PFR - 074

MAY 20 2005

COLUMBIA RIVER INTER-TRIBAL FISH COMMISSION

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Telephone 503 238 0667
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May 20, 2005

Steve Wright
Administrator and CEO,
Bonneville Power Administration
P.O. Box 3621
Portland, OR 97208-3621

Dear Mr. Wright:

The Columbia River Inter-Tribal Fish Commission (CRITFC) is sending providing these comments to express the concerns of our member tribes with the "Draft Closeout Report: BPA's Proposed Changes to PFR Base Costs," dated May 2, 2005. Thank you for providing this opportunity to comment. We would like to work with you to improve the proposal prior to the initiation of the next rate case.

We believe that the budget levels proposed for the Integrated Fish and Wildlife Program in the Power Function Review (PFR) is not sufficient to implement needed salmon restoration measures supported by the Tribes, such as measures found in both the Columbia River Basin Fish and Wildlife Program and the FCRPS Biological Opinions. These funding levels will affect important fish and wildlife rebuilding efforts during FY 2007 through FY 2009.

To correct the record, we draw your attention to the letter from CBFWA dated March 16, 2005, in which CBFWA stated that full implementation of the Northwest Power and Conservation Council (NPCC) Program will require spending about $240 million per year over ten years, not "$460" million per year as the draft proposal indicated. The point is that fish and wildlife mitigation in the Columbia River Basin will require a serious financial, as well as social and political, commitment. We do not believe that BPA's PFR proposal represents an adequate financial commitment to meeting its fish and wildlife obligations.

BPA's proposed PFR forecast for its Integrated (Direct) Program budget (on page 19 of the draft document) includes $143 million per year for direct expenses and would make $36 million of borrowing authority available for fish and wildlife mitigation. However, BPA's internal policies preclude borrowing to fund most fish and wildlife mitigation, making the availability of the capital budget largely a hollow promise. The proposed PFR expense budget would be allocated among parts of the Integrated (Direct) Program as outlined in Table 1 according to BPA staff.

Table 1. BPA Proposal (Millions of dollars)

	FY'07-'09 Proposed Spending	FY'01-'04 Average Spending	Difference
Research, Monitoring &Evaluation	$ 33	$ 41	
Info Management, Coordination & Administration	$ 7	$ 11.7	- $ 12.7
Production	$ 38	$ 39.6	-$ 1.2
Mainstem	$ 5.3	$ 6	-$ 0.7
Habitat	$ 38.5	$ 35.8	$ 12.7
New BiOp/SBP	$ 10	$ 0	
BPA Overhead	$ 11	$ 11	$ 0
TOTAL	$143.2	$145.1	- $ 1.9

The "Difference" column of Table 1 shows the change from current spending levels that would occur from carrying out the proposed budget changes. The BPA proposal is basically a net transfer of $12.7 million per year from the research, monitoring and evaluation, information management and coordination portions of the budget to habitat mitigation and "new BiOp & subbasin plans portion while reducing other portions of the budget slightly. This represents an attempt to increase the proportion of the budget spent for "on-the-ground" work. This would make an annual habitat budget of about $48.5 million which, superficially, appears to be an improvement.

However, a closer examination of the assumptions underlying the BPA proposal reveals that the funds likely to be available to carry out new habitat work will be considerably less, as we show in the calculation outlined below.

	Amount	Note
Funds Budgeted for Habitat ($M/yr)	$48.5	
Less ongoing "base" or fixed costs	-$12.1	1
Less 1.5% inflation increase in costs	-$0.7	2
Less 3.5% additional inflation in land and water costs	-$3.7	3
Less unrealized cuts in other parts of F&W Program	-$12.7	4
Total available for habitat work ($M/yr)	$19.9	

Starting with the BPA proposal amount for habitat ($48.5 million per year), about $12.1 million per year are "base" or fixed costs that BPA is required to fund (Note 1) that will not be available for new work. BPA has acknowledged the existence of inflation in the high alternative discussed as part of the PFR (1.5 or 3 percent annually) but not incorporated inflation in its proposal. Assuming the assumptions in the high case considered in the PFR, inflation will reduce the available funds by $0.7 million per year (Note 2). We do not, however, accept a 1.5 percent rate of inflation for riparian land and water leasing costs. We expect these costs to escalate by at least 6 percent annually. Thus by applying the BPA guideline of 70 percent of costs being for on-the-ground work and applying and additional 3.5 percent inflation rate more appropriate for land and water costs in the arid West, reduces the available funds by another $3.7 million per year by FY 2008 (Note 3).

Finally, the BPA proposal assumes a $12.7 million per year cut to current and future research, monitoring, data management, and coordination costs to free funds for new on-the-ground activities. While this is a commendable goal, it is counter to the increasing pressure for ESA-driven studies and ISRP monitoring. BPA's proposal acknowledges the many additional steps that must be negotiated before funding decisions will be made. This will delay decisions to reduce current RM&E and IMCA costs at least until FY 2008, mid-way through the rate period (Note 4).

For example, we note that funding for the info. management/coordination & administration portion of the budget is currently used for: StreamNet ($2.4 million/yr), the PIT tag info system ($2.1 million/yr), CBFWA ($1.7 million/yr), the Fish Passage Center ($1.3 million/yr), the ISRP/ISAB ($1.1 million/yr), CRITFC watershed support ($0.27 million/yr), Second-Tier Database ($0.24 million/yr), Columbia Basin Bulletin ($0.17 million/yr), and one-half million in miscellaneous small projects. We find it unlikely that the region collectively, or BPA unilaterally, will decide to eliminate and/or substantially cut these efforts in sufficient time to realize the projected benefits by FY 2009.

Thus we believe that the BPA proposal represents a commitment of no more than about $20 million per year for new habitat mitigation efforts. Further, by reducing the proposed budget and capping it, any cost increases in other parts of the Integrated (Direct) budget will reduce new habitat mitigation efforts. For example, any increases in the BPA fish and wildlife overhead costs above $11 million per year (whether due to inflation in salary or benefits costs or additional regulatory requirements), will reduce the funds available for habitat mitigation.

We believe that BPA's PFR proposal has not recognized the considerable uncertainty surrounding its future fish and wildlife funding needs and as a result has inequitably shifted the financial risks from the power system to fish and wildlife resources. When CBFWA conducted a review of the costs of future fish and wildlife activities, they identified a number of issues that could significantly increase those costs. For example:

1. CBFWA's analysis assumed that other branches of the federal government would provide contributions. For example, the costs for implementing plans in several subbasins (notably those in the Intermountain Province) assume funding from the federal land management agencies that may or may not be forthcoming. If additional Federal appropriations are not available, the region will need to address how to accomplish this work.
2. NOAA Fisheries staff has indicated on several occasions that implementing the subbasin plans may not address all of the activities in the forthcoming recovery plans.
3. Pending litigation on the current Biological Opinions may result in significant changes in required fish and wildlife activities, and may increase costs or affect revenues.

4. Implementation of the "Mainstem Amendment" to the NPCC Fish and Wildlife Program may increase costs or affect revenues also.
5. When favorable ocean conditions deteriorate, BPA may be called upon to fund additional activities to address weak-stock survival or productivity.
6. The NPCC Artificial Production Review and Evaluation and the Hatchery Genetic Management Plans call for changes in the operation of many hatcheries built as mitigation for the hydropower system. Preliminary estimates indicate that these changes may cost about $120 million and require about $340 million in capital borrowing. These costs are not presently reflected in the BPA draft costs for the upcoming rate case and thus costs for the Reimbursable and the Integrated Program budgets may increase.
7. The prospect of shifting the cost of the Mitchell Act hatcheries to BPA is a substantial uncertainty, considering Congress's previous interest in this issue and increasing pressures on the federal budget.

Rather than mitigating these uncertainties, BPA's draft proposal has made assumptions that exacerbate the risks. By not budgeting for likely increases in fish and wildlife costs, BPA's draft proposal will result in additional delays in needed mitigation actions.

