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TESTIMONY of

RONALD J. HOMENICK, STEPHANIE A. ADAMS, DANA M. JENSEN,

LEON D. NGUYEN, and ALEXANDER LENNOX

Witnesses for Bonneville Power Administration

SUBJECT: POWER REVENUE REQUIREMENT STUDY **Page**

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Section 1: Purpose of Testimony

Q. Please state your names and qualifications.

A. My name is Ronald J. Homenick, and my qualifications are contained in BP-14-Q-BPA-27.

A. My name is Stephanie A. Adams, and my qualifications are contained in BP-14-Q-BPA-02.

A. My name is Dana M. Jensen, and my qualifications are contained in BP-14-Q-BPA-29.

A. My name is Leon D. Nguyen, and my qualifications are contained in BP-14-Q-BPA-50

A. My name is Alexander Lennox, and my qualifications are contained in BP-14-Q-BPA-40.

Q. What is the purpose of your testimony?

A. This testimony sponsors the Power Revenue Requirement Study (Study), BP-14-E-BPA-02, and its Documentation, BP-14-E-BPA-02A. This testimony also sponsors cost analyses derived directly from the generation revenue requirement, such as the itemized cost data used in the Rate Analysis Model (RAM2014) and the embedded cost determinations for the generation inputs to ancillary services and the Army Corps of Engineers (Corps) and Bureau of Reclamation (Reclamation) transmission facilities. Documentation, BP-14-E-BPA-02A, chapter 2. Its counterpart study, the Transmission Revenue Requirement Study, BP-14-E-BPA-08, develops the transmission revenue requirement.

Section 2: Generation Revenue Requirement

Q. Did you make any changes in the BP-14 Initial Proposal to the methodology previously used to determine the generation revenue requirement?

A. No. We used the same methodology in this Initial Proposal to determine generation revenue requirements as has been used since the BPA 1987 Wholesale Power and Transmission rate filing. The basis for the revenue requirement is the total accrued expenses projected for each year of the rate period, displayed in an income statement format. In addition, a cash flow statement is used to determine whether additional net revenues are required to cover the amortization payments scheduled by the repayment study and the cash required for risk mitigation. Study, BP-14-E-BPA-02, section 1.1.

Q. How did you use the forecast of program spending levels and capital investments when developing the generation revenue requirement?

A. The program spending levels in the generation revenue requirement were developed and finalized during the 2012 Capital Investment Review (CIR) and 2012 Integrated Program Review (IPR). Beginning in January and continuing through July 2012, BPA conducted the CIR and IPR with BPA customers and constituents to examine and take comments on BPA's proposed cost projections to be used in the current BP-14 rate case. BPA issued the IPR Close Out Report on October 26, 2012, that described the program level expenses and capital investments to be used in BPA's BP-14 Initial Proposal and the preferred debt management option.

Q. Have the forecasts of program spending levels changed since the end of the IPR?

A. No. The forecasts of program spending levels are unchanged.

Q. *Has the forecast of capital investments changed since the end of the IPR?*

A. No. The forecast of capital investments has not changed since the IPR concluded. However, we have recalculated depreciation and amortization based on the capital investment forecasts included in the IPR Close Out Report. Similarly, we also reran the repayment studies to produce the planned amortization payments and resulting gross Federal interest expenses using the projected capital spending levels decided on in the IPR.

Q. *Have you made any refinements related to the revenue requirement determination?*

A. Yes. We refined the forecasting of depreciation expense and interest income to better reflect in the rate the conditions that affect actual operating year results.

Q. *Please describe the change to the depreciation forecast.*

A. We refined the depreciation forecast to include a forecast of plant retirement during the rate period at Corps and Reclamation facilities. A typical rate case depreciation forecast starts with cumulative plant investment that has been trued up to the last historical year. We have always factored in plant additions through the rate period to calculate annual depreciation expense. During an operating year, though, plant will be retired for a wide variety of reasons. To account for this, we refined our analysis by calculating the average of retirements in the last five historical years by project for Corps and Reclamation projects, then deducting that average from the annual calculation of cumulative plant for each project. This reduces depreciation expense by approximately $500,000 per year of the rate period.

Q. *Did you factor in retirements for BPA plant as well?*

A. No, it was not necessary for those plant accounts. Those short-lived investments are known by in-service year and are retired in the calculation of depreciation expense once the individual investments are fully depreciated.

Q. *Please describe the change to the forecast of interest expense.*

A. We refined the forecast of interest income to include interest income on Funds Held for Others (FHFO). BPA divides financial reserves into two categories, FHFO and reserves available for risk. FHFO refers to funds deposited with BPA that are not a result of the normal sale of services or power and that are dedicated to specific purposes. For example, other Federal agencies periodically provide funds to BPA to pay for energy efficiency improvements. Historically, the practice has been to forecast interest income during the rate period using only reserves available for risk. Including a forecast of interest earned on FHFO will better reflect actual operating results because BPA earns interest income during an operating year on all cash in the BPA Fund and on Treasury investments. This change increases interest income in the Initial Proposal revenue requirement by approximately $1.1 million per year.

Section 3: Cost Analyses

Q. Did you change anything in the cost analyses that are derived from the generation revenue requirement?

A. No. We continue to produce cost analyses as described in the BP-12 Final Power Revenue Requirement Study and Documentation.

