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February 21, 2003

Mr. Steve Wright, Administrator
Bonneville Power Administration
PO Box 3621
Portland, OR 97208

Dear Steve:

In December you told the Council that Bonneville was in its most difficult financial situation in decades, and that its condition was deteriorating. You continue to estimate that, unless intervening actions are taken, the gap between Bonneville's revenues and costs will grow to \$1.2 billion by 2006.¹ We know that this situation is unacceptable to you. It is also unacceptable to the Council and intolerable for the region.

In this letter we report that we have successfully met Bonneville's objective to limit fish and wildlife expense program spending to within \$139 million in Fiscal Year 2003. What we are providing you is a suggestion for an approach to employ given constraints and conditions that Bonneville developed. This is not a reprioritization of the fish and wildlife program, and we are not changing the recommendations provided in the provincial reviews. We have looked hard at each and every project in the fish and wildlife program, and spent an enormous amount of time reviewing Bonneville's budget information. Before getting to the specifics, we want to share with you some of the Council's broader perspective.

We agree that actions on both the revenue and cost sides of the ledger must be carefully considered. With regard to revenue, we understand that you are presenting the case for the Safety Net Cost Recovery Adjustment Clause (SN CRAC). The Council is very concerned about the impacts that this will have on ratepayers. The Council fully appreciates that additional cost reductions in Bonneville programs might reduce the currently anticipated rate impact that will come from the SN CRAC. We must not lose the economic advantage this region can enjoy when our energy supplies are robust and economical. The Council has consistently encouraged you to conduct an agencywide review to find areas where cost reductions could be made. We continue to offer that advice today. On this point, however, we offer a few words of clarification, perhaps even caution.

¹ See letter dated December 10, 2002 from Bonneville Administrator Steve Wright to F.L. Cassidy, Council Chairman.

Not every program in Bonneville can withstand significant reductions. Proportionality, participation, or the universal “sharing of pain” cannot be the standard against which this agencywide cost reduction review is judged. The sole standard must be equitability, specifically when dealing with the fish and wildlife program.

Bonneville’s many programs are not all equal. Some, such as the fish and wildlife program, respond to legal obligations that cannot be abandoned, even temporarily. Programs with such legal requirements must be viewed differently than programs that are useful and valuable but not legally required or unquestionably essential to Bonneville’s core statutory missions. Moreover, to be equitable, you must assess where various program costs are today against their planned levels. Programs operating within planned budgets are penalized for their efficiency if this is not considered. Finally, because you are considering cost reductions in the context of the SN CRAC, the significance of a possible program reduction from a rate impact perspective must be understood. It makes little sense to increase legal risks to the durability of the power system because of a cost reduction that has essentially no impact on rates.

The Council’s Review of the Fish and Wildlife Program

On December 10, 2002 you asked the Council to review the expense portion of the fish and wildlife program to: (1) contain spending in Fiscal Year 2003 to \$139 million², and; (2) create the opportunity to spend less than \$139 million in Fiscal Years 2004 through 2006.

For the first task, you advised the Council that if it would not take “appropriate steps” to meet your cost-containment objective, Bonneville would review the fish and wildlife program itself. Further, you and your staff made it clear that Bonneville’s preferred approach was a reprioritization of all current and anticipated fish and wildlife projects and that immediate project contract terminations and deferrals should be anticipated. The Council considered these comments and concluded that it was better suited than Bonneville to lead a successful review of the fish and wildlife program.

To be direct, the Council was very concerned that the approach being advocated by Bonneville would undermine the work that the Council had collaboratively completed with tribes, governors’ offices, watershed groups, state and federal agencies and other interested parties over the last three years in the Council’s provincial review process.³ Based on the budget figures developed by Bonneville, we were not convinced that an immediate rush to project contract modifications and terminations was necessary to meet your Fiscal Year 2003 spending objective. Our goal in leading this review of the fish and wildlife program has been not only to meet your cost containment need this year, but also to preserve the integrity of the decisions and priorities established by the region in the provincial reviews.⁴

² At that meeting, Bonneville representatives reiterated that it had developed estimates that predicted that Bonneville would spend nearly \$180 million in Fiscal Year 2003.

³ Section 4(h)(10)(D) of the Act directs the Council to make recommendations to Bonneville for funding fish and wildlife projects that it funds. It requires that independent scientific review, public review, and findings and considerations be made by the Council. The “Provincial Review” is the process that the Council has developed to implement section 4(h)(10)(D).

⁴ See letter dated December 20, 2002 from Council Chairman F.L. Cassidy to Bonneville Administrator Steve Wright.

With this letter we report that, with a tremendous amount of assistance from our program implementation partners and your staff, we have been successful in our efforts to date. If our guidance is implemented for the remainder of Fiscal Year 2003, Bonneville will not spend more than \$139 million in the expense program and it will meet its fish and wildlife obligations defined in the provincial review process. However, we wish to advise you in the strongest possible terms that during this exercise fundamental and profound policy issues have surfaced that must be resolved immediately.