Given this analysis, CRITFC is concerned that the BPA proposal for the Integrated Fish and Wildlife Program is not adequate to implement the Council Program and the Biological Opinions. Failure to make adequate progress could increase the risk of extinction for listed species and makes it unlikely that the region will achieve the fish and wildlife rebuilding goals in the Council's Program.

Based on our review of future fish and wildlife funding needs, we offer the following conclusions and recommendations:

BPA must meet the goals of the Fish and Wildlife Program.

- After considerable analysis, the NPCC adopted in 1987 an interim estimate of the hydropower (BPA) responsibility to fish and wildlife of 5 million returning adult salmon and mitigation for resident fish and wildlife.
- The Program also identifies specific goals for resident fish and wildlife mitigation to address the operation and construction of dams and inundation by reservoirs.
- The NPCC reaffirmed these responsibilities in adopting its amended Fish and Wildlife Program in 2000.
- Current numbers of returning salmon are approximately the same as they were when the NPCC adopted the interim goal 18 years ago.

➢ ***Therefore,*** *the funding recommended by CRITFC through FY 2009 is not likely to exceed costs necessary to achieve the Fish and Wildlife Program goals.*

Full implementation of the F&W Program and ESA activities will create economic benefits in tribal and rural areas.

- Most of the fish and wildlife activities would be implemented in rural areas east of the Cascade Mountains creating jobs and additional economic activity.
- As fish and wildlife populations increase as a result of these BPA investments, east-side rural areas will experience increased fishing, hunting and related activities, also creating additional jobs and invigorating local economies.
- For those (residential) customers served by utilities purchasing all of their power from BPA the recommended budget levels would result in about a $1 per month increase in their electric bill. The impact to those served by utilities that purchase less than their full requirements from BPA would be less.

Therefore, *CRITFC recommends that BPA examine the benefits to rural economies from its investments in fish and wildlife.*

BPA should develop a more flexible capitalization policy to facilitate land and water acquisitions.

- BPA's current policy on capitalization is unclear regarding the use of its borrowing authority to purchase land and water.
- BPA's interpretation of its policies has inhibited the implementation of the Fish and Wildlife Program.
- If BPA uses its borrowing authority for these kinds of purchases, the rate impacts of our recommendations are significantly reduced.

➢ ***Therefore,*** *BPA should modify its capitalization policy to set up mechanisms to allow borrowing funds or the use of its borrowing authority to purchase land and water.*

BPA should address the uncertainties in fish and wildlife costs in its rate case.

- We note that with the intent of providing these estimates of future budget needs, that these estimates do not incorporate numerous factors that may increase the needs, and that these budget targets are likely to be under-estimates of actual needs.
- In the previous rate case BPA used two means to address uncertainties: Cost Recovery Adjustment Clauses and revenue collection to meet more than the minimum need.

➢ ***Therefore,*** *we urge BPA to work with others to ensure its rates provide adequate fish and wildlife funding. BPA's rate provisions must ensure that it can adequately fund future additional fish and wildlife costs.*

The fish and wildlife managers have developed realistic and reasonable cost estimates for the rate case period.

- It takes some time to increase the rate of implementation.
- The 2002 rate case set BPA revenues with the intent of providing a fish and wildlife budget of $186 million per year.

➢ ***Therefore,*** *we recommend that BPA ramp up its Integrated Fish and Wildlife Program budget to meet the these targets:*

- *$186 million in FY 2006;*
- *$200 million in FY 2007;*
- *$225 million in FY 2008; and,*
- *$240 million in FY 2009.*

BPA needs to include adequate funds for fish and wildlife in its next rate case.

- Implementation of the NPCC subbasin plans and including wildlife mitigation over a ten-year period will cost between $1.5 and $2 billion.
- The total cost to implement the Fish and Wildlife Program and associated ESA needs is estimated to be about $240 million per year.
- Carrying out the subbasin plans would only accomplish between one-quarter and one-half of the habitat work needed in the tributaries of the Columbia and Snake Rivers.
- At the current BPA Integrated Program funding rate of $139 million per year, it would take about 100 years to implement the NPCC Fish and Wildlife Program.
- ***Therefore,*** *we recommend that BPA increase the amount of funds available for fish and wildlife activities to approximately $240 million per year.*

We look forward to working with BPA and the Council to revise the FY 2007 to FY 2009 budgets prior to the rate case.

Sincerely,

/S/

Olney Patt, Jr
Executive Director.

PFR - 075

MAY 20 2005

Grays Harbor PUD

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May 18, 2005

Paul E. Norman, Senior Vice President
Power Business Line
Bonneville Power Administration
P.O. Box 14428
Portland, OR 97293-4428

Re: Comments on The Power Function Review

Dear Mr. Norman,

Thank you for the opportunity to comment on BPA's Power Function Review process. While we appreciate the effort BPA has made to conduct an open process with input from constituent groups, we are very concerned that much of that input seems to have been ignored in the development of your proposed costs. Most of what was presented was prepared by BPA employees without customer input and then presented for comment by customer technical and management employees.

During the entire PFR process, BPA heard repeatedly from its customers that the customers would like BPA to set a contingency budget based upon serious cost control targets. That way if conditions are not good it will not impact rates, but if things are good BPA could use the extra income on a contingency basis. BPA rejects this suggestion and continues to establish its budget expectations in the various categories of expenditures. Why is it that BPA continues to refuse to set a budget target of expenditures that can meet a rate target of $27 per MWh inclusive of risk? Listening to customers is great. Even better would be to take customer input seriously and to incorporate their suggestions into your budget process.

The managers were presented with grossed-up numbers and justifications for why those numbers were what they were. The managers were never presented with detailed background information that could show how those numbers were arrived at. Where were the cost-benefit studies, the detailed scientific or engineering studies that would usually accompany these numbers? While I see a lot of effort to provide information, I still struggle to see the true transparency that BPA keeps talking about. Until BPA truly demonstrates a willingness to listen to customer input AND to act on its customer's recommendations, rather than proceeding down what still appears as a pre-determined path, the customers will have little faith that BPA is attempting to act in their best interests.

The following comments outline some of the areas where we feel BPA can do a better job of cutting costs.

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Transmission: Modeling of the system for optimal usage and lowest cost.

BPA's method for modeling its transmission system is not very transparent to customers. It seems that BPA's models are designed to be extremely conservative and are meant to avoid the absolute worst-case scenarios. In doing this, cost recovery requirements and expectations have to be larger than if the system were designed for optimal performance. If the models are designed to assume full usage and thus several points of congestion, this also raises revenue requirements. If generation is modeled such that it is assumed to add to congestion because it is strictly going to market, not actually lowering local transmission requirements, then costs will also be skewed upward.

Since the customers don't know exactly what methodology BPA uses to come up with its cost recovery numbers, there is no way of knowing if they are accurately derived. If the studies are driven by market expectations and not by physical realities, then we are concerned that the numbers will be skewed inappropriately and much higher than they should be.

It is incumbent upon BPA to provide its customers with information on how it determines these cost requirements. Grays Harbor believes BPA could lower its costs in this area substantially. When BPA incurs costs due to special generation or load requirements then those specific costs should be borne by that customer or generator. Since BPA is as yet not FERC jurisdictional in the transmission area it would seem that these costs could be much lower than the market.

Conservation:

Using the entire end-use cost of measures without considering their non-conservation benefits in the cost-benefit equation results in a lopsided analysis that makes many cost-effective measures appear not to be so. For example, a customer might switch from baseboard heat to an electric heat pump (1)to improve comfort, (2)to improve the recovery time of the heating system, (3)to improve the appearance and resale value of the home, (4)because they wish to add central air-conditioning, and (5)because they expect to save energy. The RTF, however, assumes in their analysis that the only motivation for the project is to save energy, and they attempt to balance the *entire cost* of the project with the energy conservation benefits.

