Bonneville Power Administration

Rethinking Secondary Revenue Crediting in Ratemaking
A Concept Paper

Question:

Whether BPA should modify the treatment of anticipated secondary revenues in determining the base power rate, perhaps employing other mechanisms to distribute the value to customers?

Reason for Undertaking This Effort:

Current estimates of secondary revenues for FY 2014-2015 are about $100 million per year below the level included in BP-12 rates. If this decrease persists into the summer of 2013 when BP-14 rates are established, that decrease would translate into an 8 percent rate increase, if all other rate elements were held at BP-12 levels. BPA program costs in power rates are expected to increase through time. If not for offsetting reductions from non-federal debt service, the rate increase could be in the 15 percent range. Thus, reduced electricity market prices can lead to increased pressure on BPA to reduce program costs, even when program cost increases make good business sense when given the importance of maintaining total system value for BPA's customers.

In the converse situation, rising electricity market prices could reduce rates, and often mask BPA program cost increases that do not receive much scrutiny due to the lower rate pressure.

In summation, the current treatment of secondary revenues has the potential to motivate decision-makers toward short-term guidance at the expense of long-term strategic decision-making. This tends to introduce unpleasant and unhealthy volatility in rates.

Options:

1) **Status Quo** – No change to current treatment.

This option recognizes that most of the other alternatives simply shift the volatility of the secondary revenue fluctuations from BPA to customers without reflecting the effect of the fluctuations on BPA's rate level.

2) **Status Quo with Change in Rate Structure** – Develop a separate rate for crediting secondary revenues.

This option could allow BPA and customers to manage the core rate levels with a long-term strategic perspective and let a separate secondary-based rate move up and down every two years coincident with the expected market. BPA and stakeholders would manage program levels and rate levels based on the core rates and let the market fluctuations, whatever they may be, flow into the separate rate.

3) Reduce the Secondary Revenue Credit and Designate Incremental Secondary Revenues for Specific Purposes– Develop a methodology to assign any realized secondary revenues above the amount of the credit to a specific rate reduction purpose.

This option would reduce the impact of market fluctuations on rate levels by establishing a lower revenue credit in rates. Revenues achieved in excess of the rate credit would be designated for specific rate reduction purposes, such as debt repayment. This option would require solving for differing effects on Slice and non-Slice customers. It would also require mitigating the risk of realized secondary revenues being below the level credited.

4) Reduce the Secondary Revenue Credit and Designate Incremental Secondary Revenues for Refund to Non-Slice Customers– Develop a methodology to refund any realized secondary revenues above the amount of the credit directly to non-Slice customers.

This option would reduce (possibly to zero) the impact of market fluctuations on rate levels by establishing a lower credit in rates. Revenues achieved in excess of the rate credit would be refunded to non-Slice customers.

Major Issues:

Scope of Measured Items – Firm Sales and Secondary Sales: In discussing secondary revenues, there are nuances that need to be considered. While it is relatively simple in ratemaking to segregate secondary energy from firm energy, this segregation is not as easy in actual operations. For example, in ratemaking, BPA separates secondary sales from the sale of firm energy due to unused HWMs; in actual operations, it is not so simple. Actual operations cannot distinguish between selling surplus firm and secondary. This distinction is important because the credit from sales of unused HWMs is assigned to the Composite Cost Pool while the credit from secondary sales is assigned to the Non-Slice Cost Pool. In defining an alternative treatment of secondary revenues, a procedure to separate sales of firm energy from sales of secondary energy would need to be developed.

Scope of Measured Items – Balancing Purchases: In defining an alternative treatment of secondary revenues, the question of whether to focus on secondary revenues or net secondary revenues needs to be answered. In ratemaking, BPA uses the term "secondary revenues" to mean the revenue from sales of secondary energy; the term "net secondary revenues" is used to mean the revenue from sales of secondary energy less the expense of balancing purchases. When determining rates, BPA keeps the revenues and purchased power costs separate; when reporting financial results, BPA generally combines the two into a net secondary revenues measurement. Both components of net secondary revenues are assigned to the Non-Slice Cost Pool. The distinction in the treatment is important because secondary revenues cannot fall below zero, while net secondary revenues can fall below zero. Slice customers bear comparable risks of both secondary revenues and balancing purchases because it is uncertain how much secondary energy from BPA they will be able to sell or whether they may have to make additional purchases of their own. The question for this exercise is how to structure rate credits for non-Slice customers: should it be based on secondary revenues only, or should it encompass balancing purchases as well (i.e., be based on net secondary revenues)?

Equitable Treatment Under Option 3: Option 3 entails using realized secondary revenues towards future rate relief rather than using anticipated secondary revenues for current rate relief. Most items that are flexible enough to be funded with current revenues thereby lower future rates are assigned to the Composite Cost Pool. Because secondary revenues are coming from the Non-Slice Cost Pool, reassignment to reduce a Composite Cost Pool item would result in rate relief flowing to a different set of customers: particularly, Slice customers. If this option is chosen, procedures would need to be developed that either direct the rate relief to only non-Slice customers, or that include contributions from Slice customers' own secondary revenues in funding a share of the future rate relief.

Refunding Mechanisms Under Option 4: Option 4 directs the use of secondary revenues to be refunded to non-Slice customers. The mechanisms to achieve the refunds need to be established.

Scope of Customer Participation: Does Option 4 require all non-Slice customers to participate? If not, separate rates may need to be established for participating and non-participating customers, and methods for ensuring that the responsibility for mitigating financial risk mitigation is shared fairly between those two groups of customers. BPA's rate and risk structure would be more complicated if there were both participating and non-participating customers.