

Comments of the M-S-R Public Power Agency Regarding BP-20 Workshops

M-S-R¹ values the opportunity to comment on BPA's BP-20 workshop materials. M-S-R is concerned that the rates presentation for Transmission does not reflect a focus on providing service at the lowest rates necessary to recover costs, nor does it reflect a desire to control those costs for Transmission. M-S-R's comments focus on five issues: (1) rate increase targets; (2) depreciation; (3) I5 Reinforcement amortization; (4) debt repayment modeling; and (5) Large Generator Interconnection Agreement ("LGIA") network upgrade credits and financing.

M-S-R urges BPA to: (1) set goals to limit Transmission rate increases, similar to its commitment on the Power side; (2) explain why reserves for risk for Transmission continue to grow, despite projections of lower reserves; (3) explain and justify the depreciation rate increase as part of BP-20; (4) explain how BPA addresses customer funded plant when it calculates depreciation expense; (5) extend the amortization period for the expected life of the now abandoned I5 Reinforcement assets, or alternatively fund the accelerated amortization through working capital/reserves; (6) reduce rates if they would collect more than "costs" of debt repayment or depreciation, rather than manually increasing costs through the repayment study; (7) explain the potential double counting of LGIA credit costs; and (8) address the pros and cons of BPA funding LGIA network upgrades with long-term debt rather than using short-term customer financing at higher costs.

¹ The M-S-R Public Power Agency ("M-S-R") is a joint powers agency formed by the Modesto Irrigation District, and the Cities of Santa Clara and Redding, California, each of which is a consumer owned utility. Beginning with a 2005 contract, M-S-R obtained contractual rights to the output from some of the first large scale wind resources developed in Washington State. M-S-R and its members currently have rights to 350 MW of wind generation in Washington and Oregon, which its members use to serve their customers and meet California's Renewable Portfolio Standards. Those customers ultimately bear the cost of the Bonneville Power Administration ("BPA") Transmission and ancillary services rates and charges.

I. Rate Targets – Caps on Increases Should Apply to Both Business Lines

During the July 25th workshop, there was a striking difference between the presentations for Power and Transmission. For Power, BPA explained it was working towards a target of keeping rate increases in line with inflation, limiting increases to roughly 2-2.5% per year, or 4-5% for the rate period. For Transmission, no mention of a similar goal was made, and a response to questions indicated no attempt is being made to keep Transmission rate increases in line with inflation. Indeed, BPA is proposing a ten (10%) percent increase in rates for Transmission, when inflation remains below three (3%) percent.

It is disappointing, if not unlawful, that no similar cost increase target is being applied to Transmission. If there are drivers that increase costs that are beyond BPA's control, there should be an effort to find off-setting reductions in other costs to maintain target increases, the same as is being done for the Power business line. The need for cost control is no different for either business line, particularly with the independent rate pressures that may be presented through the Financial Health processes, grid modernization, and projected capital investments.

The need for a focus on cost control for Transmission is highlighted, in part, by the continued growth of Transmission's reserves available for risk. The BP-18 rate case materials forecasted a reduction in Transmission's reserves over the two year rate period as follows:

| | | | |
|--|---------------|---------------|---------------|
| BPA BP-18 Forecasted Reserves for Transmission ² | | | |
| 2016 | 2017 | 2018 | 2019 |
| \$444 million | \$352 million | \$346 million | \$299 million |

² See BP-18-E-BPA-05 at 113, Table 8, line 9.

Instead of the projected decline, Transmission's reserves for risk actually grew to \$463 at the end of 2017, and are projected to grow further to \$472 million by the end of 2018. The BP-18 rates were established at a level that was projected to generate revenues sufficient to cover costs, and end 2018 with \$126 million less in reserves than is now projected. There has been no explanation provided for the growth in reserves, but it logically indicates BPA is charging Transmission customers' rates that are higher than those necessary for BPA to recover its costs, which conflicts with BPA's statutory authority.

It is essential that Transmission's cost projections be thoroughly scrubbed and reduced so that Transmission customers are not charged more than necessary for BPA to recover its costs. M-S-R would also appreciate an examination and explanation of the reasons why Transmission reserves continue to grow.

II. Depreciation

M-S-R has two concerns with Depreciation. First, BPA indicated that a new Depreciation study was performed for Transmission,³ and BPA's application of the results of that study impose about \$46 million in additional costs on Transmission customers. That alone accounts for nearly half the rate increase BPA proposes to impose on Transmission customers. BPA presents the depreciation cost as an unmovable figure, based solely on the study performed by a contractor, with no explanation or justification by BPA. M-S-R asserts that the new study must be supported with testimony in the BP-20 rate proceeding, fully explaining the changes being imposed.

