Is There a Better Way?

Presented by:

Western Public Agencies Group

Purpose of Presentation

- **Presentation purpose**
  - Determine interest in pursuing development of an alternative approach for crediting secondary revenues for consideration in the rate case
- **Not seeking to find the perfect solution today, or endorse any particular alternative approach**
- **Instead, want to find out if**
  - We should continue to tie initial PF rate level to forecast secondary revenues, and
  - Continue to have BPA hold secondary revenues actually achieved,

    or
  - Develop alternative(s) that would permit the customers to hold this money

Background

- BPA determines the firm capability of the FCRPS based on some variant of critical water
- Results in substantial amounts of power in excess of critical production for sale on the market
- Raises the issue of how to reflect these revenues when setting BPA rates
- BPA has since before the Regional Act used forecast secondary revenues to reduce preference customer firm power rates
- This approach has provided both substantial benefits and numerous problems for both BPA and its preference customers

Background – Cont'd

- Most obvious benefit of the current approach is reduction to the initial PF rate level
- The size of these reductions has varied, but at time has been substantial
- As shown on BPA's graphs, forecast net secondary revenues have varied from $100 million in 2000-2001 to over $500 million in 2009 and 2011
- Current approach also insulates PF rate from the financial consequences of market price and water volatility, at least temporarily
- Leaves management of secondary revenue risk with BPA rather than individual customer, even though responsibility for secondary revenue risk ultimately resides with preference customers

Background – Cont'd

- **The problems inherent with the current secondary crediting approach derive from a number of factors**
- **First, secondary revenues are notoriously difficult to forecast accurately**
- **Actual secondary revenues vary from forecasts for a variety of factors**
- **Market factors include**
  - Gas Prices
  - Generation availability
  - Economic conditions
  - Transmission availability
  - Unexpected load levels

Background – Cont'd

- **Factors peculiar to BPA include:**
  - FCRPS hydro conditions such as
    - Water volumes
    - Timing of flows
  - Level of BPA firm loads
- **As a result, forecast secondary revenues used to set PF rate are rarely spot on – sometimes high, sometimes low**
- **BPA graphs illustrate this dilemma**

Consequences of Current Approach

- **Consequences vary depending on whether actual secondary revenues exceed or fall short of forecasts revenues used to set PF rate**
- **When actual secondary revenues exceed forecast values**
  - BPA can end up holding multiple billions in reserves
  - Can imbue BPA with false sense of financial security, leading to more relaxed attitude toward spending
  - Holding excess secondary revenues for extended period can present a politically attractive nuisance to DC
- **When actual secondary revenues fall short of forecast values**
  - Financial reserves can melt away quickly
  - Treasury repayments can be threatened (or missed)
  - PF rate stability gives way to mid-rate period increases (CRACs trigger)
  - BPA can find itself making political concessions in DC to obtain financial assistance

Consequences of Current Approach – Cont'd

- **BPA recognizes risks (both financial and political) and has taken variety of steps to cover secondary revenue risk**
- **These have included**
  - Cost recovery adjustment clauses (CRACs) including some that were cause specific (ENW, fish costs) and those that are keyed to BPA financial reserves
  - Including additional revenues in the PF rate earmarked to cover shortfalls between forecast and actual secondary revenues (Planned Net Revenues for Risk, or PNRR)
  - Borrowing money to pay operating costs when actual secondary revenues fail to achieve forecast levels (Treasury Facility)
  - Upon occasion BPA has engaged in budget cutting in order to bring income and outgo into closer balance
  - BPA has also retained actual secondary revenues in excess of forecast values as a hedge against future secondary revenue shortfalls

Consequences of Current Approach – Cont'd

- **All of these mechanisms demonstrate two things:**
  - The current use of forecast secondary revenues to set the initial level of the PF rate introduces substantial instability to BPA finances
  - The current use of forecast secondary revenues creates a tension between PF rate and BPA financial stability on the one hand, and setting the initial PF rate at the lowest achievable level on the other hand
- **Recently BPA and its customers have made fundamental changes to how business is conducted, including:**
  - Power supply relationship under the Regional Dialogue Power contracts
  - How preference customer rates are set under TRM
  - How the Residential Exchange is administered under recent Exchange Settlement
- **The power market and the industry generally have changed materially since the passage of the Regional Act**
- **Good time to re-examine if secondary crediting approach from the 70's, given the changes since then, still the best for BPA and its customers**

