

REGIONAL DIALOGUE TECHNICAL WORKSHOP NOTES
Wednesday, March 12, 2003
BPA Rates Hearing Room, Portland, Oregon

Approximately 25 people attended; two people joined by phone.

Helen Goodwin (BPA) opened the meeting and announced there would be an additional Regional Dialogue workshop on IOU benefits March 17.

Kim Leathley (BPA) said BPA postponed work on the Regional Dialogue in all but two areas: IOU benefits and BPA cost controls. Customers want meaningful and enforceable cost-control mechanisms in place for post-2006, she acknowledged. The objectives of this meeting are to define the cost structure of power rates, inform you on the historical and current structure, and set up a foundation for discussions on policy choices that will impact the future cost structure of BPA's power rates, Leathley explained. She noted that while forecasts of FY07-11 expenses continue to change, BPA would present estimates at the next meeting.

Geoff Carr (NRU) pointed out that a couple of months ago BPA presented FY07-11 estimates. Are you saying you will be presenting changes to those estimates? he asked. Yes, those were preliminary estimates, Leathley responded, adding that some costs have gone down and some have gone up since then. She indicated that BPA would be better prepared to address FY07-11 cost/rate estimates at a later date.

Tina Ko (BPA) went through a handout on BPA's cost structure. (The meeting handouts are posted on BPA's website at www.bpa.gov/power/regionaldialogue) The presentation included an explanation of the elements, such as expenses associated with day-to-day operations and long-term commitments, that make up BPA's cost structure. BPA's revenue requirement, which is used in setting rates, is derived from its cost structure, Ko said. She next outlined the historical and current influences on BPA's cost structure.

Terry Mundorf (WPAG) asked where in its cost structure BPA reflects medium and long-term sales outside the region. I don't think that concept is captured here, Leathley acknowledged. She said BPA aims to optimize the value of surplus energy with its out-of-region sales, so the issue might also be viewed in the context of risk-management. I would suggest you think of medium and long-term surplus power sales as another category of transactions that affect your cost structure, Mundorf advised.

Ko explained a bar chart of BPA's FY01 actual expenses and noted that the high level of power purchases was an anomaly because of the drought in 2001. She outlined the influences on FY02-06 rates and explained a bar chart, comparing FY01 actual spending with FY02-06 average spending levels, based on a February forecast.

Scott Brattebo (PacifiCorp) said the bar chart understated augmentation expense and overstated IOU benefits. Your augmentation bar does not show how much you are actually paying, since you have not included the IOU augmentation buydown, he pointed

out. It is “misleading” and “unfair” to characterize that buydown as part of the IOU benefits, Brattebo contended.

Leathley said the suggested change had been made in other presentation materials and should have been made to the bar chart in the cost-structure slides.

Ko went over a list of influences on BPA’s cost structure post-FY06, divided according to base costs and additional costs. The level of these costs is dependent on what BPA’s role is, she pointed out. Another bar chart offered a side-by-side comparison of the FY01 actuals, FY02-06 average spending levels, and an “illustrative forecast” for FY07-11 spending. We have not done a full expense forecast, so we’re making no assumptions about loads for the sake of rate-type calculations at this time – we’re just showing gross expense levels, Leathley explained. She reiterated that the FY07-11 costs are for illustrative purposes. Using these illustrative numbers, it looks like FY01-11 costs could exceed FY 01 actuals by about \$460 million.

Two of the biggest components of the increase from FY01 to FY07-11 are in the categories of depreciation, amortization, and net interest (\$163 million), Columbia Generating Station/Corps/Bureau and other generating projects (\$166 million), and benefits to the residential and small farm consumers of the region’s IOUs (\$125 million). Non-Federal debt service could decline by \$49 million, Leathley said in explaining the comparisons. A set of additional miscellaneous cost items shows an increase of about \$13 million between FY 01 and the average expected expense levels for FY 07-11.

Ko pointed out that part of the increase in net interest expense for FY07-11 reflects fish and conservation investments as well as Corps and Bureau projects that are expected to come on line. Expenses are expected to be up at the Columbia Generating Station in the next rate period due to increasing the fuel inventory and undertaking a condenser tube replacement, Dave Steele (BPA) pointed out. BPA staff members said they would report back on why there is so much variation from year-to-year in Columbia Generating Station expenses.

Where does your budget process fit in with the cost structure? Mundorf asked.

Each year, we have a budgeting process that looks out seven years for capital and expenses, Chuck Maichel (BPA) said, adding that BPA is currently working on the FY04 budget. We send that budget to OMB, and it becomes part of the President’s annual budget, he said. Leathley indicated that BPA is changing its internal processes to tighten control on expenses.

What kind of a “look back” do you do? Mundorf asked. Is it part of your process to compare the actuals to your expectations when you make the budget? he asked. Yes, we do that, Maichel said. He added that some programs have established performance measures. We look at the progress toward the measures as guidance in setting the next year’s budget, Maichel explained.

Leathley said BPA managers review regular budget reports and take immediate action to remedy the situation if expenses go above projected levels. We are increasing our focus on management of budgets, she added.

We were told “unambiguously” that for the rest of the rate period, your internal operations costs would be managed to 2001 actual levels, Erick Johnson (PNGC Power) stated. Yet your spreadsheets show those costs growing and increasing \$10.3 million annually by 2006, he pointed out. Why is that? Johnson asked.

