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July 29, 2010

Mr. Steve Wright
Administrator
Bonneville Power Administration
905 NE 11th Street
Portland, OR 97232

RE: PPC Response to Draft Close-Out Report for Integrated Program Review

Dear Mr. Wright:

We appreciate the creation of a Draft Close-Out Report for the 2010 Integrated Program Review (IPR), so that customers have a chance to see and comment on the likely direction of the agency coming out of this latest budget process. In addition, we continue to appreciate the work of the BPA staff to collect and present budget information with increasing detail.

These comments are in addition to our comments submitted July 6, 2010 (attached).[1] We laud the agency for incorporating some of those suggestions into the Draft Close-Out report. These comments focus on work left to be done.

Rate Increases in a Struggling Economy

Like most of the U.S., the Northwest is struggling to emerge from a deep and persistent economic recession. A large number of PPC's member utilities have increased their retail rates to cover the 7% BPA power rate increase from the last rate case for fiscal years 2010 and 2011. Increasing retail rates have resulted in a large number of residential and commercial disconnections. Most of our utilities serve rural communities. Many have high unemployment rates and significant fractions of their communities fall below the poverty level. There is simply no more money to be had from these consumers. For many of our

[1] We would like to clarify one point in the July 6 comments. While we noted our support for additional resources and staffing of the Transmission Services organization that addresses the information and other needs of customers as they comply with reliability standards, we believe that BPA is adequately staffed in regard to its own efforts to comply with the reliability standards that apply to its own assets and activities.

members' consumers, a rate increase will force more families to make choices that no one should have to face. In light of the current, persistent economic conditions, if there must be a BPA power rate increase at all for fiscal years 2012 and 2013, BPA must take steps to make that power rate increase as small as possible.

One impression we have heard members express during the IPR process is that BPA initially proposed a budget that reflected a "business as usual" approach. The fact that the agency lost $600 million over the last two years and that the economic situation in the Northwest continues to be dismal did not seem to have much of an impact on BPA's proposed costs. As a result of surveying and talking to our membership, it is evident that many PPC members are taking draconian steps to reduce their costs, to minimize the burden on their communities. These cuts have been very painful, and have had real consequences for the utilities.

The Draft Close-Out Letter's Reductions in Proposed Program Cost Increases Are A Good Start

We appreciate the steps that BPA has taken to date to reduce some portions of its proposed budgets. The managers' meetings and workshops did result in a draft close-out letter showing a reduction in the level of cost escalation initially proposed in the IPR. From an initial increase in power rates of 12-20% (due only to rising costs), the draft close-out letter indicated a rise in rates of 7% due to BPA's proposed program budgets.

We note, however, that most of the identified savings that BPA proposes involve deferring capital expenditures to later rate periods. These accounting adjustments were made in the areas of Non-Federal debt service, CGS fuels purchases, and conservation. While we agree with the rationale for all these deferrals, it is nevertheless true that very little of BPA's proposed reduction in budget increases involves actual reduction in the increases in expenditures, much less actual reductions from current levels.[2] As described below, we believe that BPA needs to take additional steps to lower its increases in proposed program costs, especially if drivers beyond these costs create an even higher potential rate increase.

The Proposed Program Cost Increases Are Only One Of Several Costs That Will Determine BPA's Proposed Rate Increase This Fall

When BPA proposes its power rate increase in its initial rate proposal, the size of the rate increase will depend not only on program costs but also on the costs of subsidized power sales to Direct Service industrial customers, Residential Exchange Payments to investor-

[2] When asked about the agency's lack of proposals demonstrating substantive cuts in expenditures, the repeated response of BPA was that the numbers were so thoroughly scrubbed prior to the IPR that there was simply nowhere to cut. If this is the case, then the IPR is mistimed and customers need to be involved when actual budget decisions are being made. Presenting budget levels to customers that are considered to be already set from an agency perspective does not fully utilize the input, analysis, and ratepayer viewpoint that the customers bring to the table.

owned utilities, any amount of extra money that BPA decides to collect to rebuild the power side's financial reserves, risk, and BPA's forecast of wholesale power prices going forward. Each of these separate factors may add to upward pressure on the power rates. Consequently, the potential rate increase due to program costs alone (as discussed in the IPR process), while important, may not be an indication of the final, proposed rate increase.

