Bonneville Power Administration
Power Business Line

2003 Safety-Net Cost Recovery Adjustment Clause

Rebuttal Testimony

SN-03-E-BPA-13 REVENUE RECOVERY

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REBUTTAL TESTIMONY OF

VALERIE A. LEFLER, RONALD J. HOMENICK, AND DAVID M. STEELE

Witnesses for Bonneville Power Administration

SUBJECT: Revenue Recovery

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TESTIMONY OF

VALERIE A. LEFLER, RONALD J. HOMENICK AND DAVID M. STEELE

Witnesses for Bonneville Power Administration

SUBJECT: Revenue Recovery

Section 1. Introduction and Purpose of Testimony

Q. Please state your names and qualifications.

A. My name is Valerie A. Lefler and my qualifications are contained in SN-03-Q-BPA-11.

A. My name is Ronald J. Homenick and my qualifications are contained in SN-03-Q-BPA-06.

A. My name is David M. Steele and my qualifications are contained in SN-03-Q-BPA-25.

Q. What is the purpose of your testimony?

A. The purpose of our testimony is to respond to the testimony of the parties regarding Bonneville Power Administration's revenue recovery study contained in Chapter 3 of the Safety-Net Cost Recovery Adjustment Clause Study (SN-03 Study), SN-03-E-BPA-01, and in Chapter 3 of the Documentation for SN-03 Study, SN-03-E-BPA-02.

Q. How is your testimony organized?

A. Our testimony has 7 sections, including this introductory section. The second section responds to Save Our Wild Salmon Coalition and Northwest Energy Coalition's (together referred to as SOS) argument that the Energy Northwest (ENW) decommissioning fund contribution assumes an overly-optimistic rate of return. Section 3 addresses SOS's argument regarding the priority of some payments over others. Section 4 addresses the Coalition Customers' contention the BPA has not met a purportedly required "burden of proof." Section 5 deals with various issues related to BPA's conservation program and conservation augmentation. Section 6 deals with various issues having to do with BPA's capital investments and debt management. Section 7 deals with the treatment of IOU deferrals in this proposal.

Section 2. Decommissioning Fund Contributions

Q. SOS argues that BPA is overly optimistic by determining the decommissioning fund contribution assuming an annual average real rate of return on investment of 6.3 percent over the remaining license life of the Columbia Generating Station (CGS). Weiss, SN-03-E-SA-01, at 12. Do you agree?

A. No. The determination of the decommissioning fund contribution assumes BPA will contribute escalating amounts until 2024, at the end of the license period, with decommissioning to begin in 2054. The assumed real rate of return on trust fund assets is 3 percent, rather than the 6.3 percent CRITFC cited. BPA believes this is a reasonable assumption.

Section 3. Priority of Payments

Q. SOS contends that BPA has multi-year contracts with the Corps of Engineers and the Bureau of Reclamation that guarantee their budgets are funded regardless of BPA's financial situation. SOS claims that such arrangements provide funding assurances that are not given to BPA's not-yet contracted for fish programs and hydro operations. Weiss, SN-03-E-SA-01, at 23-24. Please respond.

A. The contracts referenced in the SOS testimony apparently include BPA's direct funding agreements for operations and maintenance (O&M) with the Corps and Reclamation. These are agreements developed by both parties, and include estimated five-year budgets. The contracts provide that BPA will fund certain activities, but do not guarantee specific amounts. These agreements state that "such payments shall only be made out of net proceeds as defined in 16 U.S.C., 838k(b)." In simple terms, this means that the direct funding payments are to be made after all other O&M and power purchase expenses have been paid. This puts them on a par with payments to the U.S. Treasury, which are last in BPA's priority of payments.

Section 4. Burden of Proof

Q. The Coalition Customers contend that BPA's SN CRAC proposal has not met the "burden of proof" normally required for such a large rate increase. The Coalition Customers state that BPA should wait until its future year cost reduction are estimated. Faddis, et al., SN-03-E-CC-1, at 24. Please respond.

