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

Fiscal Years 2018-2019 Proposed	**)**	**BPA Docket No. BP-18**
Power and Transmission Rate	**)**	
Adjustment Proceeding	**)**	

BRIEF ON EXCEPTIONS OF

Public Power Council
Northwest Requirements Utilities
Pacific Northwest Generating Cooperative

as

JOINT PARTY 7

SUBJECT:
Financial Reserves Policy

June 30, 2017

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I. INTRODUCTION

Pursuant to the applicable rules of procedure,[1] Public Power Council ("PPC"), Northwest Requirements Utilities ("NRU"), and Pacific Northwest Generating Cooperative ("PNGC"), together designated as Joint Party 7 ("JP07"), file this Brief on Exceptions taking exception to certain decisions regarding BPA's proposed financial reserves policy in the BP-18 Draft Record of Decision ("Draft ROD"). Members of JP07 previously filed direct (BP-18-E-JP05-01) and rebuttal (BP-18-E-JP05-02) testimony on this topic as members of Joint Party 5 ("JP05"), as well as an initial brief (BP-18-B-JP07-01). PPC and NRU members, and PNGC directly, are preference customers of BPA that purchase both wholesale power and transmission services from BPA. Taken together, JP07's member utilities comprise approximately 87 percent of BPA's Tier 1 power load and pay the vast majority of BPA's power costs.

JP07 files this Brief on Exceptions to: (1) object to the decision in the Draft ROD to use the days' cash on hand as the methodology to allocate the agency's lower and upper thresholds to each business line; (2) correct significant misstatements about JP05's proposal to allocate reserve level responsibility to each business line based on capital expenditures ("capex"); and (3) urge the Administrator to postpone the decision on the allocation between business lines so that it may be considered in conjunction with a decision on what rate actions BPA may take when a business line is under the reserves threshold.

II. ARGUMENT

A. The Draft ROD Failed to Provide Sufficient Justification for the Decision to Adopt the Days' Cash on Hand Allocation Methodology.

In response to BPA's concerns about the lack of a comprehensive financial reserves policy, members of JP07 worked in good faith to develop a sound and equitable financial

[1] BPA Rules of Procedure Governing Rate Hearings at § 1010.13(d).

reserves policy to help support the agency's long-term health and viability. Specifically, JP07 expressed willingness to support a financial reserves policy that: "links the costs and benefits of supporting BPA's credit rating; establishes the minimum level of reserves to trigger replenishment and specifies the mechanism and timeframe for such replenishment; establishes a maximum level of reserves before using them for other purposes; and is equitable between Power and Transmission business lines."[2] Unfortunately, the Draft ROD adopted a financial reserves policy that fails to meet these objectives.

The methodology adopted in the Draft ROD allocates the agency's thresholds to each business line based on days' cash on hand, which fails to align costs with benefits. The Draft ROD also failed to provide sufficient evidence that the financial reserves policy meets BPA Staff's stated goal of rate stability because it made no decisions and offered no details as to the nature, scope, or implementation of the rate action that will result from such an allocation.[3] Instead, the Draft ROD informed the power customers that ultimately they will be subject to the costs of collecting and maintaining over $300 million in financial reserves, but left them to anxiously anticipate a subsequent process that will discuss and decide the "specifics associated with that rate action."[4]

1. The Draft ROD Failed to Comport with BPA Staff's Stated Objectives.

At the outset of the rate process, BPA Staff identified three reasons for the agency to adopt a comprehensive financial reserves policy: credit support, rate stability and liquidity. However, BPA Staff testimony and the Draft ROD itself demonstrated that the *primary* purpose of the policy is credit support. With credit support as the primary purpose, the days' cash on hand metric adopted in the Draft ROD does not equitably allocate financial reserves

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[2] Deen et. al., BP-18-E-JP05-01 at 14; Initial Brief of JP07, BP-18-B-JP07-01 at 8.
[3] BP-18 Draft ROD at 228.
[4] *Id*.

responsibility between the two business lines. In addition, the Draft ROD failed to demonstrate why a financial reserves policy that allocates responsibility for the agency reserves levels between business lines based on the days' cash on hand metric would better provide rate stability or liquidity compared to other allocation methodologies.

a. Given that the Primary Purpose of a Financial Reserves Policy Is Credit Support, the Days' Cash on Hand Allocation Fails to Appropriately Align Costs with the Expected Benefits.