Issues that Require Immediate Resolution

We have addressed Fiscal Year 2003 within constraints and under conditions imposed by Bonneville that cannot continue beyond Fiscal Year 2003. Bonneville announced an immediate change in accounting practices to what it calls an “accruals method”. New accounting standards and practices have been dictated to the region with an expectation that these different rules be applied immediately. The Council’s willingness to abide by these new rules in this limited instance is in no way an endorsement or ratification. We believe that we must reach a comprehensive agreement about the program implementation akin to the Memorandum of Agreement that guided implementation in the prior rate period. We must reach agreement on accounting rules and standards. While calling for a comprehensive agreement, we single out two matters that must be resolved. We believe that the integrity of the fish and wildlife program cannot be maintained even in the shortest term without dealing with the following.

Obligations must be matched with funds to satisfy them

The current accounting methods employed by Bonneville cannot ensure that sufficient funds are available to cover its contracted fish and wildlife obligations. Bonneville estimates its costs for the direct fish and wildlife program when it sets its rates. It collects rates to meet those estimated obligations. When fish and wildlife project obligations stay within the planned levels, and rates are collected to pay for those fish and wildlife obligations, it is unacceptable that funds are not available when those obligations come due.

Failure to join obligations with funds within the fish and wildlife program has caused much of the disruption and pressure that we are experiencing. By its own accounting, Bonneville carried over \$40 million in fish and wildlife obligations from the last rate period that ended in Fiscal Year 2001 into the current rate period. The remaining revenues collected in the last rate period, however, were not made available in the current rate period. With Bonneville’s currently imposed accounting rules, the fish and wildlife program must absorb that \$40 million within the \$139 million that already was fully allocated for Fiscal Year 2003 work.

We believe there is a range of strategies to address this problem. At one end, some have recommended that Bonneville establish a fish and wildlife program budget⁵, within the general Bonneville fund, that at all times carries a balance sufficient to meet outstanding obligations and is dedicated exclusively to meeting those as they are defined in the Council’s multi-year province review process. At the other end, is a suite of accounting standards and practices such as those

⁵ Section 4(h)(10)(D) of the Act references an annual Bonneville fish and wildlife budget.

used under the previous funding Memorandum of Agreement (MOA) that utilizes carry-over and carry-forward tools. Whether or not it is necessary to reinstate those carry-over and carry-forward tools precisely as defined previously is yet to be determined. The bottom line is that if there is not a dedicated fish and wildlife fund, the Council needs accounting standards and practices that recognize and treat the fish and wildlife program as a substantial multi-year program that is sustained over time. The current “accrual accounting” rules being defined by Bonneville transform the Council’s multi-year program and provincial review into an annual program. It simply will not work to set inflexible annual spending caps, where both program and project-level budgets are zeroed out each year without regard to the project work that is contracted and must be performed.

This matter must be resolved before the Council or Bonneville can meaningfully evaluate the fish and wildlife expense program requirements beyond Fiscal Year 2003. Moreover, the efficacy of the Council’s guidance for limiting spending in Fiscal Year 2003 to no more than \$139 million depends on the immediate resolution of these matters.

Access to capital funds for land easements and acquisitions

If Bonneville is to meet its legal requirements under the Northwest Power Act and the Biological Opinions, it will need to protect habitat through land easements and/or purchases. Because of Bonneville’s inability to revenue-finance these purchases and its unwillingness to use its borrowing authority, wildlife mitigation and habitat protection for fish and wildlife under the Northwest Power Act are currently stalled. The direct result is that Bonneville is currently not implementing critical portions of the Council’s adopted fish and wildlife program.

Bonneville has provided its perspective on impediments to accessing borrowing authority funds for fish and wildlife land interest acquisition projects. Essentially four reasons have been stated: (1) Bonneville’s belief that it did not make required filings or provide sufficient notice in prior rate proceedings; (2) Bonneville’s belief that it did not adequately document or disclose to Congress that it would use these funds for such projects; (3) Bonneville’s accountants have not concluded that generally accepted accounting practices permit the use of these funds for these purposes; (4) that there are outstanding policy differences between Bonneville and the Council regarding “crediting” for wildlife mitigation.