Using this flawed methodology, the RTF has managed to eliminate a significant portion of the existing residential conservation measures from the rate-credit program. The resulting list is a patchwork affair. As an example, in the revised list of measures some heat pump measures will qualify and some won't, which will create the perception of unfair discrimination among end-use customers. Moreover, many of the measures that are being eliminated are measures with very high levels of energy savings, meaning that much potential for conservation will be untapped.

BPA and NWPCC employees putting these programs together do not have to try to make them work in the field like the utilities that must implement them. The fastest way to irritate customers is to implement programs that appear unfair and biased. Our customers won't care about explanations related to how the program is designed if they believe it to be unfair, and it will be us, not BPA, that will feel their anger.

We are in favor of having conservation programs capture all cost-effective measures, but we believe that the most appropriate measure of cost-effectiveness for BPA should simply be the cost of the program to BPA, not the end-user's cost to implement measures, because the RTF has no way of accurately quantifying the non-energy-saving benefits for customers.

Using the cost of the program to BPA as BPA's cost-effectiveness criteria opens the door for host utilities to capture a greater amount of conservation and for customers to make the decision as to what particular conservation measures are important to them. BPA should not concern itself with what the customer pays for conservation but focus instead on simply getting MWh's of conservation for the dollars it pays.

Grays Harbor believes the above approach to be a fairer model for BPA to use. We are very concerned about the direction BPA is going with its present model, as we may end up paying for a program that does not offer us any benefit. As it is now, Grays Harbor pays BPA and then gets a credit for conservation measures we do. Grays Harbor has continued a very aggressive conservation program through this last rate period because we believe it to be a cost effective way to reduce future resource requirements. We don't believe that all BPA customers have done this. This could put us at a distinct disadvantage under BPA's proposed program. It would be very discouraging to us to have to pay for conservation programs in our rates for which we may not see any credit from that for our measures. We stand to be penalized for having a history of being proactive towards conservation and those who have done little or nothing up to now may stand to benefit.

Grays Harbor is also greatly concerned with the approach to con-aug. Grays Harbor has already suffered a significant decrement from BPA and is no longer a full requirements or computed requirements customer. We do conservation so as not to have to purchase more higher cost resources than necessary. If we participate in con-aug it has just the opposite outcome for us, in that we lose a lower cost resource, which we then will have to replace some other way. We lose all advantage to conservation under these type guidelines.

We would hope that BPA is still open to possible alternatives. If this is the case, then a potential alternative that would lower rates could be as follows: instead of BPA collecting $72 million in its rates for conservation, each utility keep the money it would pay BPA to help run its programs. BPA could work with customers to create a fair performance review system. Then using this agreed upon system, BPA could review the merits of each utilities program, analyze their success and longevity, and base benefits on the breath of their programs and how successful they've been. Then, rather than provide a credit, charge those utilities that don't do conservation or have deficient programs, the difference between augmentation costs and BPA's existing costs until they start achieving conservation objectives and access no charge against utilities with quality programs. Utilities could be given a period of time to come to compliance but the conservation objectives would still be met. This would seem to be a much fairer way to do conservation. Grays Harbor would hope that BPA doesn't build a one size fits all model.

Renewables: BPA should not be acquiring renewables.

BPA should not finance renewables for utilities unless individual utilities decide they want renewables acquired for them. If BPA is essentially in resource balance and these are properly allocated, then customers should have the choice of getting their own resource or letting BPA do it for them at market. This is not a cost that should be built into general rates. We are very opposed to BPA unilaterally determining to do this and melding these high costs into the FBS costs. The Four Mile Hill geothermal project is another example of a unilateral BPA acquisition that is too expensive and should be terminated, not put into rates.

Additionally, BPA should not be paying $21 million per year for resource facility activities. The general customer base should not be expected to pay for renewable resource investments for specific entities. If specific entities desire these services and desire them from BPA, than they should be willing to pay BPA for them. BPA must stop considering that its money is being spent on these programs as if BPA magically generates the necessary funds. The money comes from ratepayers from rural areas that in many cases are depressed economically and should not be expected to pay for programs that may not benefit them.

Internal Operations:

Grays Harbor has reduced staff and cut operating costs (exclusive of power) below what they were in 2001 in response to the large rate increases over the past few years. It is for these reasons that we believe BPA should also cut its operating costs and FTE numbers below 2000 levels.

In BPA's "Strategic Direction Document" BPA states, "The goal is always to be substantially below market prices for comparable long-term products. We also believe we need to bring power rates down from today's levels to protect both taxpayer and ratepayer interests." BPA also states, "We must manage our internal operating costs and constantly seek efficiency in everything we do. For the rest of the current rate period, we set a target to bring in power-related internal operation costs at 2001 actuals.

But cost management cannot be just a short-term goal. We intend to continue to reinforce cost-consciousness as an embedded ethic at BPA."

BPA seems to have been successful at reducing PBL costs. Customers are concerned though that this is not the case for Corporate costs. Increases in Corporate FTE levels and expense are contrary to trends at PBL and other organizations. Grays Harbor is concerned that BPA is not truly reducing costs, just moving expenses from PBL to Corporate. BPA is not living up to its own strategic directives when costs continue to go up for a number of reasons. BPA indicates it needs to be a good financial steward to maintain its credit quality, but doesn't speak to the fact that it must be a good financial steward of the monies it receives from its customers. These are not necessarily the same thing. BPA seems oblivious to the damage it can do the credit ratings of its customers while ensuring sufficiency of its own.

Federal and Non-Federal Debt optimization:

Customers are very concerned that in spite of repeated requests for BPA to justify and explain its capital spending needs BPA intentionally did not include a comprehensive forecasted capital-spending plan in the PFR process. BPA agreed to present its sustainable capital program in response to repeated requests for this information by customers over the last few years. This promise continues to go unfulfilled and is long overdue. Customers need a comprehensive look at capital decisions and their impacts in future rate periods. Increases in capital spending and plant-in-service have led to higher depreciation costs, adding to our power rates.

Customers don't understand BPA's reluctance to do this, which increases our lack of faith that BPA is truly transparent in providing information to the customers. Customers are told that our rates have not gone up because of DOP, but we've no way of truly knowing this. We also do not know how BPA determines what criteria it uses to determine the cost effectiveness of its capital expenditures. BPA desires it customers support for increases to its borrowing authority, then is less than forthcoming with explanations of how this will be spent. Why? The way BPA is increasing its capital spending and accounting for depreciation and interest costs impacts rates negatively in spite of what BPA says. Customers believe BPA may be overstating its capital spending needs, and if this impression is true, it will result in overstating BPA's financing requirements, leading to sustained upward pressure on rates.

BPA can make improvements to its accounting procedures to lessen some of these impacts. Make amortization periods fit the life expectancy of projects, not just some arbitrary length of time. Use interest from cash on hand to lower net forecasted interest expenses on cash balances.

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Columbia Generating Station Operations and Maintenance Costs:

Grays Harbor supports the comments made by PPC in this area.

Corps of Engineers and Bureau of Reclamation Operations and Maintenance Costs:

Grays Harbor Supports the comments made by PPC in this area.

Fish and Wildlife Programs:

In 1996, the Senator Slade Gordon insisted on language with regard to fish that money would only be spent on those items that could be supported by good science. Through the years this does not always appear to have been the case. The customers would like to see a process developed where they have the opportunity to object to projects based upon poor science and approve projects that are based upon reasonable or good science. As it stands now customers are just a blank check and do not know which projects may be good or what criteria BPA uses to truly determine the programs it funds. The customers would also like some degree of certainty that BPA is only funding habitat programs that are impacted because of the operations of the FBS, not just any program that comes along. The States or irrigation districts should fund programs that are non-FBS habitat improvements.

Grays Harbor also supports PPC's comments in this area.

