gas prices in U.S. markets have tumbled 28 percent in the past month, falling to a new one-year low of \$6.714/btu on Tuesday, February 28. A report due this Thursday from the federal Energy Information Administration is also expected to reflect ample U.S. natural gas supplies. As such, any presumed revenues from implementation of OMB's proposal can only be characterized as highly speculative.

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