NRU

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Nancy Mitman
Acting Executive Vice President and Chief Financial Officer
Bonneville Power Administration
RE: 2014 Capital Investment Review
Via email: BPAFinance@bpa.gov

Dear Ms. Mitman:

Northwest Requirements Utilities (NRU) appreciates this opportunity to comment on the Bonneville Power Administration's (BPA) 2014 Capital Investment Review (CIR) process. These comments have been reviewed by the NRU members, and individual members have been encouraged to submit their own recommendations to BPA as they deem necessary. NRU's members appreciate the time and effort that BPA staff has put into developing BPA's Asset Strategies and the outreach to customers through the CIR workshops.

While NRU recognizes BPA's need to make capital investments in order to maintain the value in the Federal Columbia River Power System (FCRPS) and the Federal Columbia River Transmission System (FCRTS), the projected double digit rate increases (using vintage numbers that have not been updated) for both power and transmission in FY 2016-2017 are too high to absorb for a region still recovering from a long economic recession. The region has still not recovered to pre-recession employment levels, and unemployment, particularly in the rural areas, remains extremely high. BPA's comparatively low rates are the economic backbone of this region; however, the potential for a double digit rate increase, particularly now that BPA is no longer responsible for serving load growth through Tier 1 is troubling and continues to erode the value of this product, especially in comparison to low market prices. Therefore, BPA needs to either identify a corrective action that will significantly ameliorate the magnitude of a prospective rate increase in FY 2016 – FY 2017 or make further efforts at cost containment than what have been demonstrated thus far in the CIR process.

The double digit rate increase proposed for FY 2016-2017 is particularly injudicious given that BPA has preliminarily forecasted rate adjustments of 0% in FY 2018-2019 and 1% in 2020-2021. This rollercoaster of proposed rate increases is not consistent with sound business practices because it leaves BPA's public preference customers in the untenable position of not having a dependable and stable cost basis for their wholesale power supply. BPA needs to modify its debt portfolio and proposed capital spending plan in order to smooth out the rate impacts over multiple rate periods.

Furthermore, while NRU members support BPA's continued investment in the hydro, transmission, energy efficiency and other systems to support and reinforce the long-term value of BPA's assets, they need assurance that BPA will continue to provide Tier 1 power at the embedded cost of the Federal Base System (FBS) to preference customers post 2028, particularly given the level of proposed capital spending. If BPA's customer utilities are being asked to shoulder the burden of large capital investments, we need to be confident that we will continue to benefit from those investments. Without further clarity of the BPA-customer relationship post 2028, it is difficult to analyze the implications of BPA's capital program on intergenerational equity.

The Capital Investment Review Process

The CIR process is one component in BPA's financial public process which also includes the Integrated Program Review (IPR) and the Access to Capital debt management discussions. While NRU members recognize BPA's need to stagger these processes, the current CIR process is disjointed from both the IPR and Access to Capital discussions that will not commence until June. Options discussed in the IPR and Access to Capital forums could have significant impacts on BPA's capital program. NRU urges BPA to provide an opportunity to revisit the issues in an IPR/CIR 2 process after the Access to Capital discussions have concluded in order to help ensure that BPA's final capital program accurately reflects the decisions made in the upcoming processes.

It is particularly important to revisit the CIR process once BPA's Access to Capital debt management discussions conclude because BPA has not yet identified a new tool that will provide BPA with the required access to capital. BPA needs a tool that will provide adequate access to capital that is equitable to customers over time without negatively impacting rates or bond ratings.

NRU continues to be skeptical of the long-term value of the Prepay program, currently projected at $160 million in FY 2016. The Prepay program continues to be an expensive source of capital in comparison to other borrowing options available to BPA. Additionally, at this time, revenue financing of $35 million beginning in 2016 is not supportable in light of the proposed double digit rate increase for power. The upward rate pressure caused by revenue financing, combined with issues of intergenerational equity, call into question the viability of any level of revenue financing in the near term. While NRU agrees with BPA's proposed capital reduction in lieu of revenue financing, we are concerned that this reduction only highlights the lack of viable tools that BPA can utilize to meet its long term access to capital needs.