Only the first three of these stated reasons require resolution before borrowing authority can be used to fund these types of projects. They can be resolved quickly. For (1) above, if Bonneville continues to insist that it is constrained by previous failure of disclosure, it must use the current SN CRAC proceeding to remedy any filing or notice deficiencies in prior rate cases covering this rate period. We would like written confirmation that this will be done. For (2), there are many ways that we can secure confirmation from Congress that Bonneville may fund these land projects with its borrowing authority. The Council would like to take the lead in developing an appropriate submission for Congress that we will jointly support. To be clear, the Council wants Bonneville’s commitment to jointly work with Congress to clarify that existing borrowing authority is available for these purposes if Bonneville believes that this is an impediment. For (3), the Council requests that Bonneville agree to secure the assistance of mutually agreed-upon

accounting professionals to assist us in a joint evaluation of the propriety of using borrowing authority funds for these projects.

The Council does not agree to defer the implementation of critical wildlife and resident fish program requirements until other policy matters such as “crediting” are resolved. We have been able to proceed with this important work for the past 10 years in the face of a disagreement on this very point. As we move forward with these projects, the Council remains committed to working with Bonneville to resolve these long standing issues as soon as possible.

As explained in the next section, one of the means to ensure that Bonneville stays within its spending limit of \$139 million for Fiscal Year 2003 is to continue to deferral of critical wildlife mitigation for the remainder of this fiscal year. The efficacy of the Council’s guidance on how to maintain spending within \$139 million in Fiscal Year 2003 depends upon access to Bonneville’s borrowing authority for securing interests in land beginning no later than the beginning of Fiscal Year 2004.

The Council’s Specific Guidance for Fiscal Year 2003

In light of Bonneville’s current financial situation, the Council’s twin goals for Fiscal Year 2003 were to stay within the \$139 million target provided by Bonneville and to maintain the integrity of the fish and wildlife program priorities and scientific foundation established by the region in the Council’s provincial review process. The Council believed that success in that second goal would ensure that the legal requirements of the Northwest Power Act and Biological Opinions could be met this year.

The Process Used by the Council Strategy Used to Meet the Target

The Council has developed what could best be called a cash-management approach to meet Bonneville’s spending target. As discussed above, this approach was developed and prosecuted within constraints and with rules that it cannot endorse beyond Fiscal Year 2003. The steps were:

- Council and Bonneville staffs confirmed Bonneville’s October project-specific spending forecasts for Fiscal Year 2003 in a number of ways, yielding a lower spending projection.
- Project sponsors reviewed the revised Bonneville spending forecasts electronically, and confirmed or recommended adjustments to their project spending targets. Council staff made project specific adjustments, both up and down with an overall net reduction of the revised Fiscal Year 2003 spending forecast.
- The Council understood that Bonneville’s decision to not implement land easements or acquisitions (see your December 10, 2002 letter) would persist throughout the remainder of Fiscal Year 2003. Bonneville’s Fiscal Year 2003 fish and wildlife expense program spending projections included over \$20 million in such projects. Eliminating the spending projections for those projects yielded a lower overall Fiscal Year 2003 spending projection for the program.

After the expected expenditures were better honed, the Council observed that meeting the financial half of the twin goals -- spending no more than \$139 million in Fiscal Year 2003 – was within striking distance. The Council staff, with the assistance of others, once again went to a project-by-project review of the newly “trued up” list. The objective was to find efficiencies or locate projects that were not clearly regional priorities established in provincial reviews. In general, three categories of projects were identified during that exercise, as well as one specific spending discrepancy that had been resolved as a matter of policy last year. The three project categories that yielded reductions were:

- Bonneville did not consistently apply its “no carry-over” rule. These inconsistencies were eliminated. In doing this, the Council sought to keep the Fiscal Year 2003 funding levels established in the provincial review intact. It is emphasized that the Council continues to support all approved project tasks. The practical effect, however, in uniformly applying Bonneville’s “no carry-over rule” is that some project work will extend into an additional fiscal year beyond what was anticipated when the project was developed. Unfinished Fiscal Year 2002 work cannot be caught up in Fiscal Year 2003 while also performing all anticipated Fiscal Year 2003 project tasks.
- The Council staff found projects that were not reviewed by the independent science panel and prioritized in the provincial review process. The Council recommends that these projects not be funded. These projects are not within the regional priorities established by the provincial review. Funding these projects is consistent neither with 4(h)(10)(D) of the Act, nor the 2000 Fish and Wildlife Program. These projects have not met scientific review and endorsement standards on par with those that went through provincial reviews. Within this category are three projects, totaling \$900,000 must be added to Bonneville’s internal overhead.
- With regard to BiOp projects, the Council staff focused on those identified by NOAA Fisheries and Bonneville as critical for the upcoming check-ins. While the Council and region put an emphasis on BiOp implementation in the provincial reviews, this “critical-for-check-in” standard is a higher standard than was employed during the provincial reviews.

