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TO: Nancy Mittman, Chief Financial Officer, Bonneville Power Administration

FR: The Public Power Council

RE: Integrated Program Review 2

DATE: March 13, 2015

Introduction

We would like to thank BPA for initiating the IPR-2 process in response to customer and stakeholder requests. Given the potential rate increase faced by customers in FY 2016 and the long-term challenges to the agency, it is essential to take every opportunity for BPA and its customers to engage on revenue requirement and financial issues. We appreciate that BPA staff was responsive in bringing forth information regarding potential paths to move towards expensing of energy efficiency investments, and also in responding to most customer requests for information.

PPC continues to be deeply concerned regarding the level of the proposed increase to rates for the BP-16 rate period and the long-term trajectory of BPA rates. These comments address recommendations to reduce BPA's revenue requirement and options that BPA could use to expense some energy efficiency investments in the next rate period without incremental rate impacts if there is broad customer consensus to move in that direction at this time.

Overall, PPC believes BPA should not adopt a Tier 1 rate increase beyond the already onerous increase contained in the Initial Proposal. Adopting PPC's proposals below would reduce BPA's Power revenue requirement by approximately $35 million. This would potentially allow BPA to move approximately $25 million of energy efficiency investments to the expense category and address other potential rate pressures without increasing rates beyond the Initial Proposal level.

BPA should additionally consider measures to adjust its targets for conservation acquisition to more accurate and sustainable levels. This would reduce the burden of conservation acquisition on BPA finances regardless of the ultimate resolution of conservation financing in the upcoming rate period. Finally, BPA should continue to engage with customers to define the best long-term model for conservation acquisition by BPA and preference customers.

Overall Competitiveness of BPA Rates

This is a time of significant evolution and long-term uncertainty in the electrical business. Increasing penetration of intermittent resources on the Western electrical grid has had the effect of significantly altering the electrical power market, lowering both overall spot market prices, and changing the traditional diurnal patterns of electrical prices. Flat loads and distributed generation are also challenging the traditional assumptions underlying the business models of utilities.

Although the future is inherently uncertain, it seems likely that BPA is going to face increasing competitive pressures over time. BPA has begun to respond to this issue by discussing long term affordability, particularly in the context of its capital programs. Although preference customers hold take or pay contracts through FY 2028, serious efforts to address the long-term cost structure must be aggressive and immediate. Additional costs that BPA chooses to assume now may prove difficult to shed by 2028. If BPA rate increases continue to be unsustainably high and less competitive with power markets as the expiration date of the contracts approaches, it could have alarmingly detrimental impacts for the agency and the region's consumers.

Over the last several decades, although BPA has sometimes been over market, the agency has generally been well under market. PPC is concerned that the paradigm is changing. BPA is going to have to address the issue of costs more directly; having a high single-digit power rate increase every two years is unsustainable, particularly if the power prices in the broader wholesale market continue to decline.

In the longer term, BPA must take a harder look at its overall cost structure. What would the agency do if the power revenue requirement needed to be cut by $20 million, or by $60 million? What would it take to attain flat power rates? These are the type of questions and tradeoffs that must be addressed to achieve a sustainable trajectory of BPA costs over time.

Obviously, this is a conversation that needs to continue beyond the confines of IPR-2, but the serious engagement must start now. PPC appreciates that BPA staff have started work to consider the long-term cost structure and competitiveness. We look forward to

working with BPA on this challenging issue going forward. The question presented in the current proceedings is what steps can be taken today?

Immediate BP-16 Rates, Costs, and Finance Considerations

There are a number of immediate considerations that can be addressed in this IPR-2 process for the upcoming rate period.

Undistributed Reduction

BPA continues to propose an overly conservative estimate of the amount of undistributed reduction that it should be assuming on the power side. BPA should increase the undistributed reduction for Power Services to at least $30 million (a $10 million increase over BPA's current assumption). This can be accomplished by assuming 100% of the historical underspending for the FY 2010-2012 period for BPA direct costs and making a slightly more aggressive assumption regarding underspending on indirect costs (Corps, Bureau, Fish and Wildlife, CGS, etc).

Energy Efficiency

Regardless of whether steps are ultimately taken in this rate period to expense a portion of its energy efficiency acquisitions, BPA should adjust the size of its capital budget for conservation. This approach is broadly supported among public power and would have a number of benefits. These include increased borrowing authority, lower interest expense through time and greater consistency with the regional load growth and conservation potential situation while retaining the fundamental value and services of the current program.

First, BPA should re-evaluate its assumed target for energy efficiency investments in the BP-16 rate period. Public power has shown great capacity to achieve cost effective conservation. But, it is not appropriate to assume an ongoing upward trajectory based on the end of the official Sixth Power Plan targets. As shown on slide 6 of BPA's IPR-2 materials, actual savings over the FY 2010 through FY 2014 period averaged 119 aMW per year compared to targets of 101 aMW per year. However, actual savings in FY 2013 and FY 2014 were approximately 88 aMW per year. Given this trajectory, which reflects the staleness of Sixth Power Plan assumptions, the out-year targets of nearly 140 aMW for FY 2016-17 do not appear reasonable or realistic.

PPC supports the position that BPA should adopt conservation targets for the upcoming rate period based on the average level of the five years actually contained in the Sixth Power plan. This level of approximately 100 aMW per year provides a more sustainable and realistic level of potential savings to assume in rates for the FY 2016-17 period in the absence of the Seventh Power Plan.