Risk Mitigation:

This issue is so contentious it was left for another day. Grays Harbor continues to believe that BPA should set its rates at $27/MWh inclusive of risk. For BPA to imply that the next 3-year rate period could or would be more volatile than the last 5 years is extremely difficult to understand. BPA oversubscribed the system by over 3000 aMW's, 2500 of which went to the IOU's and DSI's. This will be gone except for 500aMW's that may be given to the DSI's and BPA is in resource balance otherwise. The markets are much more stable and predictable than they were in 2000-01 and BPA will not be in the market buying. BPA stands to benefit from higher secondary prices just as it has the past three years. BPA has over $800 million in cash and has not missed a treasury payment in spite of 5 poor water years in a row. BPA has also been able to remove the SN CRAC due to increased secondary revenues. None of us have a crystal ball to look into the future but for BPA to imply it needs $6 to 8/MWh additional costs as a premium for risk because the future may be more volatile is absolutely unbelievable.

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Grays Harbor believes BPA could set its rates at $25.5/MWh and add an additional $1.5 to get to $27/MWh. If BPA insists upon rates from $34 to as high as $40/MWh this would be devastating to the economy of the Northwest. Our economy was built upon low cost rates and in most cases this has been our single most significant economic advantage. In one fell swoop BPA may single handedly strike a blow to devastate our local economies and push the region into recession. BPA must consider the financial health of the region, not just BPA's. Ultimately, it's the ratepayers of the Northwest who bear the risk of a missed treasury payment.

Conclusion:

BPA must continue to do everything it can to lower costs. If BPA's "Strategic Direction" document is to have any credibility BPA will find ways to get to a $27/MWh rate that is inclusive of any risk premium.

Again, thank you for the opportunity to comment.

Sincerely,

Richard D. Lovely
General Manager
Grays Harbor PUD

PFR - 076

MAY 2 0 2005

Asgharian,Maryam A - T

From: rarego@lakeviewlight.com

Sent: Friday, May 20, 2005 5:10 PM

To: BPA Public Involvement

Subject: Comment on Power Function Review

Comment on **Power Function Review**
View open comment periods on http://www.bpa.gov/comment

Robin A. Rego
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BPA fish and wildlife mitigation is funded primarily by utility customers. As a customer of BPA, we would like to provide the following comments on BPA's fish and wildlife spending. · BPA's customers are currently paying nearly $700 million per year in fish and wildlife costs. Further increases to BPA's fish and wildlife mitigation program are unjustified at this time, and would unnecessarily burden ratepayers. · BPA's fish and wildlife mitigation program should be based on biological goals and objectives designed to meet its legal obligations. · The measure of success for BPA's fish and wildlife program should be biological effectiveness, not the amount of money spent. · Customers support BPA's proposal to shift funding from administrative and overhead functions to projects that directly benefit fish and wildlife. · It is inappropriate and contrary to statute to expect BPA's customers to mitigate for all the problems identified in subbasin plans. Customers strongly object to paying for mitigation that is not directly related to impacts of the federal hydrosystem. · BPA has a responsibility to advocate for its customers any time decisions are being made on how the customers' money is being spent.

PFR-077

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MAY 20 2005

May 20, 2005

Mr. Paul Norman
Senior Vice President, Power Business Line
Bonneville Power Administration
P.O. Box 14428
Portland OR. 97295-4428

RE: Response to BPA's Power Function Review Draft Closeout Report

Dear Mr. Norman:

Prior to the start of BPA's rate setting processes, the agency normally conducts a program cost review that result in program cost amounts that establish the revenue requirements for BPA's initial rates proposal. This year's process, the Power Function Review (PFR), was extremely important for two reasons: the process establishes the direction for the Agency's costs for the next three year rate period, and it occurs at a time when BPA's costs and the rates it charges customers have been higher than at any time in their history. PNGC believes that BPA needs to take this opportunity to establish a direction for controlling and reducing its costs, so that its rates to customers can be reduced and stabilized.

We appreciate the exchange of information with agency staff during this process. However, the draft PFR results miss the mark and falls short of substantially changing the direction on BPA's program costs.

BPA's draft PFR Closeout Report cites that the process resulted in "substantial cost reductions" (Steve Wright letter of May 11, 2005). We disagree. We do not think that a three percent reduction ($80 million) out of the originally proposed PFR program cost ($2,674 million) constitutes substantial cost reductions.

More to the point, the PFR closeout amounts are cost increases over the FY 2002 to 2006 average expenses in all reporting categories except for: Long Term Generating Projects, IOU Settlement Payments, and Power Purchases. If the category of Power Purchases is excluded, the category for Long Term Generating Projects and the IOU settlement payments show cost reductions totaling $55 million. The remaining categories show cost increases totaling $229 million over the 2002 to 2006 expense averages.

We believe that starting the next rate period with expected program costs at the amounts reported in the draft PFR Closeout Report will result in rates that are higher than necessary for carrying

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out BPA's responsibilities. The cost increases are the wrong direction for BPA's programs and BPA's costs should be reduced across the board so the agency operates more economically.

PNGC Power has worked closely with other BPA customers to develop the comments being submitted under the Public Power Council letterhead. Those comments suggest numerous ways that BPA could achieve costs reductions and improve BPA's budgeting process. We strongly support those suggestions and urge that BPA work to include them in the final PFR Closeout Report and include the results in the Agency's initial rate proposal.

Those actions constitute a good first step and will allow the agency to initiate its rate setting process. However, BPA must not stop there and should continue the cost review and reduction process from this initial level. Next, BPA should seek further reductions in its costs across all of its program categories. This second step would lead to cost reductions that would be included in BPA's final rate proposal toward the end of the rate case.

The above steps are not enough by themselves. Following the rate case, BPA should institute an ongoing process to continuously review with the customers its actual costs, and work to control and reduce its costs over the rate period. Those cost reductions should be translated into savings and rate reductions that are returned to the customers as they occur.

At both the technical and management sessions for the PFR Closeout, BPA stated that the program costs being reported were necessary for BPA to complete its mission. Further, BPA challenged customers to suggest cost cuts. The customers have traditionally been hesitant to micro manage BPA, preferring to suggest that program levels need reductions and expecting BPA to take appropriate actions. This is, in part, because of the customers' belief that BPA's managers are in a better position to determine where to cut costs and balance the impact of making cost reductions. It is also because BPA has been slow to provide the customers with detailed information that could be used to judge the impacts of suggested reductions. We have asked BPA to provide information that would help customers make recommendations on reducing costs by understanding the trade offs and impacts of implementing the customer's suggestions. An alternative would be for BPA to embrace an across the board ten percent reduction in the program amounts reported in the draft PFR closeout. That is, eliminate $259.4 million of its $2.594 billion PFR expenses.

In some areas we have suggested approaches that would reduce BPA's costs. For example, PNGC has proposed an approach where utilities are responsible for their conservation and BPA does not collect money in its rates to redistribute funds back to utilities. We think such an approach will still meet the region's responsibility and result in reduced BPA revenue requirement.

In BPA's total fish and wildlife program, PNGC notes that funding has increased without abate over the years. In the PFR, BPA estimates that its customers will spend nearly $700 million per year in fish and wildlife costs in the coming rate period. This number is unacceptably high; BPA simply has not gone far enough to reduce expenditures in this category. These cost increases are especially frustrating because it is still unclear what the biological priorities of the total fish and wildlife program are, and PNGC is still unsure as to what has been accomplished with the massive investments made over the years.

We contributed to and support the concepts related to fish and wildlife in the Public Power Council document, but PNGC highlights the following areas for additional attention:

First, BPA must be a proactive participant in all forums where fish and wildlife costs are incurred by its customers. BPA has a responsibility to ensure that fish and wildlife programs outside of BPA's management (i.e. US Army Corps of Engineers, Bureau of Reclamation programs, and others), but funded through ratepayer dollars, are pursued in the most biologically sound and cost-effective way possible, and that they relate directly to BPA's mitigation responsibility.

