



July 30, 2004

**Via Electronic and U.S. Mail**

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Dear Paul,

Based on the information presented at the recent SN CRAC meeting, PPC reaffirms its opposition to any SN CRAC for FY 2005. In particular, we oppose BPA charging rates higher than necessary next year in the interest of “rate stability”. While we realize that the financial information presented at the meeting is preliminary, the case for eliminating the SN CRAC is strong and is unlikely to be altered by updated financial data that will be presented at the formal SN CRAC workshop in August.

The experiment with flexible rates over the last few years has not been a happy one, either for BPA or for its customers. When PPC supported the concept of multiple CRACs, we did not envision the incentive that the CRACs would give BPA to accelerate its internal costs.

Nor did we envision the more profound problem that providing BPA with flexible rates, tied to BPA’s costs and financial condition, would hamstring BPA’s ability to negotiate with external entities that control some aspects of BPA’s costs. No matter what explanations BPA provides to outsiders regarding the volatility of its finances, as long as BPA has more than half a billion dollars in reserves and the ability to raise its rates on short notice, the agency will lack credibility in negotiating with outside entities.

We have a number of suggestions to solve this problem, ranging from shorter rate periods, to eliminating rate adjustment clauses (or at least tying them only to streamflows and market prices), to rethinking the whole concept of

Treasury Payment Probability (TPP) as a means of evaluating the agency's financial health. We will address these solutions in greater detail in our comments on BPA's long-term future.

In the short-term, we must mitigate the enormous damage done to the region by BPA's rate increases, and use every available method to reduce rates now.

### **BPA Posits A False Dichotomy Between Low Rates Now And Higher Rates Later**

In their presentation, BPA representatives said that there are two conflicting goals in the SN CRAC rate case – having a significant reduction in rates now, and keeping rates “stable”. The clear implication is that large reductions in the SN CRAC (for example, reducing it to zero) would be undesirable. For in that event, a risk would arise of having higher rates the following year, and therefore BPA ought to equalize forecasted rates over the 2-year period, rather than reduce rates as far as is feasible this year. While we will discuss in the next section of these comments why BPA's general financial assumptions are unduly pessimistic, we now look briefly at whether establishing “stable” rates on a forecasted basis is a good thing, as opposed to implementing the lowest possible rate now.

BPA's analysis assumed that BPA's costs are fixed, and independent of its financial condition. As noted, this is not the case – the higher the level of BPA reserves, and the better BPA's financial condition, the greater the external pressures to increase BPA's costs. If BPA imposes higher than necessary rates now, we may still find ourselves without “rate stability” – suffering from high rates next year, and even higher rates the following year, due to increases in BPA costs.

Keeping rates high in the pursuit of “rate stability” has another downside. The biggest problem created by the persistence of the CRACs and high rates is the growth of the belief, without and, to a limited extent, within BPA, that the existing “energy crisis” rate in the low to mid-thirties is the “natural” long-term base rate, and it is perfectly acceptable to continue charging at such a level after 2006. BPA will suffer a loss of political support from its customers if it becomes apparent that this is indeed BPA's long-run rates policy. Eliminating the SN CRAC sends a signal to customers that BPA is intent on reducing its rates as much as possible, not on maintaining in perpetuity the extremely high “stable rates” associated with the energy crisis.

Naturally, there is a risk of below-normal water conditions in FY05, and BPA cites the risk of poor nonfirm revenues as a reason for limiting the size of any

rate decrease. BPA notes that it overforecast nonfirm revenues in FY02 in the aftermath of the energy crisis, and that the highest rate of nonfirm revenues it has observed is \$530 million. (The year that BPA realized \$530 million was FY03 – a year with streamflows 83% of normal – thus poor water conditions *per se* do not prevent BPA from achieving high levels of nonfirm revenues.) If FY05 turns out to be a poor water year, with nonfirm revenues significantly lower than expected, it will likely be necessary to revisit BPA’s overall cost structure and staffing levels. BPA should not be collecting revenues over and above its already high rates in anticipation of a drought.

### **BPA’s Apparent Goal Of “Rate Stability” Is Not Aggressive Enough – BPA Should Not Have A SN CRAC**

According to the GRSPs,

The Administrator may elect at his discretion, to reduce the SN CRAC rate adjustment. If the Administrator so elects, BPA will recalibrate the caps for the SN CRAC and the thresholds for the FB CRAC and SN CRAC for the later years to maintain the equivalent of the three-year TPP of 80 percent.

(BPA's 2002 GRSPs for Power Rates, Revised FY03, p. 129-130).

BPA suggests (based on current numbers that will be updated before the August workshop) that without altering the current SN CRAC thresholds, BPA will collect a further \$288 million in FB and SN CRAC revenues in FY05 – \$96 million from the FB CRAC, and \$192 million from the SN CRAC. BPA has further declared that this implies an 11.2% FB CRAC and a 17.5% SN CRAC in FY05.

An SN CRAC of this amount will produce FY05 PBL *modified net* revenues of \$207 million and a 1-year TPP of 99% – translating to a 2-year TPP of 93.5%, well above the 2-year TPP of 86.2% that corresponds to a 3-year 80% TPP. This reflects neither an additional \$11 million in Sounding Board expense reductions and revenue enhancements, nor BPA’s forecast of increased secondary revenues due to higher anticipated market prices (potentially totaling between \$103 and \$196 million in additional revenues, \$150 million on average), nor a potential \$9 million increase in fish credits due to improved market prices.

Taking those adjustments into account, BPA’s modified net revenues would be about \$170 million better, or almost as much as the \$192 million that BPA intends to collect through the SN CRAC. What with the extremely high TPP that BPA forecasts in FY05, the Administrator should exercise his discretion to lower the SN CRAC to zero by using updated FY05-06 numbers reflecting the Sounding

Board and nonfirm revenue improvements. In doing so, BPA can still easily meet the TPP criterion specified in the GRSPs.

We thank BPA for presenting preliminary SN CRAC materials. In light of the relatively short turnaround between BPA's presenting information at the formal workshop and when BPA has to make a decision on the SN CRAC, it is most useful to look at some SN CRAC issues before the August workshop.

And, thank you for the opportunity to provide these comments.

Sincerely,

A handwritten signature in black ink, reading "C. Clark Leone". The signature is written in a cursive style with a large, looping "C" and "L".

C. Clark Leone  
Manager