Second, BPA should adjust its assumption that 25% of conservation acquisition spending will be self-funded by utilities. A suggestion was made that BPA should assume that 30% of conservation would be self-funded, which would reduce BPA's forecast energy efficiency spending by about $5 million a year. BPA acknowledged that public utilities had self-funded over 29% percent of energy efficiency expenditures over the last couple of years.

For purposes of determining the revenue requirement, BPA should assume at least a 29% self-funding level, as experienced over the last several years. Having more than a quarter of utilities participating in self-funding is a robust number, and under I-937 larger Washington utilities are obligated to capture all cost-effective conservation. We do not find merit in the concern raised during IPR2 that some large utilities have done conservation potential assessments that show less cost-effective conservation. This would imply that, even though utilities have done detailed analyses of the conservation potential in their service territories, they should be responsible for doing an amount of conservation in excess of the measured conservation potential.

Furthermore, public power significantly exceeded the energy efficiency targets established during the five-year portion of the Sixth Power Plan, by 56 aMW, and BPA has not proposed giving credit for that overachievement. Public power also exceeded its energy efficiency targets during the Fifth Power Plan, and BPA allowed a crediting of public power's Fifth Power Plan overachievements to the level of energy efficiency required in the Sixth Power Plan.

BPA should provide similar crediting to public power's achievement of energy efficiency in excess of targets, which would reduce BPA's revenue requirement for energy efficiency. While it is true that much of this expenditure is currently capitalized, reductions in capitalized energy efficiency expenditures would reduce BPA's need to expend capital to finance energy efficiency.

More generally, BPA has chosen an energy efficiency mechanism that maximizes the financial burden on BPA, even given the willingness of many utilities in public power to assume responsibility for doing their own energy efficiency (particularly given that larger Washington state utilities are under a legal requirement to capture cost-effective conservation, irrespective of what BPA does).

In the longer term, BPA should fundamentally reexamine its current model for achieving energy efficiency. PPC looks forward to working collaboratively with BPA and other stakeholders to find solutions that are in the best interest of BPA, preference customers, and the region as a whole.

Fish and Wildlife

The fish and wildlife program is a major driver of rates, but BPA did not consider any change to the fish and wildlife program. Approximately one-quarter of the direct fish and wildlife program is unrelated to the BiOp and fish accord obligations. Customers have regularly offered suggestions as to how some of this funding could be streamlined by eliminating outdated or redundant projects.

Secondary Revenue Forecast

BPA could reduce its power rate increase significantly by adopting PPC's recommendations in the rate case. PPC has advanced methodology refinements that would increase BPA's forecast of net secondary revenues in the rate case by $25.4 million.

Personnel Costs

Given the human resource management challenges faced by the agency over the last several years, PPC staff requested information regarding the potential for BPA personnel cost assumptions being overstated. Although BPA intends to fill open positions as quickly as possible, BPA provided information that personnel costs could be approximately $2.1 million below original IPR assumptions. BPA should reduce its revenue requirement by this amount.

The Effects of Reducing BPA's Revenue Requirement

Implementing the above adjustments to BPA's revenue requirement will have a number of benefits. First of all, a reduction in forecasted revenue requirement can be used to offset the additional 0.5% power rate increase that BPA is now forecasting due to a reduced secondary revenue forecast. Second, the reduction in forecast revenue requirement should be sufficient to allow a significant level of shift toward expensing of energy efficiency in the BP-16 rate case. PPC's position at this time is that any additional expensing for BP-16 should be limited to the amount that can be accommodated without increasing the power rate increase BPA included in its Initial Proposal in the rate case.

There are a number of advantages in starting to transition to expensing energy efficiency. These include greater access to Federal borrowing authority and long term interest savings. BPA has the tools to begin that transition by reducing its revenue requirement, without increasing its rates over the level proposed in BPA's rate case initial proposal.

Bond Refinancing

In the IPR-2 workshop BPA unveiled a new proposal for expensing energy efficiency, which involves expensing all energy efficiency in BP-16, and using roughly a quarter-billion dollars of maturing Energy Northwest bonds currently assigned to the transmission side of BPA's business to partially offset the short term rate impacts.

Using the bonds in this fashion essentially continues some debt financing of energy efficiency until all the bonds are refinanced; here, the debt is carried on Energy Northwest's books instead of counting against Treasury borrowing authority.

PPC believes that BPA's focus should be on finding ways to cut its revenue requirement rather than relying solely on bond refinancing to reduce the impact of expensing energy efficiency. While there may be a secondary role for bond refinancing in some ultimate resolution of phasing-in expensing energy efficiency, it should not be the primary mechanism BPA uses for doing so.

It should be noted that this is not the last opportunity to use bond refinancing to offset the impact of revenue expensing energy efficiency, if desired. More than $300 million of Energy Northwest Columbia Generating Station bonds mature every year between 2018 and 2024, and a portion of those bonds could be refinanced to offset the impact of revenue expensing energy efficiency, with the approval of the Energy Northwest governing boards.

Conclusion

Given the sizable rate increase BPA proposed in its Initial Proposal, the focus of results from IPR-2 should shift towards taking needed steps to ensure that the final rate increase is no greater than the Initial Proposal. As described above, PPC believes that BPA can reduce the burden of conservation acquisition on BPA finances and potentially expense some level of energy efficiency investments in the BP-16 rate period, without exceeding the rate increase in its Initial Proposal.

Thank you for your consideration of these comments.

Sincerely,

Scott Corwin
Executive Director
Public Power Council