Time to Consider a Different Approach

- **One idea for a different approach is to credit secondary revenues as actually earned by BPA, instead of embedding forecast values in PF rate**
- Embed in PF rate secondary revenues at level BPA certain to achieve, such as secondary revenues BPA is 90% sure of recovering based on historical experience
- This would equate to about $90 million annually
- Actual secondary revenues achieved by BPA in excess of this amount could be credited quarterly on customer power bills – same approach as Exchange Settlement
- Could use TOCA of non-slice pool customers as allocator as Slice purchases would not get a credit

Time to Consider a Different Approach – Cont'd

- **What are some of the frequently asked questions about such an approach**
- **What is the Wholesale rate impact of such a change**
  - Worst case – take entire secondary credit out all at once(minus $90 million)
  - $320M = 6 mills = 20%
  - Such an impact would be unacceptable and requires mitigation
  - One way is to stage the secondary revenue credit reduction in over three rate periods (or about $100 million per rate period)
  - Approximately a 7% increase for each of the three rate periods
  - Use available reserves (if any) to decrease rate impact

Time to Consider a Different Approach – Cont′d

- **What would be the retail rate impact**
  - Retail rate impact under remove entire credit at once is about one-half of wholesale impact, or about 3% for each implementation rate period
  - Utility would have choices on how to deal with this at the local level
    - ✓ Set retail rate on full PF rate and give credits on retail bills based on credits received from BPA
    - ✓ Embed a percentage of expected secondary revenues that utility has high probability of receiving
    - ✓ Embed full secondary revenue credit in retail rate and have risk mitigation mechanisms, such as cash reserves and line of credit, for when secondary revenues fall short
- **Would BPA lose interest in aggressively marketing secondary**
  - BPA marketers are professionals who take pride in their work
  - Extremely unlikely that they would lose interest in getting best price for their product

Time to Consider a Different Approach – Cont′d

- **Will monthly credit on bill paid by BPA to customer create a politically attractive nuisance to politicians**
  - Some concern that crediting actual secondary revenues achieved by BPA will increase secondary revenue visibility
  - Just opposite likely the case
  - From time to time, BPA has accumulated and held for extended periods over $1.5 billion in secondary revenues – a painfully obvious treasure trove
  - Under the real time crediting, the amount of secondary revenues in BPA's hands would be smaller, and would be held for shorter periods (a quarter)
  - If anything, this new approach would reduce the political visibility of secondary revenues
  - Bill credit paid under Exchange Settlement has not attracted notice
  - If concerned, can include a contract amendment that obligates BPA to make the secondary revenue credit payment, giving same protection as preference got under Regional Dialogue contract

Time to Consider a Different Approach – Cont′d

- **Can we be sure that BPA will pay the credit and not divert the money to other uses**
  - BPA has demonstrated in the aftermath of PGE/GNA cases that it can and will make credit payments and not divert money
  - Same has held true for payments to all parties under the Exchange Settlement
  - If there is concern, again a contract amendment obligating BPA to make such payments could be crafted and offered
  - Risk of diversion of secondary revenues would be less as BPA would have a much more stable financial situation, and less need and less time to divert these funds

Conclusion

- **With the changes BPA has recently implemented, and the changes in the market and industry, perhaps we need to consider the following questions**
  - Do customers want lowest possible rates through maximum secondary revenue credit, and the attendant rate and BPA financial instability?
  - Do customers want to find a way to develop a more stable PF rate while still receiving the full benefit of secondary revenues?
  - Is BPA or the preference customers best suited to hold secondary revenues?
  - Are customers ready and able to manage their share of secondary revenue volatility?
- **This may be the best time yet to seriously examine these questions, and to determine if a better secondary crediting mechanism can be fashioned**