The final proposed rate increase, with all the costs accounted for, is the result that matters to ratepayers in the end. Given that we do not have any information at this point on the other programs and factors mentioned above, PPC reiterates that BPA must reduce its proposed budgets to the maximum extent that it can so that the overall rate increase is kept as small as possible. We understand the role of BPA as "steward" of the assets of the federal power and transmission systems and the need to maintain those assets in good working order. We also understand, however, that a significant amount of the proposed program costs are for efforts that, while important, are not specifically critical within the next rate period.

BPA Should Reopen IPR if the Rate Increase Proposed Significantly Exceeds the Increase Currently Forecasted To Result From Increased Program Budgets

In November, if BPA proposes a rate increase significantly above the current IPR level, customers will insist that the IPR process be reopened to take an even harder look at BPA's cost structure, with the realization that the additional cuts will often be painful and have real consequences. To do otherwise would only add to the pain that communities served by public power are already facing. For example, freezing the level of expenditures in BPA's Agency Services at current levels would probably be one of the measures that customers would advocate, and this would mean that some parts of BPA's Agency Services would have to cut expenditures, to compensate for unavoidable Agency Services cost increases elsewhere. As another example, customers would have to take a much harder look at why BPA's budget for contractors is expanding so rapidly, and why there has been an increase in the GS and step level of BPA employees, which has had the effect of driving up total BPA personnel costs.

Despite the extensive and useful briefings that BPA has provided, working from the outside, customers have no more than a small fraction of the knowledge that BPA has about its cost structure, and where cost cuts can be made. BPA needs to use its superior knowledge of its cost structure to limit the size of the <u>overall</u> rate increase, given the economic circumstances currently facing the Pacific Northwest.

Illustrative Cost Reduction Proposals for BPA

As stated above, the agency is in the best position to identify additional areas for budget reductions, and to determine the extent and timing of further reductions in order to limit egregious rate impacts. We urge them to do so, and especially so if the other factors on rates are pushing the initial rate proposal beyond the range discussed in the IPR Close-Out Report. Below are areas that deserve further exploration in that respect.

1. Treatment of Energy Northwest Fuels Costs

In its draft Close-Out decision BPA did provide for capitalizing one CGS nuclear fuel purchase, which reduced BPA's revenue requirement for the upcoming rate period by $10 million/year. Public power representatives met with BPA staff to discuss why BPA was still reluctant to follow standard nuclear industry practice, and expense nuclear fuel as it is burned. BPA staff stated that doing this would cause unanticipated problems with BPA's repayment study, and would not reduce BPA's revenue requirement for the upcoming rate period. We are continuing to work with agency staff on this issue, but believe that there are ways to expense nuclear fuel when burned that do not adversely impact the repayment study. We think that capitalizing and then expensing fuel as it is burned will reduce BPA's revenue requirement by $20 million, over and above the one fuel capitalization that BPA has already proposed.

2. Corps, Bureau Non-Routine Extraordinary Maintenance

As noted in our earlier comments, we believe that non-routine extraordinary maintenance on the FCRPS should be capitalized, given that this work (such as on Grand Coulee's Third Powerhouse) is designed to refurbish and increase the reliability of these hydro plants for decades. BPA's costs in the next rate period could be reduced by about $5 million a year by capitalizing non-routine extraordinary maintenance.

3. Cultural Resources

BPA, via the Corps and Bureau, proposes more than doubling its spending on Cultural Resources, from $3.9 million to $8.3 million in the next rate period. Funding on Cultural Resources has been significant and stable for the last fifteen years – now is not the time to double spending on a discretionary program. BPA could maintain Cultural Resources spending at current levels, which would save $4.4 million.

4. Fish and Wildlife

It is our understanding that BPA is in talks with fish and wildlife interests regarding the ability of the fish and wildlife program to efficiently absorb additional spending, and it is our understanding that the current belief is that fish and wildlife spending is forecast to be $13 million/year less than what is in the current budget. BPA should reduce its budget to reflect the reduced forecast spending.

