

# Discussion Paper Terms and Conditions for Use of Transmission Services Financial Reserves for Power Services Financial Requirements<sup>1</sup>

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BPA's Transmission Services holds about \$600 million in accumulated unencumbered reserves, some of which (to be determined) could be used by Power Services to ensure agency Treasury repayment. Besides the quantity of fund that might be available, how these financial reserves are to be used and the impact on BPA's risk modeling are issues that will be raised in the rate case. While this paper is written with the use of transmission reserves in mind, at some time in the future the concepts – the principles and the methods – discussed below would apply to potential use of Power Services cash reserves by Transmission Services.

At the outset, we need to establish several ground rules, written from the perspective of Power's use of Transmission's liquid or cash reserves (hereafter, "cash reserves"):

1. The amount of cash reserves potentially available to Power Services would be assessed after Transmission Services' own need for cash reserves is established. The assessment could take into account net revenue risk of Transmission Services, working capital needs, amounts of revenue-financed capital, any adjustments to revenue requirements furnished by cash reserves and cash held (*i.e.*, encumbered) for others, such as third-party funding of transmission services.
2. Transmission Services will be fully compensated by Power Services for the use of the reserves using the same interest rates that would prevail in the rate case for a transmission revenue credit due to earned interest.
3. Any arrangement would be structured such that, were Transmission Services to have any unexpected liquidity needs that it could not meet because of reserve draws taken by Power Services, it be the responsibility of Power Services to provide needed liquidity, up to the amount Power Services had drawn from Transmission Services' reserves.

For Treasury Payment Probability assessment, BPA's risk models – primarily Toolkit and RiskMod – consider all forms of short-term financial measures to ensure

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<sup>1</sup> We intend this to be a basis for discussion and do not intend this paper to be a proposal as to specific terms and conditions.

Treasury repayment: Power Services' liquid reserves on hand ("cash reserves"), Planned Net Revenue for Risk, use of Transmission Services reserves as defined above and the use of a recently negotiated Treasury borrowing line. For modeling purposes, the use of any of these four sources could be paid back in the form of Cost Recovery Adjustment Clauses, PNRR in future rates, or by other similar means. In real time, how and which reserves are used would be decisions by the Administrator.

The potential use of Transmission Services cash reserves has not been a significant factor in BPA's rate-making. In the past, Transmission Services cash-reserves availability has been a relatively small amount. Now, with cash reserves being drawn down due to the current poor hydro year, the issue of the use of Treasury and Transmission Services reserves becomes more important to current and future rates.

While the terms and conditions for use of the short-term Treasury borrowing line have been established and reflected in the Toolkit, the rules or terms for a loan between business lines have not been set. When those rules are set, all of the above tools can be assessed by the Toolkit and RiskMod models to produce an expected TPP. The purpose of this paper is to propose terms and conditions for use of the Transmission Services reserves available for Power Services risk.

One objective on the power side is to minimize any rate shock resulting from the Toolkit / RiskMod analysis while recognizing BPA's overall Treasury and payment obligations. To minimize rate shock we need to establish 1) the conditions that would trigger any use of reserves from the other business line (e.g., reserves drawn down to a pre-specified level such as cash working capital for the business lined); 2) the order in which all sources of funds are used in modeling; and 3) for any use of Transmission Services reserves, the time over which repayment by power rates will be assumed to be made.

The first usage of liquidity should come from those sources that will not cause an immediate rate impact: cash reserves and PNRR being collected in revenues from current rates. The second usage should be from freed-up Transmission Services cash reserves with terms and conditions defined below. Finally, the Treasury line of credit, with the terms of such borrowing, would be reflected in BPA's risk models.

While the principles regarding the intra-agency borrowings have been defined, the specific terms and conditions have not. The objective for Power Services rates should be to minimize a significant rate shock due to any borrowing from Transmission Services while paying back Transmission Services in a timely manner, recognizing that interest on such borrowings will be accruing.

For this reason, borrowings from Transmission Services should carry the longest terms for payback – six years is proposed – of all the sources of cash reserves, for two reasons: First, it is likely that there will be significant other cost adjustments to power rates on top of CRACs and PNRR, which will be used to rebuild reserves and to pay Treasury. The cost pressures that drove the reserves down may still be causing problems for the agency – for example, low power-market prices may continue to reduce the secondary-revenue credits. Second, a longer period would allow time for the natural ebb and flow of the hydro and market cycles to experience some good-revenue years to offset the bad-revenue years. At the next rate-change opportunity – rate case or CRAC – the amortization of the Transmission Services borrowing would begin. That is, if a good hydro/revenue year was estimated in the six-year period, then the extra revenues should be used to pay back the Transmission Services loan. The out-year, good-revenue results would likely not be included in calculating the rate-period TPP but would affect the course of rates in the later years.

This proposal of a six-year payback should be tested, using BPA’s risk-model information, to see the impact on rates outside the rate period from the varying conditions that affect the risk-model results.

In conclusion, the order of usage to be modeled would be:

- Use of Power Services cash reserves on hand and use of PNRR being collected during a rate period.
- Use of freed-up Transmission Services financial reserves with resulting interest, scheduled repayment and good-water-year payback modeled in the risk analysis.
- Use of the Treasury borrowing line with the terms of that line modeled in the risk analysis

If these are insufficient to ensure TPP for a given rate period, then PNRR and CRACs would be used to establish the desired Treasury repayment probability.