While a financial reserves policy may come with other benefits, the Draft ROD was clear that the primary objective of the financial reserves policy is to maintain BPA's credit rating. "Financial reserves are a key component of BPA's credit rating,"[5] a "decline in BPA's credit rating due to low financial reserves would increase BPA's interest expense for years and would be detrimental to the agency's overall financial health,"[6] and "[o]btaining Non-Federal Debt at favorable terms and rates is now, more than ever, critically important to BPA's mission of providing power and transmission services to the Region at the lowest rates possible consistent with sound business principles."[7] Certainly, adopting a policy that improves the agency's financial health is a laudable goal, but not if such policy unduly burdens one business line over the other and does not truly align costs with benefits.

Maintaining "equity" between the business lines was among BPA's primary objectives when developing a financial reserves policy.[8] BPA considered equity, which seeks "to ensure the policy *reasonably* impacts BPA's divergent customer base," to be "critical to developing a well-balanced policy."[9] Thus, in developing a policy that affects both business lines, the Draft ROD recognized that "it is appropriate to consider how the benefits (and burdens) of that

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[5] BP-18 Draft ROD at 152.
[6] *Id.* at 136.
[7] *Id.* at 150.
[8] Harris et. al., BP-18-E-BPA-17 at 24.
[9] BP-18 Draft ROD at 207 (emphasis added).

proposed policy should be shared between the different customer classes served by the business lines."[10] Yet, BPA Staff's own analysis showed that under the days' cash on hand metric, power customers would bear about 75 percent of the responsibility of the agency lower threshold of reserves while only receiving 42 percent of the potential benefits associated with avoiding a credit downgrade over the next ten years. This fails to align costs with benefits, and thus JP07 takes exception to the Draft ROD's conclusion that the days' cash on hand method "equitably aligns costs and benefits between Power and Transmission."[11]

In contrast, JP05 proposed to allocate the agency's reserves thresholds to each business line based on that business line's total projection of capital investment to be made during the following ten years. This would align better with the policy's primary purpose of credit support because it associates the cost of maintaining the credit rating with the benefit of borrowing lower-cost money realized by the business line borrowing the money.

The Draft ROD stated that BPA's statutes do not prescribe one allocation method over the other and "whether one valid method prevails over another depends on the facts and circumstances at issue."[12] In fact, the Draft ROD recognized that both days' cash on hand and capex methods "could be viewed as valid methods for calculating the lower thresholds for business lines," and both methods "are arguably consistent with equity and cost causation principles."[13] However, the Draft ROD ultimately adopted the days' cash on hand allocation method based in large part on a belief that it is "more consistent with cost causation."[14]

[10] BP-18 Draft ROD at 207-208.
[11] *Id.* at 228.
[12] *Id.* at 222.
[13] *Id.*
[14] *Id.*

Despite this assertion, "BPA agrees that in many other situations, allocating costs based on relative benefit could be *more consistent* with cost causation principles."[15] Cost causation, according to the Draft ROD, "requires comparing *the costs assessed against a party* to the burdens imposed or *benefits drawn by that party*."[16] As explained in the testimony of JP05, power customers are unable to support a financial reserves policy that looks to collect $300 million, or an average of $30 million per year, over the remaining life of the Regional Dialogue Contracts but is expected to yield a benefit of at most $160 million, or $16 million per year, from a credit support perspective. Because the cost of BPA's financial reserves policy greatly exceeds any benefit that power customers would derive from maintaining BPA's current credit rating, the Draft ROD's allocation methodology fails the very cost causation test the Draft ROD sets out to support that methodology.

Finally, the Draft ROD argued that a strong business case exists for developing and adopting a financial reserves policy. BPA explained that "credit rating agencies give BPA a credit rating each time BPA-backed debt is sold into third-party markets," BPA's current credit rating produces "high demand and very competitive interest rates for BPA-backed debt," and "[a]ccessing these markets is now, more than ever, critically important to BPA's mission of providing power and transmission services to the region."[17] Therefore, BPA Staff argued that adopting a financial reserves policy is beneficial to the agency because it will help avoid a credit rating downgrade.[18] But, if adopting a financial reserves policy presents such a strong business case for the agency, the methodology for allocating the agency's reserves should present at least an equivalent business case for each of the agency's two business lines. Instead, the allocation

[15] BP-18 Draft ROD at 224 (internal quotation and citation omitted; emphasis added).
[16] *Id*. (internal quotation and citation omitted; emphasis added).
[17] *Id*. at 135.
[18] *Id*. at 180.

methodology adopted in the Draft ROD presents a dreadful business case for the power customers because it results in Power Services shouldering most of the burden for a policy that is designed to benefit the entire agency and that is expected to benefit Transmission Services more than Power Services. Such disparate treatment of the agency's two business lines is clearly at odds with BPA Staff's objective of developing "a well-balanced policy."[19]

b. The Draft ROD Failed to Demonstrate that the Financial Reserves Policy Would Support Rate Stability.