A. BPA questions what is the "burden of proof" that is "normally required." The Coalition Customers responded to BPA's data request BPA-CC-007, by saying "BPA's 'burden of proof,' as used here, is to convincingly demonstrate that its proposed actions . . . are meeting these expectations." The data response, while it quotes a portion of one sentence from a BPA report (What Led to the Current BPA Financial Crisis? A BPA Report to the Region), fails to identify or define a "burden of proof" under which BPA is required to meet in proposing the establishment of rates. The Coalition Customers attempt to impose their own subjective standard on BPA's actions, which BPA rejects. BPA is mindful of its obligation to recover its costs and will balance this obligation with the concerns expressed by BPA's regional customers and constituents. However, no standard exists that requires BPA to "convincingly demonstrate" that its proposed actions meet any given set of expectations. In regard to future-year cost reductions, BPA has projected its costs for FYs 2004-2006, and includes cost cuts over that period. The fact that BPA continues to look for additional cost cuts does not mean the expense levels for those years cannot be justified. BPA has proposed a multi-year SN CRAC with variability that would take into consideration changes in expense levels in the future when the rate for the upcoming year is being set.

Section 5. Conservation Program

Q. CRITFC observes that BPA has not performed an independent audit on BPA's C&RD program. CRITFC testifies that there might be other conservation resource development programs that would be more cost effective. Finally, CRITFC notes there appears to be

a different standard for auditing programs run by Bonneville's utilities and the fish and wildlife program. Sheets, et al., SN-03-E-CR/YA-01, at 47. Please respond.

A. The C&RD is a credit available to BPA's regional power customers through BPA's power sale contracts that take action to further conservation and renewables activities in the region. One of the objectives in establishing the C&RD is to provide local control of the funds spent to incentivize customers. Participating customers are required to submit interim reports annually along with a financial audit on their C&RD expenditures to both BPA to ensure accountability. Participating customers must file a final reconciliation at the end of the rate period or the contract period, whichever is shorter. If expenditures are less than the amount of C&RD available a customer is obligated to reimburse BPA the difference. Even though the C&RD program is not structured as an acquisition program, BPA and the region have nonetheless achieved incremental energy savings from it. The energy savings for FY 2002 of the C&RD program equals about 19 aMW.

BPA also has Conservation Augmentation (ConAug) agreements with customers for the acquisition of energy savings. Under these agreements all customers are subject to oversight, audit, and verification by BPA regarding the efficacy of the conservation programs funded under ConAug. We understand that, like the conservation acquisition requirements for oversight, audit, and verification, fish and wildlife spending is subject to similar requirements ever since Congress amended section 4(h)(10)(D) of the Northwest Power Act to address concerns over fish and wildlife spending and fishery manager conflicts of interest.

Q. The Joint Customers, Western Public Agencies Group (WPAG), and Generating Publics propose that BPA amortize the investments for ConAug over 20 years, as opposed to the shorter 10-year period assumed in the Initial Proposal. The Joint Customers contend that financing an asset over its useful life spreads the cost recovery for the asset over those who benefit from the asset. By financing the ConAug capital investments over

20 years, the Joint Customers claim will save BPA an average of $8.4 million from 2003 through 2006. Bliven, et al., SN-03-E-JC-01, at 17; Saleba and Piliaris, SN-03-E-WA-01, at 8; Lovely, et al., SN-03-E-GP-01, at 4. Please respond.

A. The $8.4 million annual average savings cited in the testimony of the Joint Customers are net revenue effects that would result from changing the service life, not cash effects. In the income statement, the amortization of these investments is the accrual accounting treatment of writing-down intangible capital assets, in other words, a non-cash, depreciation-like expense. From a cash standpoint, there would be little effect on the SN CRAC rate from changing BPA's policy on the current ConAug amortization. There would be no impact on the principal payments to Treasury, since the schedule of Federal principal payments is not being changed from that scheduled in the May 2000 Proposal. Interest payments would likely increase due to a somewhat higher interest rate on longer-term bonds. BPA believes that the current policy is the prudent and correct treatment. For regulatory assets such as conservation that can only be capitalized under Financial Accounting Standard Number 71, the useful life of the asset must be tied to the ability to demonstrate cost recovery. BPA's policy is based on the view that for ConAug, cost recovery is best demonstrated by the duration of signed power contracts, through 2011. BPA intends to review and re-consider the policy on conservation capitalization prior to the next rate case, and will initiate discussions with BPA's independent auditor to determine the implications of making such a change in the middle of a contract period.