Second, the Integrated Program should be implemented through a zero-based budget, based on biological goals and objectives that have been prioritized to meet BPA's legal mitigation obligations. The measure of success for BPA's fish and wildlife program should be biological effectiveness, not the *amount* of money spent. BPA cannot justify increasing its Integrated Program without performance standards, and a clear zero-based budget approach. Any amounts spent above the program's nearly $70 million of contractually obligated funding should be carefully evaluated to ensure it will be used for high priority, cost-effective and biologically sound measures. Efforts to portray a continuation of the current funding level of $139 million expense as the 'status quo' are misleading. In fact, a fair representation of the 'status quo' would be only the funding required to meet current base obligations. Anything in addition to that figure represents an increase over status quo.

Third, subbasin plans should be considered when making decisions about prioritizing projects, but PNGC Power strongly objects to paying for mitigation that is not directly related to impacts of the federal hydrosystem. There are numerous funding sources and statutory obligations regarding fish and wildlife in the Northwest. Simply adopting others' definition of BPA's mitigation responsibilities would betray BPA's responsibility to its customers. There is great value in identifying the limiting factors for fish and wildlife that are not the responsibility of the federal hydrosystem, but to expect BPA's customers to pay for them is inappropriate, wrong and contrary to statute. We appreciate BPA's effort to bring clarity to this issue in the enclosure to its April 25, 2005 letter to CBFWA.

To conclude, PNGC has long been an advocate of program review, capital expenditures review, and the Customer Collaborative, where some degree of transparency on BPA's planned and actual expenses has been reached. However, transparency is not the end goal. PNGC Power urges BPA to bring its cost structure down so the resulting rates to customers are lower than the current rates. To accomplish this, BPA needs to reduce cost going into its initial rate proposal and then work down from there.

Sincerely,

Douglas R. Brawley

PFR - 078

MAY 2 0 2005

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May 20, 2005

Paul E. Norman
Senior Vice President – Power Business Line
Bonneville Power Administration
P.O. Box 14428
Portland, OR 97208-3621

Re: Comments on Power Function Review Draft Closeout Report

Dear Paul,

Attached you will please find the comments of the Western Public Agencies Group on the Draft Closeout Report for the Power Function Review. The utilities that comprise the Western Public Agencies Group appreciate the opportunity to comment on the important issues discussed in the Power Function Review process, and look forward to continuing to work with BPA on these matters.

Should you or your staff have any questions regarding these comments, please feel free to call me.

Yours truly,

Terence L. Mundorf

COMMENTS OF THE WESTERN PUBLIC AGENCIES GROUP

ON THE

DRAFT POWER BUSINESS FUNCTION REVIEW CLOSE-OUT LETTER

1. Introduction

These comments are submitted on behalf of the utilities that comprise the Western Public Agencies Group (WPAG)[1]. Because the level of BPA's rates is of vital importance to the local economies of the WPAG utilities, they have actively participated in both the technical workshops and the policy forum of the Power Function Review (PFR) process.

2. The PFR Process Should be Improved

The PFR process was information intensive, with BPA and its generating partners providing copious amounts of data. They also responded to queries on specific topic areas. In this respect, the PFR process was well designed and executed. This type of information exchange should provide a foundation upon which BPA and its customers can build a more open and cooperative relationship.

However, from the point of view of resolving issues, seeking consensus and achieving regional support for the program levels that will provide the basis for the upcoming BPA power rate case, the PFR process was deficient. The format of the PFR process, and in particular the policy forum discussions, presented customers and others with an opportunity to air their differences over BPA program proposals. It did not provide any meaningful opportunity to forge consensus or explore opportunities for compromise and agreement.

By providing the customers and others with the opportunity to state their differences without providing an opportunity to seek consensus, this process put the Administrator in a position not dissimilar to his role in the rate case. Rather than collaborating with customers to forge consensus, the PFR format forces the Administrator into the role of judge, picking and choosing among the contending arguments advanced by the participants. This serves to create more distance between the Administrator and his customers, and deprives him of the opportunity to work with his customers and other interested parties to foster program levels that have wide-spread support and acceptance.

In this regard, the PFR process was a missed opportunity to resolve differences and seek common solutions. We can and should do better than this. BPA, its customers and other interested parties should redesign the PFR process so that it has as its stated objective reaching consensus, to the extent possible, on the program levels to be used in the BPA power rate case. The PFR process should not settle for mere understanding of BPA's

[1] Some of the WPAG utilities may elect to submit individual comments on topics of particular importance to them.

initial thoughts on its program levels, but should set a more ambitious goal of forging regional support for BPA's program levels.

3. <u>Draft Results of the PFR Process</u>

The information provided to participants in the PFR process resulted in substantially increased transparency regarding BPA's program costs. However, increased transparency is not the sole measure of success.

Given the fact that BPA's purchased power expenses are forecast to drop by nearly one-half a billion dollars at the start of the next rate period, and in the absence of any cost generating event such as the California market melt-down, customers reasonably expected that BPA's power rates would decrease to historical levels in the range of \$27/mWH. Instead, customers may be facing a BPA power rate increase that may reach \$8/MWh. Judged on the basis of the resulting rates paid by customers, this is not a success.

Increases to proposed program levels play a part in this potential increase, and they will be discussed in some detail later in these comments. However, BPA also has cited two additional reasons for this potential rate increase; the provision of increased benefits to all customers and constituents, and additional risks that BPA feels that it is facing. Each of these factors deserves some discussion.

a. <u>Increased Benefits</u>

BPA has cited a number of increased "benefits" that it feels contribute to the upward rate pressure, including serving preference customer load that has increased by about 3,000 aMW, increased financial benefits to the IOUs, increased fish and wildlife costs, and conservation costs, to name a few.

In the first instance, if it is fair to cite increased preference customer loads served by BPA as a cause of a potential rate increase, then it is also fair to cite BPA's discretionary Subscription decision to sell 2,500 aMW of power to the IOUs and DSIs as a major cause of BPA cost increases, since preference customers are still paying for these decisions under various settlement agreements that stretch through the next rate period. And it is difficult to credit the notion that preference customer loads are contributing cost pressure when it is remembered that the entire preference customer load, including the 3,000 aMW increase, is being served out of the existing Federal base system (FBS).

But more to the point, if it is a fact that BPA's largesse in bestowing "benefits" on customers and regional constituents is driving another round of BPA power rate increases, it is time to examine whether these "benefits" should be scaled back or reduced. BPA's preference customers cannot continue to fund, at the price of higher and higher rates, benefits to one and all. BPA should examine whether acting as the source of benefits for all is in the interests of BPA and its preference customers.

b. The Costs of Risk

Another major cause cited by BPA as driving the need for a rate increase is the additional risk that BPA has determined it faces. There is serious concern that BPA is over-estimating the risks that it faces, and is making policy decisions that unnecessarily increase the costs of risk included in the rates. And while there has been some discussion of this topic in the PFR process, it has not been sufficient to permit customers to voice their concerns, nor to allow the Administrator the opportunity to respond to them.

BPA's power rates need to come down. To achieve that goal, it is vital that there be a careful examination of the real risk factors that BPA faces, and the costs that should be included in BPA's rates to deal with them. This must include examination of discretionary decisions, such as the appropriate Treasury payment probability, the proper level of liquidity reserves and the use of conditional budgeting, among other matters.

The WPAG utilities recommend that as soon as practicable BPA convene meetings with customers' policy makers, other interested parties and the Administrator to deal with these important issues. These are fundamental policy issues, and should not be relegated to the rate case.

4. Specific Program Recommendations

The WPAG utilities generally endorse the recommendations made to BPA in the Public Power Council comments on the PFR Draft Report, and in particular the fish and wildlife recommendations made therein. In addition, the following comments are submitted for consideration by BPA.

a. Internal Operations

Corporate G&A Reduction – Consistent with the PBL/TBL objective of holding costs to FY01 levels, based on additional information made recently made available by BPA, it appears that FY07-09 Corporate costs will be held at or near FY01 levels. BPA is to be commended for this effort. However, it also appears that additional reductions in overhead costs will be available through such efforts as the Enterprise Process Improvement Project. These additional reductions should be vigorously pursued and reflected in the rate case revenue requirement when documented. And finally, BPA should continuously examine staffing levels to determine if additional reductions of FTE are warranted.