Rate stability is a crucial concern of BPA's power customers and was appropriately included as an objective in developing a financial reserves policy. Although the Draft ROD decided "that rate action will result when a business line has financial reserves below its [lower] threshold," it did not describe the nature, scope, or implementation of that important rate action.[20] Instead, the Draft ROD left power customers with a mere declaration that "[t]he specifics associated with that rate action, *e.g.*, the magnitude and timing of a CRAC, will be discussed in a subsequent process."[21] Without deciding these key specifics, neither the agency nor its customers can assess whether the financial reserves policy meets the objective of rate stability. As described in more detail below, JP07 does not dispute the draft decision to delay the decision on what rate actions will be taken when a business line is under its threshold, but does urge the Administrator to also delay the decision on the allocation methodology. This would allow BPA customers to consider whether the rate actions, the timing of such actions, and the allocation between business lines together achieve the objective of rate stability.

[19] BP-18 Draft ROD at 207 (quoting BPA Staff testimony).
[20] *Id*.
[21] *Id*.

c. <u>BPA's Arguments Regarding Liquidity Are Gratuitous Because the Benefits of Liquidity Are Achieved under Either Allocation Methodology.</u>

The Draft ROD argued that the capex allocation does not take into account the liquidity benefits of holding financial reserves.[22] BPA conceded that it is not developing a financial reserves policy to solve a liquidity problem,[23] but the Draft ROD argued that having additional liquidity is nonetheless beneficial to each business line.[24] The more financial reserves an entity has, the more liquidity it has, and the more it is able to withstand unexpected adverse circumstances, according to the Draft ROD.[25] Certainly, having more money in the bank is always better from the perspective of liquidity, and having an infinite amount of cash in the BPA Fund would position BPA especially well to withstand any and all unexpected adverse circumstances. This argument is gratuitous because it could be made to support *any* level of financial reserves; therefore, it adds no meaningful benefit to the power customers' analysis of the Draft ROD's allocation methodology or the financial reserves policy as a whole.

2. Capex Allocation Methodology Accurately Reflects the Benefits of Credit Support.

The Draft ROD argued that the capex allocation method fails to reflect an additional benefit of BPA's credit rating related to refinancing activities.[26] In order to directly capture the benefits of BPA's credit rating as it relates to refinancing activities, the allocation methodology would need to be based on actual non-Federal debt issuances. Under such an allocation methodology, 58 percent of the potential benefits would accrue to transmission and 42 percent to power over the next ten years.[27]

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[22] BP-18 Draft ROD at 227.
[23] *Id*. at 195.
[24] *Id*. at 227.
[25] *Id*. at 195.
[26] *Id*. at 226.
[27] Deen et. al., BP-18-E-JP05-01 at 13.

Despite this resulting in a more favorable allocation to power, JP05 chose not to advance this allocation methodology in its testimony. Instead, in the spirit of constructive engagement, power customers proposed the capex allocation methodology because it had a similar outcome to a strict "benefits"-based allocation (i.e., the aforementioned methodology considering only non-Federal debt issuances) and had several other advantages for all BPA customers. Specifically, it would be more stable through time and avoid potential unintended consequences of financial management decisions being influenced by their impact on the allocation of responsibility for financial reserves between business lines. As described in the JP05 direct testimony:

> By taking a long-term and balanced view of aligning costs and benefits, the proposal acknowledges that both business lines benefit from BPA managing its access to capital and debt portfolio on an integrated basis. BPA should continue to take advantage of the best available financing options available at the time capital is raised, but it is not possible to know today what the least-cost source of future capital will be.[28]

The assertion that that the capex allocation methodology fails to take into account refinancing activities is inaccurate. In actuality, the outcome of the capex allocation methodology reflects the benefits afforded to power customers under refinancing activities if for no other reason than the amount of reserves responsibility allocated to power is actually higher under the capex proposal than one that considers only non-Federal debt issuances.

While the capex methodology results in an outcome that closely matches costs with benefits, the days' cash on hand approach does not account directly or indirectly for any benefits of credit support, including refinancing, and results in an allocation that is unreasonably out of line with the credit support benefits of the policy.