The specific discrepancy was:

- Bonneville’s spending projections assumed that the implementation of the “water brokerage program” (RPA 151) would be funded from the fish and wildlife expense program. This is inconsistent with specific Council action taken last year. At the January 2002 Council meeting in Vancouver, the Council recommended that \$2.5 million of “Action Plan” funds made available by Bonneville’s Power Business Line to address the impacts of the 2001 power emergency on anadromous fish be protected in a placeholder for the specific purpose of funding the water brokerage program which is required by the 2000 Biological Opinion. Bonneville has projected spending on this program to be \$700,000 for Fiscal Year 2003. This cost must be funded from another source.

After applying the rules and standards noted in the six bullet points above to the “trued up” spending projections, the Council staff estimated that Fiscal Year 2003 spending for expense projects to be approximately **\$114,614,422**. The project-by project spending estimates are provided in Table 1 attached. They are organized by province and this table shows the overall Fiscal Year 2003 spending forecast.

When placeholders for funding subbasin planning, independent science functions, and addressing “gaps” for research, monitoring and evaluation required by the 2000 Biological Opinion and Bonneville’s overhead are added in, the total projects spending forecast for Fiscal Year 2003 is \$137,364,422. Table 2 shows the placeholder categories and amounts and total anticipated Fiscal Year 2003 spending projection.

As stated, this is a cash-management response to Bonneville’s request, and in no way should be construed as a Council reprioritization. To make this approach successful, Bonneville is going to have to follow actual project performance and its project and placeholder spending much more closely than it ever has before. Bonneville must be able to report current project and program-level spending twice a month beginning immediately. We see this as a necessary element in managing the program accounting under the “accrual” accounting rules currently imposed. Also, both Bonneville and the Council need to make provision for some minor project-level adjustments to the spending projections in Table 1 once project sponsors have an opportunity to review this guidance. We do not anticipate adjustments that would cause our projections to exceed \$139 million. The Council and Bonneville staff should agree upon the means to gather, consider and document these changes over the next few weeks. Something that follows the approach of the quarterly review meetings that we had before these events overtook us should be used.

Finally, our review of the fish and wildlife program for Fiscal Year 2003 costs has uncovered issues in addition to those discussed previously that must be dealt with. First, we are tremendously concerned about the Bonneville overhead cost increases. In Fiscal Year 2001 Bonneville’s overhead costs for this program were \$ 7.4 million. Bonneville insists that it requires \$12.1 million for its overhead costs in Fiscal Year 2003. This is an increase of 64%. It is difficult to accept this rate of expansion, especially when these overhead costs compete with on-the-ground fish and wildlife projects. We are also more convinced than ever that research, monitoring, and evaluation initiatives are uncoordinated and expanding at an incredible pace. There seems to be no willingness to approach this critical work in a more deliberate, rationale, and cost-effective manner. The Council will be paying very close attention to this situation in its pending mainstem/systemwide project recommendations. This is not a problem created entirely by Bonneville. However, we are calling on Bonneville to break free of the forces that would ignore and compound the problem, and work with us on a solution.

Fiscal Years 2004 through 2006

The Council cannot proceed to evaluate fish and wildlife expense program spending levels without resolving the issues identified above. At this point, the Council stands by its earlier statement to you that it is concerned that a reduction in Bonneville's spending commitment below \$139 million may jeopardize its ability to meet legal requirements under the Biological Opinions and the Northwest Power Act. Critical Biological Opinion check-ins are imminent. These are the funds that are necessary to implement many of the important projects and programs that must be in place to succeed in those evaluations. The reductions precipitated by Bonneville's immediate switch to its "accrual rules" are going to have an impact on our fish and wildlife restoration efforts. We are concerned that deeper and sustained cuts in the out-years may have serious impacts that could retard the progress we have been making.

We also want to alert you that we are seeing building pressure from Bonneville's 2000 Biological Opinion for salmon. The charge to pour all funds possible into that plan is squeezing out critical work for un-listed salmon, wildlife, and resident fish that must be accomplished under the Northwest Power Act. Bonneville has coined the term "Integrated Program" to describe a vision of a coordinated and balanced approach to its Endangered Species Act and Northwest Power Act obligations. Bonneville needs to look more to the Council to make this vision a reality. The Council does not believe the current federal drift to a listed-salmon only program is supported by sound science, sound public policy, or the law.

The Council offers this guidance with the utmost regard for the financial challenges you are facing. We are also keenly aware of and deeply concerned with the burden that ratepayers are shouldering now and how that burden will grow with another rate increase. It is precisely with the ratepayers in mind that the Council insists upon accounting and management reforms. The ratepayers deserve to know that their collected monies are being spent efficiently and for the purposes for which they were collected. We also recognize that this region continues to have one of the most complex and important fish and wildlife restoration problems in the world. Our guidance to you today is intended to balance many aspects of these urgent situations. While many challenges remain, we trust that you will understand the Council's effort and the seriousness with which we undertook this review. We look forward to continuing to resolve these issues with Bonneville.

Sincerely,

~

Judi Danielson
Chair