AWEC

Alliance of Western Energy Consumers ◆ 818 SW 3rd Avenue, #266 ◆ Portland, OR 97204 ◆ 971-544-7169 ◆ nwenergyusers.org

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Via Electronic Submission

Elliot Mainzer
Administrator and Chief Executive Officer
Bonneville Power Administration
911 NE 11th Avenue
Portland, OR 97232

Re: BP-20 Workshops – Transmission Rates, Power Rates, and Transmission and Power Risk

Dear Administrator Mainzer:

The Alliance of Western Energy Consumers ("AWEC") appreciates the opportunity to provide comments on the Bonneville Power Administration's ("BPA" or "Agency") proposals regarding transmission rates, power rates, and transmission and power risks that will be addressed in the BP-20 rate case for the 2020-2021 rate period. AWEC members purchase a broad range of power and transmission services from BPA. Accordingly, AWEC members are interested in the ongoing BP-20 workshops and upcoming BP-20 rate case.

BPA's initial indications of 5% power and 10% transmission rate increases for the BP-20 rate period have been troubling for many ratepayers. Around the country, ratepayers have been experiencing significant rate reductions in connection with tax reform. Further, volatile economic conditions have had varying impacts on different industries, putting increasing strain on many business sectors, including businesses that contribute significantly to BPA's customer base. Recent seasonal peak market prices might have been favorable towards BPA. Notwithstanding, long-term market prices in the Northwest continue to be below the rate for preference power. Given these dynamics, the issues surrounding BPA's competitiveness continue to be of great importance for the BP-20 rate period.

For BPA's preference product to have the value BPA claims it does, ratepayers need to be confident that rates will remain stable, and that there is a possibility that the Tier 1 rates might be back in the money in the future. Continuing the historical pattern of 5-10% biennial rate increases, however, will not give Tier 1 ratepayers such confidence. AWEC is hopeful that BPA will be able to identify opportunities to avoid the proposed rate increase to power customers, and offers the following comments in support of that objective.

I. Repayment Study

AWEC continues to have major concerns with BPA's repayment study. AWEC generally believes that those studies are no longer reliable for setting rates. The Diagonal Bricklayer Model construct that BPA uses to calculate repayment is not the optimal way for BPA to manage its debt, or to manage BPA's access to capital. The model appears to have little resemblance to the way BPA actually manages its capital obligations. Further, the modeling is cumbersome and not transparent, since ratepayers have little to no meaningful opportunity to review the repayment model itself.

It is inherently punitive to charge customers the higher of cost or cashflow, as BPA does with respect to minimum required net revenues. Doing so results in BPA recouping an amount of capital that exceeds 100% of its investment since timing differences exist between when the capital is recovered for accrual accounting purposes (i.e., depreciation expense) and when the capital is recovered for cash-flow purposes (i.e., principal repayment). The harmful nature of this dynamic is exacerbated for items with relatively short-term repayment periods, such as Large Generator Interconnection Agreements.

Notwithstanding, one of the reasons to be optimistic about BPA's ability to become competitive in the future is the fact that there is a significant amount of repayment embedded in rates at this time. AWEC understands that BPA is expecting an average annual amount of approximately $130 million in minimum required net revenues for the BP-18 rate proceeding. These revenues provide significant head room in rates, which BPA may be able to avoid in order to bring down the rate increase, provided that BPA can actively manage and reduce the repayment requirement.

As a result, AWEC encourages BPA to reconsider its reliance on outdated repayment study methodology, if rates are to regain their competitiveness in western power markets.

a. AWEC supports BPA's proposed changes in the presentation of minimum required net revenues.

AWEC understands BPA intends to change its presentation of minimum required net revenues, as well as the treatment of Energy Northwest debt obligations. AWEC understands that this change is due in part to new lease accounting standards.

Based on the information BPA has presented so far in the BP-18 rate case process, AWEC is generally supportive of BPA's proposed changes. The prior presentation, in which BPA prepared two separate repayment studies—one with Energy Northwest debt, and another excluding the Energy Northwest debt—was extremely difficult to review. AWEC is hopeful that BPA's proposed changes will make it significantly easier to review the repayment study, as well simplify the process of preparing the study.

b. The repayment model should assume that Energy Northwest debt may be refinanced, consistent with BPA's actual business planning assumptions.