[28] Deen et. al., BP-18-E-JP05-01 at 23-24.

3. Capex Allocation Methodology Accounts for Federal and Non-Federal Borrowing.

Finally, JP07 takes exception to the Draft ROD's assertion that the JP05 capex allocation methodology focuses "only on non-Federal borrowing."[29] As described in testimony, the capex allocation explicitly accounts for all planned capital expenditures, regardless of the type of debt issued: Federal or non-Federal. Specifically, the JP05 proposal was "to allocate responsibility for agency total reserves as the proportion of each business line's forecasted contribution to BPA's overall planned capital expenditures on a rolling 10-year basis."[30] As noted in the JP05 testimony, "[o]ur allocation proposal is based purely on the future capital needs of each business line" because both business lines "benefit from BPA managing its access to capital and debt portfolio on an integrated basis."[31] This means BPA can issue Federal or non-Federal debt and it will not affect the capex allocation between the two business lines. This is advantageous because the capex methodology matches costs with benefits but will be stable through time and allow BPA to manage its debt on an integrated basis without concerns that decisions on the source of capital will dramatically change the allocation of financial reserves between business lines.

B. The Administrator Should Defer the Final Decision on the Allocation Methodology Until the Agency Is Ready to Determine *All* Aspects of the Financial Reserves Policy.

In the Draft ROD, BPA stated that certain aspects of the financial reserves policy (namely, "the magnitude and timing of a CRAC"[32]) would be better suited for discussion and decision after the conclusion of the rate proceeding. In addition, the Draft ROD acknowledged that "determining the lower threshold for each business line in the FRP was one of the most

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[29] BP-18 Draft ROD at 227.
[30] Deen et. al., BP-18-E-JP05-01 at 18.
[31] *Id*. at 23.
[32] BP-18 Draft ROD at 228.

difficult issues in this case."[33] It conceded that both the days' cash on hand method and the capex methods "are founded on compelling principles," both were supported by "well-reasoned arguments," both "are arguably consistent with equity and cost causation principles," and both "could be viewed as valid methods for calculating the lower thresholds for the business lines."[34] If the Administrator indeed believes so, then the agency should take additional time to further consider both methods and develop an allocation methodology that preserves and combines the strengths of each method without producing the disparate impacts of the strict days' cash on hand methodology. After all, the two methodologies need not be mutually exclusive, and given the magnitude of the policy's potential impacts, the agency should take the time it needs to develop a truly well-balanced policy that achieves the equity and cost causation objectives that the agency claims to have sought to achieve.

There is no harm in the agency taking additional time to further consider the allocation methodology and doing it while considering all the other important aspects of the financial reserves policy. As discussed above, the arguments the Draft ROD advanced in support of ultimately adopting the days' cash on hand methodology are not compelling and the decision is not well-supported. The Draft ROD's adoption of a financial reserves policy with upper and lower thresholds at the agency level and $20 million of PNRR per year in the revenue requirement used to set Power rates will satisfy the credit agencies and assuage their concerns with BPA's declining financial reserves.[35] As BPA Staff noted, inter-business line issues are of no interest to the rating agencies,[36] and the Draft ROD's adoption of an agency financial reserves

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[33] BP-18 Draft ROD at 222.
[34] *Id*. at 222.
[35] *Id*. at 152.
[36] *Id*. at 207 (quoting BPA Staff).

policy will fill a policy gap that credit rating agencies believe currently exists at BPA.[37] At the same time, it will allow the agency additional time outside of rate case constraints to develop a well-balanced policy that reasonably impacts and could be supported by all of BPA's customers.

III. CONCLUSION

For the reasons presented above, JP07 respectfully takes exception to the Draft ROD's decision to adopt the days' cash on hand metric as the methodology to allocate the agency's upper and lower thresholds to each business line. JP07 also urges the Administrator to further consider the best allocation methodology for the business lines and defer adopting such a methodology until the agency is prepared to decide all the key aspects of how to implement its financial reserves policy.

Respectfully submitted this 30th day of June, 2017.

s/ Irene A. Scruggs	*s/ Betsy Bridge*	*s/ Christopher Hill*
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[37] BP-18 Draft ROD at 152.

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing on the Bonneville Power Administration's Office of General Counsel, the Hearing Clerk, and all litigants in this proceeding by uploading it to the BP-18 Rate Case Secure Website pursuant to BP-18-HOO-02 and BP-18-HOO-05.

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