Information Technology Reduction – BPA has adopted as a target a 25% reduction in corporate information technology (IT) costs. This target should be measured from FY05 forecast IT costs, rather than measuring it based on forecast FY07-09 costs. This would result in a $11 million reduction in IT costs compared with IT costs currently forecast for the FY07-09 period.

Industry Restructuring Cost Allocation Reduction – An allocation to PBL of 40% of the industry restructuring budget is clearly unjustified in light of the fact that the preponderance of this budget item is being spent in support of the formation of a regional *transmission* organization. This is not an appropriate allocation. The amount of industry restructuring costs allocated to PBL should be reduced to 10%.

b. Columbia Generating Station Costs

Debt Financing of CGS Projects – The FY07-09 revenue requirement should be predicated on ENW debt financing all capital items that qualify for such treatment. This would include capital projects as well as fuel. This would produce a reduction of the FY07-09 revenue requirement of about $13 million.

Fuel Expense Reduction – A major opportunity exists to reduce CGS fuel costs by pursuit of the Uranium Tails Pilot Project and the use of debt financing for nuclear fuel. Both of these should be actively pursued, with appropriate savings being reflected in the PBL revenue requirement.

c. Corp/Bureau Costs

The operating and maintenance costs proposed by the Corp and Bureau for the generating resources of the FBS need additional scrutiny. Over $50 million per year has been added to O&M expenditures during this rate period. Adequate justification has not been provided to warrant increasing this amount by an additional $44 million per year during the next rate period. This is an area where substantial reductions to the proposed budget amounts are warranted.

d. Conservation Program

Renewables as an Alternative – BPA should include a renewables alternative in its conservation rate credit proposal. This should be done without imposing unnecessary requirements, such as requiring utilities to pre-commit three months prior to the start of the rate period. Some utilities may only need rate credit assistance for their renewable resource investment for one year. Providing customers with the greatest practical number of options is the best way to ensure a successful program.

Conservation Investment Amortization – Conservation Augmentation investments should be depreciated and amortized over the estimated useful life of the measures being installed, rather than the remaining contract term. Doing so is consistent with BPA's approach to other resource investments, including its treatment of legacy conservation investments, and will materially reduce the rate pressure faced by BPA.

e. Renewables Program

Four Mile Hill Geothermal Project – BPA should take all steps necessary to terminate its acquisition of the Four Mile Hill project. Based on available information, it appears that

BPA has reasonable ground for terminating this acquisition, and it should do so. Eliminating this cost would reduce net costs by about $11 million.

f. Transmission Acquisition

Forecast of Transmission Services – BPA's need for transmission depends on the amount of secondary energy it has available to sell, and so it varies greatly from month to month and year to year. It is unclear whether the transmission forecasting techniques used by BPA properly forecast the least cost mix of short and long term transmission. Failure to do so results in unnecessary costs being included in BPA's power rates. BPA must take all steps necessary to use forecast techniques that result in the least cost combination of short and long term transmission acquisition costs.

5. Conclusion

While the PFR process achieved new levels of transparency regarding costs, much remains to be done. First, additional cost reductions must be identified and implemented. Second, the whole topic of costs of risk that are appropriate to include in the power rates must be the subject of further discussion. And third, BPA and its customers should discuss ways to improve the format of this process to create opportunities to find consensus and agreement on program issue.

The WPAG utilities appreciate the opportunity to provide these comments, and look forward to working cooperatively with BPA on these issues.

PFR-079

MAY 20 2005

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FACSIMILE MESSAGE

DATE:	May 20, 2005
NUMBER OF PAGES (Including Cover Sheet):	5 pages
TO:	Stephen J. Wright, BPA Administrator
FAX NO.:	503-230-4018
FROM:	Steve Marshall, AGM, Power & Transmission Services PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY
FACSIMILE NO.:	(425) 783-8305
TELEPHONE NO.:	(425) 783- 8473
MESSAGE:	Following is a 4-page letter to Administrator Stephen Wright

SNOHOMISH COUNTY PUD PUBLIC UTILITY DISTRICT NO. 1

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May 20, 2005

Via Email, Facsimile and U.S. Mail

Stephen J. Wright
Administrator
Bonneville Power Administration
PO Box 14428
Portland, OR 97293-4428

Re: BPA Power Function Review Close-Out Letter Comments

Dear Administrator Wright:

The Bonneville Power Administration has set a May 20th deadline for comments on its draft "Power Function Review Close-Out letter." The overall message in BPA's draft letter is that it is on a path of *increasing* BPA's wholesale power rates starting October 1, 2006 instead of *reducing* BPA's current record high rates, as the region had expected.

On February 24, the Public Power Council asked BPA to set and meet a $27 per megawatt hour *maximum* rate target for the next wholesale power rate period, inclusive of risk. Before 2001, BPA rates were $23/MWh. BPA has attributed its current record high rates of approximately $31/MWh mostly on the 2000/2001 California/West Coast energy crisis. As a result, customers expect BPA to lower rates next year substantially from BPA's current high levels now that the effects of the California market problems are no longer a dominant factor.

But, at the last two BPA Power Function Review meetings, BPA has made it clear that it would *not* lower rates significantly, and instead BPA was likely to *increase* its wholesale power rates up to as much as $39 or $40/MWh.

This is unacceptable. Many BPA customers have tried to absorb as much of BPA's last record high rate increase as they could-- trusting that BPA would lower rates in the next rate period toward the previous level of $23/MWh.

The economic consequence of BPA's failure to lower its rates will be severe. Based on recent estimates, BPA's failure could cost the region 30,000 to 60,000 jobs and the loss of tens of millions of dollars in federal, state and local tax revenue. This prospect calls for BPA to take immediate and decisive action.

This letter suggests a set of actions that BPA needs to take now to be able to achieve the PPC $27/MWh maximum rate target for BPA's fiscal years 2007-2009, which will start on October 1, 2006:

First, we need a commitment from the BPA Administrator and senior staff that BPA will agree to the PPC rate target of $27MWh. Meeting this target requires the will to achieve it, and the region needs to know that the Administrator has agreed to work hard to meet this goal. Two years ago in the document "BPA at a Crossroads," BPA employees themselves urged the Administrator to set a specific rate target goal. Setting a stretch rate goal is the first management step in making sure rates are set to ensure economic growth in the region.

Second, BPA should agree now to make all spending decisions part of the power rate case for next year. When state public utility commissions conduct rate cases, revenue requirements are part of the rate case—they do not precede the rate case. BPA itself used to include a revenue requirement in its rate cases, which can be done without the need for legislation. Spending on travel, salary increases, FTE levels, extraordinary O&M, DSI subsidies, research projects, consultants, IT levels and every other category of spending should be subject to the next 16 months of close review and revision until the $27/MWh target is met.

Third, one of the largest rate pressures is BPA's treatment of the risk that it may not be able to make a Treasury payment if secondary revenues are below projections. Last month, BPA indicated that it may seek a rate risk premium of $8/MWh, which is far in excess of anything previously imposed by BPA. We believe that the risk premium can be close to zero if BPA adopts a combination of 1) contingent budget cuts and 2) a line of credit from the U.S. Treasury or a bank line of credit.

So far BPA's only proposed tool to deal with risk is to ask its customers for more revenue—either up front in a large reserve fund or in the form of contingent, but automatic, increases in rates. In contrast, other businesses know that if they have a revenue shortfall, they will have to address it by a combination of 1) cutting costs and 2) arranging a line of credit in advance to meet and bridge anticipated temporary problems. Raising prices to customers is not an option.