Second, it is not clear how BPA is addressing depreciation for customer funded plant. For example, during the past 5 or 6 years BPA has used Transmission reserves to fund \$15 million of capital investment each year. BPA has also extensively discussed the possibility of significant levels of revenue financing of capital projects in the Financial Health workshops. M-S-R understands that depreciable plant does not include contributed plant. However, it is not clear

³ M-S-R understands that BPA does not study depreciation for Power assets because BPA does not own the Power assets.

whether or not BPA is applying Depreciation expense to its customer funded assets, nor is it clear what BPA would do if a program of revenue financing of capital investments is pursued.

III. I5 Reinforcement Amortization Should be Over the Life of the Planned Asset, or Alternatively Funded with Reserves

The July 25th workshop materials indicate that BPA intends to amortize Transmission's \$130 million investment in studies of the now abandoned I5 Reinforcement project over a period of five years. That 5 year amortization causes a \$26 million per year increase in Transmission's revenue requirement, accounting for roughly 2.5% of the projected 10% rate increase. Under common utility ratemaking principles, abandoned plant is amortized over the expected life of the asset. M-S-R understands the bulk of the I5 Reinforcement project would have involved long-life transmission plant – with a life of 30 or more years. Because the investment was made to develop a long-lived asset, the investment should be amortized over the corresponding long-life period of 30 plus years, not 5 years. The 5 year amortization period has not been justified, and will impose significantly higher rate increases on Transmission customers than would occur if the investment is recovered over a reasonable time period.

Alternatively, if BPA proceeds with amortizing the investment over a shorter time period (presumably to address access to capital concerns), the expense should be funded through working capital, or in the case of BPA Transmission, reserves.

IV. Apply Revenues in Excess of Depreciation or Repayment to Reduce Rates

Based on the July 25th presentation on the repayment study, M-S-R understands that, if the revenue requirement for a particular year is higher than “costs,” including the greater of debts to be repaid as determined by the repayment study or depreciation, BPA manually adjusts the repayment model or its output to increase repayments in that year. M-S-R asserts that making the manual adjustment sets BPA's rates higher than necessary to recover its costs, including repayment of debt over a reasonable period of years. To provide transparency,

BPA should fully document and explain any adjustment to the repayment model or its output, particularly any adjustment that increases projected or planned repayment of debt. Further, given the various other upward pressures on Transmission rates, instead of adding debt repayment or other costs to match projected revenues, BPA should reduce the rates for that year, bringing the rates down to the level necessary for revenues to recover BPA's actual costs, including repayment of debt over a reasonable period of time.

V. LGIA Double-Recovery and BPA Funding of Network Upgrades

M-S-R has two comments regarding BPA's treatment of network upgrade funding under Large Generator Interconnection Agreements (LGIA). First, during the July 25th workshop, a number of questions were raised regarding the manner in which BPA accounts for funds received from customers, and corresponding credits issued to customers when they fund network upgrades pursuant to LGIA. The discussion indicated there is a potential double-counting – once when BPA accounts for the credits as negative cash, and again when BPA accrues cash to offset the credit. M-S-R would appreciate clarification of BPA's LGIA accounting and rate treatment.

Second, customer funding of network upgrades is a short-term borrowing from the customer to fund upgrades of long-lived assets. M-S-R understands the funds are returned, with interest, over a period that is typically seven years (although the LGIA provides for terms up to 20 years). From workshop discussions, M-S-R understands the interest rate applied to the funds is one of the more expensive forms of borrowing for BPA.⁴

Consistent with the *pro forma* LGIA, BPA's standard LGIA allows BPA to elect to fund network upgrades on its own rather than having customers provide short-term financing of the upgrades.⁵ M-S-R is aware of other transmission owning

⁴ The LGIA provides for interest based on "the rate for ten-year bonds posted on Bloomberg, L.P., under the United States Government Agency fair market yield curve (yield curve number 84)."

⁵ This is reflected in section 11.3, which includes the following statement: "Unless Transmission Provider or Transmission Owner elects to fund the capital for the Network Upgrades, they shall be solely funded by Interconnection Customer."

utilities electing to fund network upgrades associated with LGIA's.⁶ M-S-R would appreciate a discussion as to whether or not BPA has considered funding LGIA network upgrades, and how the resulting costs would compare with the current method of using customer funding. In addition to potentially lowering interest costs, BPA funding LGIA network upgrades through long-term debt would: (1) better match the repayment with the life of the asset; and (2) reduce the complexity of the current LGIA accounting. M-S-R acknowledges that doing so would utilize some of BPA's limited access to capital. However, the July 25th discussion of expanding the Regional Cooperation Debt ("RCD") indicated that, if the RCD expansion goes forward, BPA would utilize its least cost source of funding, which would indicate other sources of funding would be used before using LGIA customer funding.

VI. Conclusion

M-S-R appreciates the opportunity to provide its comments on the BP-20 workshop developments, and looks forward to working with BPA on the issues identified above.

⁶ See e.g., LGIAs submitted for filing by Southern California Edison in FERC Docket Nos. ER10-796, ER10-2169, ER11-2177, ER11-2204, ER11-2316, ER11-2322, ER11-2411, ER11-2455.