5. Renewable Resources

As we noted previously, BPA has a $4 million item in its budget for unspecified renewable resource development. After customer requests, BPA still did not provide detail on why this $4 million item was needed in the IPR process aside from alluding to potential capacity pilot studies. This item could be removed from BPA's budget for the next rate period.

6. FY10 and FY11 Agency Services Spending

BPA released a final report for Phase 2 of the IPR in the last rate proceeding on June 19, 2009, giving Agency budgets for FY10 and FY11. In the prior IPR2, BPA stated that spending on Internal Operations would be $238 million in FY10, and $242 million in FY11. In the current IPR, BPA indicated that its 2010 Start of Year budget was $251 million – a $17 million increase over IPR2, and that its FY11 budget would be $269 million – a $25 million increase over IPR2. (It should be noted that BPA cut Agency Services IPR2 budget numbers by about nine and a half million dollars from the earlier IPR1 numbers – not only did the agency not achieve the planned cost reductions from IPR1 to IPR2, but it failed to keep even to the original IPR1 budget in Agency Services.)

A significant part of that discrepancy comes in the area of Technology Innovation. In this IPR, BPA reported the prior IPR2 numbers as "2011 rate case" numbers, and their actual planned budgets as their "2011 IPR" numbers. The reported "2011 rate case" numbers track the IPR2 numbers fairly accurately, with the exception of Technology Innovation, where the IPR2 budgeted Technology Innovation is $2.06 million in FY10, and $2.07 million in FY11, while Technology Innovation's Start of Year FY10 budget was $13.1 million in FY10, and the "2011 rate case" number for Technology innovation was given as $12.87 million – six times the actual FY11 IPR2 budget for Technology Innovation.

Even without Technology Innovation, BPA's current Agency Services FY11 budget is $15 million over the number reported in IPR2 just over a year ago.

BPA could reduce its overrun of the IPR2 budget in FY11 by 50% - a reduction of $12 million. Assuming that 1/3 of the Agency Services budget goes to power, that would reduce power costs by $4 million – which would provide a $2 million decrease in costs both in FY12 and FY13.

7. Agency Services Long-Term

After making the above recommended cut in the FY11 Agency Services budget (to a level of $257 million), BPA could limit the escalation in Agency Services to 3% a year in FY12 and FY13. This would lead to Agency Services budgets of $265 million in FY12, and $273 million in FY13. BPA's initial IPR proposal was to spend $298 million in FY12, and $303 million in FY13, so that would be a reduction of $31 million/year. We appreciate that $10 million of that reduction is already accounted for by BPA's Draft Close-Out decision not to buy hydro projects insurance, leaving about $21 million/year. Assuming one-third of agency services are charged to power, that would be about $7 million/year in remaining power savings. BPA has already identified $4.7 million/year in program reductions/suspensions, so that would leave about $2.3 million in power-side reductions to be made, or about $10 million additional in Agency Services reductions. When added to the savings from cutting the FY11 budget, that would be a cost reduction of $4.3 million/year.

8. Conservation

BPA's decision in the Draft Close-Out regarding capitalization of conservation is helpful. There is another question that goes beyond the IPR process, regarding the appropriate timing of BPA conservation efforts given the persistence of the recession, particularly given that BPA is preparing to gear up to a considerably higher level of funding. The rate of ramp up and particular measures available under these economic conditions may deserve more analysis in light of the current pressure on BPA's costs and rates.

Conclusion

If BPA's initial rate proposal results in a substantial additional boost to the size of the rate increase, the IPR process should be reopened to find sharper, considerably more painful cost reductions. The above suggestions we have displayed would make revenue requirement reductions in excess of $50 million/year from BPA's draft Close-Out proposal, helping to moderate a rate increase during this very difficult time for Northwest citizens. We appreciate the work of BPA and utility staff throughout the IPR Process. The level of information available continues to improve each year.

We look forward to continue working with you in the shared interest of maintaining a safe, reliable, affordable power supply for the ratepayers of preference customers in our region.

Sincerely,

Scott Corwin

Scott Corwin
Executive Director

Attachment