AWEC understands that, in the Diagonal Bricklayer Model, BPA does not assume any ability to roll or refinance Energy Northwest debt. Notwithstanding, in BPA's access to capital workshops, BPA has proposed to rely on this refinancing as a source of capital for an indefinite period of time. Consistent with BPA's actual practices, AWEC recommends that the repayment study assume that principal payments associated with Energy Northwest debt may be refinanced or rolled in order to reduce BPA's repayment obligations.

Further, AWEC recommends that BPA's debt capacity to issue obligations through Energy Northwest should also be considered in the Borrowing Authority limit parameter within the repayment model.

c. *When modeling repayment requirements, BPA should consider the term of the financial obligation, not just the interest rate.*

Order RA 6120.2 requires that revenues go to federal debt by application to the highest interest-bearing investment first. In the past, however, this has lead to somewhat arbitrary results. In BP-18, AWEC observed that the levelized repayment requirement was being driven by higher cost obligations, which were eligible to be called by the model, but were not selected because other, higher cost obligations were called ahead of the obligations that were driving the critical year debt service obligation. Further, many of the obligations driving the repayment were relatively short- term obligations, where BPA possessed no ability to roll or refinance the obligation.

AWEC believes that, if the model, in calculating the levelized repayment, were to consider the term of the obligations, and not just the interest rate, BPA could reduce the repayment requirement significantly. Thus, AWEC recommends that BPA consider allowing the model to retire debt obligations in advance of other obligations that carry a higher interest rate, if doing so results in a lower levelized repayment calculation.

Under such a proposal, BPA would still adopt a policy that results in the retirement of the highest cost debt first. BPA's definition of what constitutes the highest cost debt obligation, however, would change. Under the current framework, BPA only considers the interest rate of the debt, but the cost of a debt obligation is not limited to just the interest rate. To determine the cost of a debt obligation, one must consider a multitude of factors, such as the term.

While obligations with a short term may come with a lower interest rate, those obligations come at a greater cost to BPA, since the principal must be repaid in a more expedited manner. Given the option to repay a short-term obligation or a long-term obligation, BPA may wish to call the short-term obligation in order to avoid the impending principal payment, even if the short-term obligation carries a lower interest rate.

If a significant sum of obligations are all coming due in a single year in the near term, and there is no way for BPA to refinance or restructure those obligations, it would not be consistent with sound business principles for BPA, for example, to call an obligation with a higher interest rate that is not due for several decades in the future, only for BPA to default on the current debt. The term of the obligation also has to be taken into consideration when making the decisions surrounding which obligations to call early in the repayment model. AWEC appreciates consideration of this issue, and at a minimum, requests that BPA consider how this issue impacts the repayment requirement.

d. *The repayment study for power should be relaxed relative to the transmission repayment study.*

AWEC continues to believe that Order RA 6120.2 requires BPA's repayment study for power to be relaxed, relative to BPA's repayment study for transmission. Specifically, Order RA 6120.2 does not require the power repayment study to consider whether each annual increment of federal investment is repaid in the repayment period. Rather, Order RA 6120.2 only requires power rates to be sufficient to recover each dollar of power investment over the repayment period. Thus, when performing the repayment study for power, it is permissible for the year-to-year repayment levels to be insufficient, provided that each dollar of investment is repaid over the repayment period.

e. BPA should carry a reserve against net plant for accumulated minimum required net revenues.

As noted above, the repayment methodology is punitive to ratepayers and results in ratepayers repaying more than 100% of the federal investment due to differences between accrual accounting and cash accounting. Requiring ratepayers to pay the higher of accrual accounting or cash accounting is fundamentally unfair and results in ratepayers systematically overpaying for their use of the federal investment, due to the timing differences surrounding the schedule of depreciation and the schedule of principal repayment.

An even more problematic aspect of BPA's approach is that, if rates are set on the basis of cashflows, ratepayers never get later credit for the additional cash repayment that the ratepayers financed through the minimum required net revenues in rates. To avoid overpaying, AWEC believes it is appropriate for BPA to carry a reserve account as an offset to net plant for accumulated minimum required net revenues. Such a reserve account would not impact the repayment study itself, but the depreciation accrual. To the extent that ratepayers have paid funds in excess of depreciation expenses, they should get credit for those amounts as an offset to plant balances in future periods. Absent such a mechanism, BPA will invariably recoup more than 100% of the federal investment.