We said we would keep the internal operations costs in PBL and Shared Services to 2001 actual levels from 2003 to 2006, Leathley responded. The spreadsheets indicate that we will have a \$48 million total increase in costs (\$12 million increase in each of four years), so it appears BPA is not managing to FY01 levels, she stated. An important point is that we assume we will have \$30 million in offsetting revenues from PBL’s efficiencies projects, Leathley explained. That means we will still have to cut \$18 million, which we have committed to do, she added.

What is the source of these offsetting revenues? Johnson asked. Leathley indicated that PBL has seven or eight efficiency projects, including improving internal processes for data collection and management, which would reduce FTE; optimizing hydro generation; and calibrating generation to the power market. Are the efficiency gains realized? Johnson asked. Were any FTEs removed? he inquired. Leathley said no FTE had been eliminated yet, but the programs are not fully implemented.

We were told “in unambiguous terms” that PBL internal costs would be managed to 2001 actuals or below, Johnson reiterated. I’d expect to see “a flat line” on those costs, he stated.

The revenue offsets were part of this commitment, Leathley responded. It would be extremely difficult for us to get to 2001 actuals without the revenue offsets, she stated.

This is utterly unacceptable, Johnson responded.

Randy Hardy (HEC) said he represents the vendors of Columbia Vista software, which BPA is using to optimize hydrosystem generation. They are halfway through the installation and already the system is realizing about 50 additional megawatts of generation, he said.

We are counting the revenue increase from that optimization against the expenses of the programs, Leathley said. If we had not made the expenditures for the efficiency programs, we would not have gotten the revenues, she stated.

I don’t know when we started parsing revenues and expenses, Doug Brawley (PNGC Power) commented. You have taken this expected revenue and used it against an area of expense that is increasing at the rate of \$10 million a year, he said. “It is disingenuous” to assign this revenue to corporate overhead because it is convenient to do so, Brawley

said. You are giving yourself cover for keeping costs up, and “it is unacceptable,” he stated.

The average expenditures for these programs you’re referring to are not increasing, Paul Murphy (Golden NW) pointed out.

This “nitpicking” over expenses is hurting agency morale, and we should be willing to trust BPA on this, Steve Weiss (NWECA) said. This isn’t where “the big bucks” are, he added. Even if cuts are made in these areas, it wouldn’t make a difference in rates, but it will hurt morale, and BPA’s business will suffer, Weiss continued. “This stuff is peanuts,” and we ought to concentrate on the big things, he added.

It may look small, but between ENW, Corps, and Bureau increases, the difference adds up to a \$600 million over the rate period, Kevin Clark (Seattle) pointed out.

This is the type of “government bashing” that does not help, Weiss said. BPA is working hard at this and doing a good job, he indicated.

You have to deal with all of the line items to get the totals down, Murphy responded. We can’t afford not to look at all of the line items, Brawley agreed. We have rates that are 70 percent higher than they were in 2000, he said. Our ratepayers can’t afford it any more, Brawley stated.

What kind of internal budget process do you have? Clark asked. Does it link to your Congressional budget, your anticipated revenues, or the rate case? he asked. What is your internal “not-to-exceed” number? Clark asked.

There was a disconnect between the 2000 rate case and the budget, Leathley acknowledged.

What numbers were you managing to? Clark asked. You said every manager has a budget to manage to, and I want to know the construct for the 2001-2006 rates on Day One of the rate period, he said.

It was an internal financial objective, Steele responded. We have internal objectives that are cumulatively tied to the net revenue target, he explained. Did that match the revenue requirement? Probably not, Steele added.

Who determines the financial objectives? Mundorf asked. Steele said BPA’s senior managers set the objectives.

Leathley pointed out that BPA has turned its budgeting process “on its head” since 2001. We are now managing to the revenue requirement, she stated.

Your process is still not transparent enough to people outside the agency, Clark stated. It would be helpful if you could make it clearer, he said.

This does not work for us, Johnson stated. It is unacceptable to use the efficiency revenues to offset costs that are increasing, he said. “My board will think its been lied to,” Johnson said. You need to figure out what your customers can afford to pay, he continued. People will not buy power at your prices – “much, much more has to be done” to get costs down, Johnson said.

We don’t think the numbers are good enough, Leathley responded. Our ultimate objective is to get to 2001 actuals “straight out,” she said. Some expenses are going up, Leathley pointed out, adding that, for example, additional security costs of up to \$4 million annually “are not insignificant.” Our commitment is to get our expenses as low as possible, she stated.

I don’t think the PNGC Board is aware of these revenue offsets, Johnson said. We have tried to be honest about this, Leathley replied, indicating that BPA has talked about the revenue offset on many occasions.

Well, it looks like “a shell game,” Johnson said. We can’t afford the prices you want to charge, he said, adding that PNGC cut its budget 17 percent for 2003.

I’m interested in the budget structure, Clark stated. Can we get the numbers you will manage to for the remainder of the rate period? he asked. Clark said he’d also like to know about mid-course adjustments and how spending is estimated and managed.

This is more than a data request, Mundorf said. It would be worthwhile to talk about this further, he stated.

Leathley explained an additional handout on alternative cost structures for FY 01-11. She said that the middle of the sheet represents the base case and the columns on the right indicate increases and their ramifications, and the columns on the left indicate decreases and their ramifications. The chart sets up a framework for us to consider the tradeoffs associated with either course, Leathley elaborated.

A continuing dialogue on how you manage your finances would be helpful, Mundorf stated. He suggested an additional meeting March 26. Leathley said she would see whether BPA could be prepared with the new information for another meeting in two weeks.

Adjourn: 12:05 p.m.