- **Contingent budgeting. Instead of contingent and automatic increases in rates, (such as CRACs) BPA needs to set contingent and automatic cuts in costs. BPA's current budgeting process does not set spending priorities. BPA should establish three tiers of spending (including from its suppliers): Tier 1 is essential spending without which the agency cannot operate even for a year or is mandated by law; Tier 2 is spending that is essential at some point, but can be reduced or deferred with some but not significant risk; Tier 3 is spending that is desirable and prudent, but not essential. The contingent budget cuts would be subject to a trigger similar to the current SN-CRAC trigger. If BPA's secondary revenue projections do not meet expectations, it would trigger cuts in Tier 3 spending. If significant and unexpected economic conditions continued, cuts to Tier 2 spending would be triggered. BPA could set the tiers, but if BPA does not have the time or the expertise to set such tiers, an independent outside expert, such as KEMA, could be retained to set the three tiers**

(KEMA has already identified tens of millions of dollars in BPA spending cuts. KEMA's report is available on the BPA website).

- **Line of credit. Paul Norman said BPA has discussed obtaining a line of credit from the U.S. Treasury in order to deal with the risk of a shortfall in making a payment due to low secondary revenues. This would make sense for Treasury since a significant BPA rate increase to cover risk would cause the loss of tens of thousands of regional jobs and thereby cut federal tax revenues to the U.S. Treasury. But if Treasury is unwilling to grant a line of credit, a standby bank letter of credit to BPA should be established with clear and enforceable draw down and repayment conditions.**

Fourth, BPA can and should make its current line item budget and spending available on line for review, subject only to employee privacy and active litigation exceptions. How much does BPA spend on travel, consultants, office space, insurance, etc.? Without this level of detail, customers cannot meaningfully suggest significant spending recommendations. If this level of detail can be compelled from BPA under FOIA, BPA should make the line item information easily available on its website. If not, then BPA should at least make it available as part of a rate case process for review. With this information, customers can make more informed recommendations.

Fifth, BPA should consult and work with its customers before selecting the next BPA Chief Financial Officer (CFO). Ordinarily customers would have no say, but with record high rates projected to go even higher, this is not an ordinary time. The next BPA CFO should have experience in establishing tough spending priorities, meeting stretch goals, and working with continuous process improvement programs.

Sixth, BPA and DOE should immediately appoint a blue ribbon task force led, for example, by Energy Northwest's CEO to also include Northwest private sector business leaders from Boeing, Weyerhaeuser, Kimberly-Clark and others to report by December 1st on a program to meet a $27/MWh target rate. There is time to do this before the 2006 rate case is initiated.

There is a definite contrast between Energy Northwest's cost control efforts and BPA's. Energy Northwest has set clear budget targets for managers, laid off 200 employees, and cut its costs by over 10% from the start of the Power Function Review Process to date. ENW benchmarks its financial and operating performance in clear terms, works on creative cost savings ideas such as reprocessing DOD fuel and works with Congress to modify and eliminate unreasonable mandates that do not fit their Northwest needs. ENW responds to a board of directors that includes many of its major customers.

One final overall comment: Later this year BPA will propose 20 year power contracts. The Northwest Planning and Conservation Council has said long term contracts are essential now to protect the region from outside interference and to create the needed stability for regional utility planning for conservation and power resources. But, without fundamental

changes to BPA's cost control, dispute resolution and governance processes, the 20 year BPA contracts will be the equivalent of a blank check – which prudent utilities will not be able to sign. The current BPA cost control process is unacceptable. And because no one can know who will head BPA in ten years, governance reform is an essential part of long-term contracts as well.

In summary, we believe BPA needs fundamental change. BPA customers have suffered through five years of record high rates and increasing costs, with the expectation that rates would be cut once the major costs associated with the 2000/2001 energy crisis were over. BPA should adopt a budgeting method, both internally and with its external partners, which establishes an overall rate target and then requires costs to be open, flexible, and variable in response to changes in risks and revenues. As a first measure, BPA should refrain from making additional cost commitments, such as those related to Fish & Wildlife funding and levels of DSI service, that will further lock in the higher rates BPA is currently predicting. BPA should then conduct a rigorous cost control and prioritization process to set the measures that would be required to reach the PPC $27/MWh maximum rate target with the help of a blue ribbon task force and then openly review the BPA revenue requirement in the BPA rate case starting in early 2006. There is time to take action, but if we wait, many of the most promising opportunities will be lost.

Very truly yours,

Snohomish County Public Utility District

By: Steve Marshall
Assistant General Manager
Power & Transmission Services

Cc: Northwest Delegation
Samuel Wright Bodman, Secretary of Energy
Bruce Carnes, Associate Deputy Secretary

This letter was sent via email to: sjwright@bpa.gov; the.secretary@hq.doe.gov; faxed to: (503) 230-4018, (202) 586-4403; and mail

PFR - 080

MAY [illegible]

NRU

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May 19, 2005
Via Electronic and U.S. Mail

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Re:BPA's Power Function Review Process

Introduction

Northwest Requirements Utilities is submitting the following comments regarding BPA's 2005 Power Function Review draft proposal. NRU represents 49 consumer owned utilities that account for over 20% of BPA's power supply sales to public preference utilities. NRU members may be submitting comments to you individually. A number of NRU system General Managers have actively participated in the PFR process, as have our staff. We have contributed to the development of the Public Power Council's comments, which advance the recommendations of the Joint Customers, other than with regard to "conditional budgeting" discussed below. We concur with those comments. However, we would like to take this opportunity to provide additional emphasis on three broad subjects that are drivers of the potential rates we are facing: These include BPA fish and wildlife costs, BPA's other cost areas and the rate effects of BPA risk mitigation.

BPA's power rates are critical non discretionary component of our member utilities' costs of providing service to their local communities. In some cases the cost of BPA power makes up more than 60 percent of these utilities' total cost of service. Initially for this rate period, NRU's members taking Priority Firm service expected power rates of 2.2 cents per kWh. Instead, under trying conditions, and after a very difficult regional process, the majority of our members found that rates would be as much as 50 percent higher for the five-year period FY 2002 to FY 2006. During the ensuing rate period, BPA did a commendable job of cutting or holding down costs, and using appropriate financial tools, to help mitigate the impacts of higher rates.

Our members are looking forward to a rate reduction on October 1, 2006 as a means to both stimulate their local economies and provide consumers with long awaited rate relief. With the PPC recommendations on cost reductions, we believe that a 27 mill per kWh remains a reasonable planning target for the Agency. That target is only viable if the Agency demonstrates aggressive action to examine program practices and cut costs, particularly for other agencies relying upon BPA for funding support. However, from our perspective, in the PFR process the Agency has not demonstrated the same vigor in pursuing cost reductions or creative approaches to financing as was shown in the SN CRAC process.

In addition, we would note that our members have first hand experience with the challenge of achieving key objectives and responsibilities, while controlling costs. We recognize the difficult but sustainable choices that must be made to manage and control costs while ensuring critical objectives are achieved.

A 27-mill rate would represent a 10 percent reduction from current rates and would provide a welcome stimulus to the economies within the service territories our members serve. In addition, it would reduce the rate impact for many of NRU's members holding pre-subscription contracts, and facing a significant BPA rate increase in 2007.

PFR Cost Levels as of the May 2nd BPA Close Out Letter

Our understanding is that BPA's cost levels for power were about 28.5 mills/kWh going into the PFR process. As a result of the PFR review, BPA recommended about $80 million in reductions per year out of an estimated total annual expense of $2.674 billion, which has the consequence of dropping the average rate to 27.5 mills/kWh, prior to consideration of risk – which could range anywhere up to an additional 8 mills/kWh. BPA needs to find further reductions, and work with the customers on a risk mitigation package that results in lower rates, with a PF rate as close to $27 mill/kWh as possible.

Fish and Wildlife Costs

BPA's most volatile cost area is the fish and wildlife program. In total this program consumes nearly $700 million per year, including the revenue effects of lost generation. This level of spending makes up 20% of BPA's total costs and 16 to 17% of BPA's 22 mill base rate. While certain aspects of spending and lost revenue are beyond the Agency's direct control, there are a series of recommendations that can be adopted that would reduce BPA's costs.