Section 4: Repayment Study

Q. Did you make any changes to the repayment study model?

A. No. We continue to use the same model as described in the BP-12 rate proceeding.

Q. Have you changed any of the inputs to the repayment model?

A. Yes. In addition to the projected capital investments noted earlier, we have included forecasts of future transactions affecting capitalized contracts.

Q. Please describe these forecasts.

A. We are forecasting transactions affecting two sets of capitalized contracts. First, we are forecasting the refinancing of Columbia Generating Station (CGS) debt that will come due in fiscal years (FY) 2014 and 2015. This transaction will better align debt with asset life now that CGS has been relicensed. The second transaction involves refinancing debt held by Lewis County PUD that is associated with its Cowlitz Falls facility. Combined, we expect these transactions to reduce the revenue requirement by over $85 million per year, which if not implemented would result in approximately a 4 percent rate increase. These transactions were described at the public Access to Capital Debt Management Workshop on June 19, 2012.

Q. Did you make any other changes involving the repayment study?

A. Yes. Rather than allow the repayment study to determine the level of Federal repayment in FY 2014 and 2015, we fixed the total of amortization and irrigation assistance to equal the total non-cash elements (*i.e.,* depreciation, the capitalization adjustment, and accrual revenues) forecast for that period.

Q. Why did you do this?

A. The purpose of the repayment study is to establish annually a long-term plan for repayment that satisfies the statutory requirement for ensuring "timely repayment of the Federal investment." It does this by levelizing Federal principal and resulting interest payments with the non-Federal projects' debt service for a given study year plus the ensuing repayment period (50 years for generation).

The original repayment methodology from the 1960s used a particular revenue forecast as the starting point: those revenues, less all cash-related expenses, represented resources available each year in the study for principal and interest payments. If the study could develop a levelized schedule to fulfill repayment requirements within the repayment period, existing power rates could be extended. In the early 1980s, as BPA developed a plan to make up for missed annual repayments and unpaid interest expense, the methodology was modified in order to determine the lowest possible levelized debt service. This was done by excluding the revenue forecast and determining the debt service in isolation.

What we are doing now is akin to the original methodology; namely, giving the study a predetermined value to set for the rate period repayment, equal to the total non-cash elements in the revenue requirement for that study year. The study begins the levelized debt service for Federal and non-Federal obligations after the test year and extends it over the repayment period. This approach succeeds because BPA and Energy Northwest anticipate revenues from the Tennessee Valley Authority related to a debt issuance for the acquisition of nuclear fuel. Those revenues are a key component of the transaction and are considered in the cost recovery demonstration in the Power Revenue Requirement Study, where they provide an offset to the debt service, thus lowering the overall debt service there rather than in the repayment study.

Section 5: Possible Changes for Final Proposal

Q. Could there be additional changes affecting the Power Revenue Requirement Study in the BP-14 Final Proposal?

A. Yes. The repayment study database will be updated for any debt management actions completed prior to the Final Proposal. The Final Study may reflect BPA's borrowing plan and repayment plan for FY 2013–2015. We will also update the repayment study for any changes in non-Federal debt management data and assumptions. If a new interest rate forecast has been performed, that will be reflected as well. The estimate of FY 2013 ending reserves will be updated for the Final Study, which could affect such things as interest credit amounts, key risk modeling data assumptions, and probability results. We will correct any inconsistencies found in the study. For example, we discovered after the determination of rates and the compilation of documents that the value of Corps and Reclamation transmission plant had not been updated. This will be corrected for the Final Proposal. Finally, if BPA chooses to update its program spending forecasts for FY 2014–2015 after the publication of the Initial Proposal, the results would be used in the Final Proposal.

Q. Are other changes in the Power Revenue Requirement Study possible in the Final Proposal?

A. Yes. In the BP-12 rate proceeding, we included a contra-expense to recognize that the application of unspent Green Energy Premium (GEP) revenues earned during the WP-07 and WP-10 rate periods will offset Power Services' share of Wind Integration Team (WIT) expenses. Homenick *et al.*, BP-12-E-BPA-13, at 4. BPA plans to fully expend these funds during FY 2012–2013. However, if it appears that these funds will not be fully expended by the end of FY 2013, we will apply the remainder to offset FY 2014-2015 costs in a manner similar to that described in the BP-12 rate proceeding.

BPA is in the process of developing an Access to Capital strategy. The strategy includes a financing tool, called the prepayment program, that would affect the Power Revenue Requirement Study. BPA issued a request for offers in August 2012, but responses are not due until after the publication of the Initial Proposal. If the program moves forward, it will need to be incorporated in the Final Proposal revenue requirement.

Q. How would the prepayment program affect the revenue requirement?

A. The prepayment program involves customers prepaying future power bills by purchasing blocks of revenue credits that would be applied to billings through FY 2028, when the current Regional Dialogue contracts expire. Application of the credits will reduce cash flows from revenues and would need to be included in the statement of cash flows and the determination of whether Minimum Required Net Revenues are needed. The credits would be included in line 7, Accrual Revenues, on the Statement of Cash Flows. *See* Study Table 7. The credits would have the effect of reducing cash generated from operations.

Q. Does that conclude your testimony?

A. Yes.