

April 26th Workshop

BPA is seeking customer comment on its draft cost functionalization principles that will be applicable to acquisitions and services that benefit both power and transmission functions. By functionalization, BPA means the process of allocating costs between Power and Transmission to be recovered in rates. The full document is attached. BPA's intent is to take these principles through a 7(i) process.

BPA is seeking feedback to: 1) test our draft principles with external stakeholders; and 2) test whether BPA should take these principles through the BP-14 rate case prior to having any costs in this category, or wait until BPA has costs to which they would apply and then go through the formal rate case process. BPA believes the benefit of including the principles in the BP-14 rate case is to provide more certainty to applicable business cases as they are initially developed and tested internally at BPA.

We are requesting that you submit your comments prior to May 25th 2012.

Please send your comments and questions to Daniel Fisher at dhfisher@bpa.gov.



**DRAFT -Cost Functionalization¹ Principles Applicable for Acquisitions and Services That Benefit Both Power and Transmission Functions
March 31, 2012**

A. Purpose

The purpose of these principles is to form a foundation that guides BPA's allocation of costs incurred on power purchase agreements, energy storage devices, and demand-side management programs that provide benefits to both BPA's power and transmission functions. While initially applicable to power purchase agreements, energy storage devices, and demand-side management programs, these principles could be applied to include other acquisitions and services that benefit both power and transmission functions.

B. Background

BPA is actively researching/screening several non-wires solutions to transmission constraints. If a non-wires solution is determined to be the least cost solution to solve a transmission constraint, BPA will need to address a host of functionalization questions that will naturally follow. These principles represent BPA's first response to those questions.

Traditionally, transmission congestion is solved through reinforcements to existing transmission lines or through the construction of an entirely new transmission line. These added costs are then functionally allocated to the transmission revenue requirement and collected through transmission rates. Similarly, energy or capacity shortfalls between BPA's resources and load obligation are met through power purchases, the cost of which is functionally allocated to the generation revenue requirement and collected through power rates. A non-wires solution, however, may not follow the traditional flow of functionalization since non-wires solutions could consist of a power acquisition that delays or avoids the cost of building a new transmission line. In addition, some non-wires solutions have multiple benefits beyond that of the delayed or avoided transmission line, such as reduced transmission losses and power production.

¹ While these principles are titled "functionalization" principles, these principles are not dictating or proposing a particular accounting or rate development treatment. These principles provide the basis for determining to what extent certain costs would be recovered through transmission rates versus power rates.

[Placeholder - Insert description/discussion of external stakeholder input.]

The cost functionalization principles are consistent with BPA's legal guidelines governing the establishment of rates, as described in the BP-12 rate case. *See* BP-12-A-02, section 1.1.2. These principles are also consistent with the cost allocation decisions made in power's Tiered Rate Methodology (TRM), BP-12-A-03.

C. Costs Functionalization Principles

1. **All costs collected through rates** - The cost functionalization principles will be applied in a manner consistent with the Administrator's statutory responsibility to timely and reasonably recover BPA's costs through rates. 16 U.S.C. § 839e(a)(1).
2. **Cost established in Integrated Program Review (or its successor) with functionalization of those costs established in a rate case** –A joint power and transmission rate case study will identify the costs covered by the functionalization principles.
3. **Applicable to new costs** – costs subject to these principles are those that are new and that BPA will recover through rates beginning October 2013 or later.
4. **Transparent causation** – For costs to be covered by these principles, the underlying causation for the costs will be identified, and acknowledged by both power and transmission organizations as providing a cross-agency benefit prior to being incurred.
5. **Forward-looking cost allocation** – Cost functionalization will be based on the best available information at the time of the decision. Absent legal challenge with the initial functionalization or if a significant change in circumstances² is demonstrated through a subsequent rate case, BPA will not revisit cost functionalization decisions due to information provided after the time the decision is made. Such new information includes, but is not limited to, success of the underlying resource or asset, forecast error, and actual strategic use of the resource or asset. A decision to revise the functionalization due to a significant change in circumstance will be applied prospectively.
6. **Costs functionalized commensurate with benefits received** - Cost functionalization methods functionalize costs for acquisitions and services with cross-agency benefits in a manner that is at least roughly commensurate with the benefits received by those who will pay those costs. This principle is supported by principles 7, 8, and 9. Principles 7 and 8 are applied when benefits can be quantified. Principle 9 is a general approach applied when principle 7 and 8 cannot be reasonably applied.