II. Dispatchable Energy Resource Balancing Service Rates

AWEC continues to object to the overall construct surrounding DERBS. AWEC has voiced its concerns with respect to the DERBS construct in prior comments and will not repeat those comments here. Fundamentally, however, AWEC believes that the "incremental standard deviation" methodology is inequitable, particularly for federal customers with cogeneration resources. DERBS revenues are a small part of BPA's generation inputs revenue requirement, but for those DERBS customers who also happen to be struggling with the competitiveness of BPA's power product, it is a significant concern.

AWEC recognizes that DERBS rates are expected to decline in the initial proposal. Notwithstanding, AWEC views the DERBS rates as being higher than the average cost of balancing services, simply because this small group of customers has been carved out into a separate class. In the incremental standard deviation methodology, the benefits of intra-class diversity stay within the class. To the extent that a small number of customers with little diversity are so unfortunate to be placed in a class together, those customers end up paying more. Requiring customers to pay additional costs, solely because the rate class was defined in a certain way, is not a fair result. Accordingly, AWEC looks forward to further consideration of the methodology in the BP-20 rate case.

III. Secondary Revenues

AWEC appreciates the adder in the secondary revenue model that BPA implemented in the BP-18 rate case to account for incremental revenues associated with trading in power markets outside of the Northwest. In recent months, AWEC has observed an increasing demand for capacity products outside of the Northwest, particularly the types of capacity products that BPA is capable of offering. Accordingly, AWEC requests that BPA's secondary revenue forecast consider these potentially lucrative opportunities in the test period. AWEC understands that BPA has recently entered into a capacity sale to PGE, and AWEC requests BPA continue to seek out and undertake similar efforts to monetize the surplus capacity from the hydro system. As an example, the current market might be ripe for BPA to entertain the types of capacity exchanges that were once popular prior to the emergence of liquid bilateral markets.

Fundamentally, there is a mismatch between BPA's definition of firm power, and the definition of firm power used by other entities in the region. BPA establishes its firm product based on critical water, while for others, Schedule C is sufficient. This means that in 79 out of 80 water years, BPA is in a position of selling secondary capacity into short-term energy markets, essentially for free. Others in the region clearly lean on this secondary capacity for meeting resource adequacy requirements without paying BPA and its customers for this use of the Federal System. In order for BPA to maximize the value of its system, careful reconciliation should take place between the critical water assumptions and the actual capacity BPA is providing to the region. BPA should consider what its rates would be if the true firm capability for the FCRPS was, for example, 15,000 MW, rather than the approximate 7,700 MW currently under consideration in the rate period high watermark process.

AWEC also appreciates Staff's proposed changes to the way that the Net Secondary Revenue ("NSR") credit is calculated. Although Staff's proposal to use the mean NSR distribution rather than the median in setting the NSR credit would decrease NSR by $4.5 million, which is in addition to the estimated $90 million decrease, AWEC recognizes that Staff's proposal will more accurately reflect its expected value.

IV. Power and Transmission Risk

BPA has proposed two potential changes regarding the FRP: 1) potential implementation of a new mechanism used to trigger the cost recovery adjustment clause; and 2) implementation of the FRP through a Financial Reserves Surcharge that is calculated annually and capped at $40 million for power and $15 million for transmission, rather than through the existing $20 million collected from power rates for planned net revenues for risk.

While AWEC appreciates BPA's efforts to avoid the $20 million collection for PNRR, AWEC remains concerned with BPA's FRP, as the cap on the proposed Financial Reserves Surcharge for power is double the amount collected for PNRR, and still does not include the cap for transmission reserves.

Further, AWEC is concerned that BPA has not adequately considered the value of the liquidity facility. BPA has used the analogy that one does not put groceries on the credit card, as justification for not using the liquidity facility. AWEC does not agree with that analogy, however. First, it is appropriate in some circumstances to put groceries on the credit card, provided that the shopper has the ability to repay the credit card balance. Second, BPA's circumstances are not analogous to an individual shopping at a supermarket. The actual amount of repayment in any give year for BPA is determined by the repayment studies, and borrowing from the liquidity facility will not result in a dollar for dollar increase to the repayment requirement in years subsequent to drawing on the facility. Once the mechanics of the repayment study are taken into consideration, AWEC expects that borrowing from the liquidity facility will not have material impacts on the repayment requirements. Accordingly, AWEC believes it is appropriate for BPA to rely on the liquidity facility to replenish reserves, since it might do so without resulting in a corresponding increase to repayment.

AWEC appreciates this opportunity to comment on the above-referenced BP-20 rate case workshops and looks forward to working with Staff in the period leading up to the development of the initial proposal.

/s/ John Carr
Executive Director
Alliance of Western Energy Consumers