In River Transportation Study We strongly recommend that for rate making purposes BPA assume that any In River Transportation Study associated with the UPAs in the 2004 Biological Opinion be moved out of the FY 07 - 09 rate period. Second, if and when such a study is conducted, BPA must actively work with the other action Agencies and NOAA Fisheries to ensure that the study is designed and performed in the most economical manner possible. The study should be deferred until all Removable Spillway Weirs are in place, which should occur after FY 2009. Also, those designing any study should first recognize the impacts of recent scientific studies regarding Snake River Fall Chinook reservoir life history migration patterns (delayed migrants) that have previously been counted as mortalities. The BPA Customer Coalition in the 2004 Biological Opinion litigation have examined this question with counsel, and believe there is a strong legal foundation as well as a compelling financial case for this recommendation. We would be happy to meet with you to discuss these conclusions.

The In River Transportation Study has been identified as costing $23 M per year in FY 08 and FY 09, primarily due to foregone generation tied to voluntary spill. This amounts to $46 M over a three year period, or about $15 M per year. This is close to a 0.2 mill/kWh increase from what rates would otherwise be. BPA should not add the costs of this study to the revenue requirement.

(Note that this does not represent a reduction to the average PF rate, because the study was not included in the revenue assumptions for the PFR).

Revenue from Removable Spillway Weirs BPA should include the revenues from the additional power generation that will result from installations of RSWs. The revenue should be used to reduce rates, not as a partial or total offset to foregone revenue from a possible In River Transportation Study. Because BPA identified this revenue as basically offsetting the losses from the In River Transportation Study, we would therefore expect to see a 0.2 mill/kWh reduction in what the PF rate would otherwise be as a result of this action.

Integrated Funding Program Level In the Draft Closeout Report, BPA recommends an integrated program \$143 M expense level, and to shift \$15 M of current research monitoring and evaluation activities to fund additional enhancement efforts, and to maintain hatchery programs. This is generally consistent with recommendations offered by NRU staff during the PFR work sessions. Any support for the \$143 M is predicated on the following assumptions:

- This funding level incorporates any BPA financial obligations for Subbasin Plans for the next rate period.
- Over time there will be a more thorough examination of the integrated program needs, from the bottom up, with the intent of focusing funds for direct enhancement efforts, or to maintain hatchery programs.
- There will be no special rate adjustment clause for unanticipated fish costs.

Amortize long lived assets, such as hatcheries over their useful lives BPA-funded hatcheries are amortized over 15 years while hatcheries funded by appropriations are funded over their useful lives. BPA should re-evaluate the amortization period used for hatcheries and extend that period to be consistent with the amortization period used for appropriations.

BPA's Other Costs

Internal Operations BPA needs to vigorously pursue the findings of the KEMA/EPIP study. Considerable customer and agency effort has been devoted to this study and our view of most of the findings in this study is that they are sensible approaches to reducing BPA's costs. BPA has been too conservative in incorporating only \$8 million of estimated savings from the KEMA study into rates for 2007 to 2009. We believe that it is reasonable to assume that BPA will be able to achieve savings in the \$27 million per year range recommended by PPC.

We would also like to spend additional time with your staff reviewing the cost increases in Corporate, particularly compared to the more rigorous cost controls evident in the PBL and TBL branches. There appears at this time to be a difference of information between BPA and customer staff on the growth rate of Corporate compared to 2001 actuals. We may have a subsequent recommendation for a reduction in this area.

Corps and Bureau Costs These costs are projected to go up dramatically over the next rate period. The O&M budgets for the Corps and Bureau for FY07-09 average \$45 million per year more than in the current rate period. The Capital budget for FY07-09 averages \$28 million per year more than the current rate period (\$197 million compared to \$284 million on a rate period average basis). This represents a nearly 23% increase over current spending levels, more than double the rate of inflation. More justification is needed for these increased funding levels. This is also the area where only slight reductions have been proposed compared to the initial PFR data. We suggest that BPA should request that the Corps and Bureau reduce the rate of increase significantly prior to the closeout of PFR and propose at least a $5 million per year targeted funding level reduction for FY 2007 to 2009. We believe this lower funding level can be achieved without any degradation in the reliability and security of Corps and Bureau facilities.

Renewables If the outcome of the arbitration this summer allows BPA to withdraw from the Four Mile Hill Geothermal contract, BPA should remove the costs associated with this resource from its FY09 revenue requirement in time for the rate case Final Proposal. We are not convinced that the FY07-08 (and potentially FY09) geothermal net costs should be replaced with "facilitation" cost placeholder cost amounts of $5.5 million in 2007 and $11 million in 2008. At this point it is unclear what tangible and substantive benefits will accrue from the expenditure of these funds.

Summary of the NRU Recommendations for PFR Adjustments

The combination of the above recommendations will yield further cost reductions on the order of $50 million per year. This level of cost reduction, combined with the cost reductions proposed in the draft PFR proposal will bring the resultant rate below 27 mills, before consideration of risk. While this represents progress, it will likely still be insufficient for achieving the size of a rate reduction your customers are seeking. Other Joint Customer recommendations move us closer to that target. In this circumstance BPA will need to re-examine some large financial commitments. It is time to ask whether the region can provide ongoing service to the DSIs, and whether there is any opportunity to mutually agree restructure the cost of IOU residential and small farm customer benefits as part of a longer term discussion about the future role of the Agency.

Risk Mitigation

All of BPA's program levels must also be evaluated in the context of BPA's approach to risk mitigation. Certain risk mitigation proposals that BPA has discussed with the customers could add 7 to 8 mills per kWh to the PF rate on an effective rate basis. That is, if BPA's PF rate before risk were 26.5 mills/kWh, and its rate after risk recovery were 34 mills, this would mean that 22 percent of BPA's effective rate would be related to risk mitigation. With these dramatic numbers in mind we make the following suggestions:

- We must work to ensure that BPA is not overstating the level of and need to recover risk from its customers.
- We must find a balance between BPA holding customer provided funds for risk mitigation and the customers themselves holding those funds. Our initial inclination is to have the customers hold the majority of these funds.
- We are committed to working with BPA to establish a risk mitigation approach for FY 2007 to FY 2009 that is affordable for the customers. This may mean that we need to revisit selective program levels in the context of risk mitigation.
- Finally, we may need to re-visit the recommendations made in the 10-Year Financial Plan in the context of the rate increases that may arise from a rigid application of that plan.

Given the breadth of issues associated with risk mitigation, and the potential consequence on rates, NRU recommends that BPA and the customers hold a joint management level review of risk mitigation options, in addition to the normal technical work that occurs in a PBL rate case. We will be contacting your staff to determine the organization, timing, and possible agenda for such a discussion.

Other Views Regarding "Conditional Budgeting"

NRU staff does not support the approach of "conditional budgeting" as a risk mitigation tool. Conditional budgeting has been explained as a requirement for the Agency to essentially prepare two budgets, a regular budget, plus discrete expenditures that would be eliminated in the event of poor water or other adverse financial conditions. Our lack of support is based in part on the following:

- If customers want BPA to abide by spending caps in various functional areas as a way of controlling costs, including not exceeding spending authority in good revenue years, then conversely the Agency should have the flexibility to plan to spend if needed to budgeted levels during poor revenue years.
- This may be administratively burdensome in response to a set of circumstances that may not in fact materialize.
- With nearly 40% of the Agency's forecasted expenses tied to debt service alone, and with other significant non-discretionary expenses, the contingency budget reduction in those areas where the Administrator has discretion would have to be very large to have much of an impact.

As an alternative approach, if poor financial conditions develop, the Agency working in conjunction with customers should develop a plan tied to those emerging conditions, and then promptly implement it. For example, using the Sounding Board, BPA identified a plan to achieve $100 million in reduced expenses as a way of avoiding a Safety Net CRAC last year.

Conclusion

Thank you for the opportunity to comment. We appreciate all of the effort your staff has put into the Power Function Review. Hopefully working together, we can reach the common financial and rate results that both the Agency and the customers are striving to achieve.

Best Regards,

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