² An example of a change in circumstances could be a fast-acting storage device with flexible active/reactive power capabilities that was originally acquired by the Power function to provide regulation and following as part of generation inputs for ancillary services (100% functionalized to Power). At a later date it is determined by BPA that the fast-acting storage device is better used to provide reactive support. The costs from that time forward would then be 100% functionalized to Transmission.

Principles 7 and 8 are applicable when benefits can be reasonably quantified.

7. **Annual functionalization percentage set on quantifiable benefits received relative to total quantifiable benefits** – A functionalization percentage will be calculated for each function based on the total quantified benefits. Results will be rounded to whole percentage points and will total 100 percent.

8. **Quantifiable benefit measured with macro benefits³** – Measurement of the total quantifiable benefits will include macro benefits. Macro benefits are defined as those that are quantified to have or are expected to provide benefits equal to at least 2 percent of the annual cost. The following macro benefits have been identified:
 - a. Additional revenue benefit. Calculated with effective rates at time of calculation and market forecast rates consistent with the Power Risk and Market Price Study (or its successor) used in the most recent rate case (including rate case proposals). This would include any estimates of additional revenue from transmission sales, secondary energy sales, and sales of capacity-related services (such as ancillary services, Resource Support Services, and peak load service). Additional revenue benefits will take into account business unit revenue credits (such as generation inputs provided to transmission by power).
 - b. Transmission loss benefit. Loss reductions will be valued with the market prices consistent with the Power Risk and Market Price Study (or its successor) used in the most recent rate case (including rate case proposals).
 - c. Option benefit. The value to a business unit of being able to make a choice in the future. Option value that cannot be reasonably quantified but is expected to provide a benefit equal to at least 2 percent of the annual cost will be deemed to be equal to 2 percent of the annual cost.
 - d. Public policy and societal benefits. Public policy and societal benefits that cannot be reasonably quantified but are expected to provide benefits equal to at least 2 percent of the annual cost will be deemed to be equal to 2 percent of the annual cost. If there is no consistent, measurable method of assigning these benefits directly to the business unit benefactor, the calculated or deemed benefit will be distributed 50%/50%.

³ See Appendix for examples of macro benefits and their relationship to within-business-unit cost allocation.

Principle 9 will apply when benefits are not reasonably quantified. This principle may also apply when the total annual benefits as quantified through principles 7 and 8 are substantially less than the annual cost incurred.

9. **General allocation of costs** – A general functionalization will be used when a particular project, effort, acquisition, or service is determined to provide a cross-agency benefit but the necessary information is not available to reasonably apply principles 7 and 8. This principle may also be used when the total annual benefits as measured through principles 7 and 8 are substantially less than the annual cost incurred.
 - a. 100% functionalized to business unit with primary need – if a particular business unit can be identified to have the primary need, such as a non-wires solution, 100% of the costs will remain with that business unit until principle 7 and 8 ,or 9(c) can be applied. For example, research and permitting costs incurred to explore and test the viability of a possible but unselected solution.
 - b. 50%/50% - Even Distributions – Costs incurred that are determined to serve the general purpose of the agency will be split 50% to power and 50% to transmission. This split is used when there is no consistent, measurable method of assigning costs directly to the benefactor through principle 7 and 8, or 9(c). Costs are general in nature and are not directly affected by changes in traditional cost drivers⁴. Collection of costs or measurement of driver is cost prohibitive – it is uneconomical to attempt more precise allocations. Lack of causal relationship to benefactors prevents a clear distinction for assigning the cost.
 - c. Directed Allocation – Costs that can be distributed with more precision than 9(a) or 9(b) by basing the allocation on specific cost drivers. Activities are managed and budgeted centrally, but methods exist to assign costs to benefactors. Functions can be linked to cost drivers and can change based on those drivers. Direction of effort studies or other means can be used to allocate in a cost-effective manner.

10. **Five-year time horizon** – If annual functionalized cost shares are needed beyond 5 years, the percentage cost shares for the remaining life of the expense will be set equal to the 5th year's percentage cost share.

⁴ An example of a cost driver used by BPA to functionalize costs is Full-Time Equivalent levels in each of BPA's power and transmission functions.

Appendix

Examples of macro benefits and their relationship to within-business-unit cost allocation:

- Benefit of deferred or avoided resource or asset purchase. Annual change in revenue requirement (this could include avoided system augmentation or power purchases made to support Tier 2 rates). The nature of this benefit will inform the within-business-unit allocation of costs to specific rates (such as power's Composite or Tier 2 Rate Pools or deferral of transmission infrastructure upgrades for a specific time period).
- Additional revenue benefit. The nature of the revenue source will inform the within-business-unit allocation of costs to specific rate pools (such as power's Composite or Non-Slice Cost Pools or specific segmentation of transmission-related costs).