Section 6. Capital and Debt Management Issues

Q. Springfield Utility Board (SUB) recommends that BPA should pursue freeing up $24 million in reserve funds for rate mitigation and should assume it is successful when developing the CRAC. In addition, SUB suggests that BPA should actively pursue refinancing opportunities which would lower debt service to lower the SN CRAC. Nelson, SN-03-E-SP-01, at 7. Please respond.

A. BPA is considering such actions, and will reflect any refinancings that have been completed in the Final Studies. Additionally, BPA's proposed variable rate design would allow future refinancings, after they have been completed, to be reflected in the annual calculation of the SN CRAC rate for the subsequent year.

Q. WPAG states that its understanding is the PBL capital program is entirely funded with debt, that this is a fairly common practice for publicly owned utilities, and that given the financial difficulties facing BPA such reliance on debt financing is prudent. Saleba, et al., SN-03-E-WA-01, at 20-21. Because capital spending can affect BPA's cash reserves if rate revenues are used to fund capital project, WPAG proposes not allowing BPA to collect revenues used to fund capital items through the operation of the SN CRAC by placing a limit on expenditures on capital items at a level equal to the sum of Treasury borrowing and appropriations. Id. at 22. Please respond.

A. Both the May 2000 Proposal and the current proposal reflect BPA's power capital costs being fully funded by Treasury bonds or Congressional appropriations. BPA is not proposing to revenue-finance any power-related capital investment. BPA has never revenue financed capital investments unless a revenue-financing assumption has been incorporated when setting rates, for instance in the 1995 general rate case, which included $15 million for FY 1996 in each of the power and transmission revenue requirements. For these reasons, BPA does not see a need to include limits on revenue financing. (The recent transmission rate case does include an assumption that revenues in FYs 2004-2005 will fund some amount of transmission capital investment, and this is reflected in the agency accrual-to-cash adjustment.)

The timing of events is such that BPA never precisely borrows dollar-for-dollar for capital programs in a given year. In so doing, deferred borrowing is created. Deferred borrowing refers to capital expenditures that will be funded by borrowing from Treasury, but are temporarily financed with revenues. It is the difference between

cumulative capital expenditures and cumulative borrowing for each capital program. Although this could be characterized as revenue financing, it is a temporary event. However, BPA's financial reserves consist of cash and deferred borrowing, both of which are included in the Toolkit for risk mitigation. Regardless, it would not be BPA's intent to use SN CRAC revenues to directly fund capital programs.

Q. WPAG states that because BPA has not received credit from Treasury for prepayments to Treasury, such accelerated payment of Treasury obligations can reduce the amount of cash BPA has available to make its scheduled Treasury payment, that this situation can cause an SN CRAC rate increase, and therefore the amortization of Federal debt should be subject to limits. Saleba, et al., SN-03-E-WA-01, at 22-23. WPAG proposes that principal payments of Federal debt be capped at levels not to exceed the sum of amounts due in the fiscal year, amounts scheduled to be repaid in the May 2000 rate case 50-year repayment study, and savings available from the refinancing of ENW bonds. Saleba, et al., SN-03-E-WA-01, at 23. Please respond.

A. What WPAG advocates is generally what BPA has been following in the current rate period as well as prior rate periods since getting back on track making amortization payments in the mid-1980s. It is only through the debt optimization program that BPA has repaid more power-related Federal principal than the amounts planned in rate filings. (Some proceeds from sale of transmission delivery facilities have been applied to advanced amortization of transmission-related Federal debt, in accordance with agreements with customers.) Otherwise, annual payments have only exceeded the rate filing plan in minor ways, such as when end-of-year adjustments for over-payment of appropriation interest are applied to amortization or when the payment of a whole bond cause the actual payment to exceed the plan (e.g., scheduled payment is $148 million, but three $50 million bonds are repaid, thus resulting in $2 million payment above the scheduled amount). Therefore BPA does not see a need to include the proposed cap.

Q. Does this conclude your testimony?

A. Yes.