Two New Components to the CIR: Affordability Cap and Prioritization Process

BPA has introduced two new components in this CIR process. First, BPA developed the Affordability Cap to place a limit on the impact of planned cumulative capital expenditures on BPA's rates, cost structure, and access to financing. We strongly support BPA's goal to control the rate impact of the capital program; however, as noted above, BPA's proposed "affordable" capital program is not in line with customers' ability to pay. As currently structured, the "affordability cap" is misnamed because it appears to be based on BPA's historic spending patterns and internal constraints to execute a large capital investment program, rather than being grounded in the context of power and transmission rates. There is nothing we see to directly link the "affordability cap" with projections of affordable rates for power or transmission.

Additionally, NRU Members would appreciate clarity on what the impact a change in the size of the capital program for the current or next rate period would have on rates. For example, on the expense side, BPA has provided the "yardstick" measurement that a $20 million increase or decrease in expense spending has approximately a 1% rate impact. Understanding this relationship for capital spending would help BPA's customers gauge the magnitude of a capital project's impact on rates. We recognize that this is a more complicated description because the source of funding for capital projects varies, and the different sources of funding impacts rates in different manners. Nonetheless, more information on this topic would be helpful.

BPA should also incorporate the goal of long-term rate stability into the Affordability Cap criteria. BPA's projection to increase rates by double digits for FY 2016-2017, followed by rate increases of 0% and 1% in the next two rate periods does not exhibit rate stability or affordability over time.

Second, NRU members agree that the Prioritization Process is useful and should continue to be refined and expanded to other BPA investments. NRU supports BPA placing precedence on "Core Sustain" investments before funding "Expansion" investments. We expect that BPA will continue to refine this process as the agency and customers gain experience working through the various steps.

NRU agrees that BPA should evaluate projects not only from a regional total cost/benefit perspective, but also from a BPA cost/benefit perspective. In other words, BPA should include an analysis of the net impact on BPA's costs and rates as a separate metric in the Prioritization Process.

NRU requests that BPA provide additional information about the process for determining the scope of the original submittals before projects entered the Prioritization Process. For example, did BPA give any guidelines to limit the scope of the original submittals? What was BPA's starting position? Such information would make the comparison between what was originally submitted and ultimately approved more meaningful. Also, NRU does not support excluding expansion projects of less than $3 million from the prioritization process for FY 2016 – FY 2017 because such projects in aggregate are a commitment of over $60 million per year.

Additionally, BPA should add a "portfolio optimization" component to the Cross-Agency Review in the Prioritization Process. This step would examine whether the portfolio of projects have interrelated impacts. If BPA moves forward with one project, would the resulting impacts from that project reduce or negate the need for another project in the portfolio? This review would be helpful in ensuring that BPA's limited capital dollars are optimally deployed.

Finally, while NRU agrees that the process for prioritizing projects is a useful tool and should continue to be applied and expanded to cover additional areas of capital expenditure, we note that the proposed prioritized expansion portfolio of 40 projects contains no projects for Power Services—the majority of projects are Transmission, with a small number of Information

Technology and Facilities projects. We question the final outcome in which a significant amount of capital spending is going toward Transmission expansions while many of the hydro assets are in need of reliability/availability improvements to extend their useful life.

Hydro Strategies

NRU members recognize that the hydro system is aging and requires significant investments to maintain its current capacity and reliability. As the current situation at Grant County PUD's Wanapum Dam clearly illustrates, a robust capital program is needed to protect and preserve BPA's existing hydro assets. NRU is troubled that BPA's FCRPS total O&M costs of $583 million are 110% of industry median while capital investments are only 64% of industry median. Additionally, utilizing the national hydroAMP model, BPA notes that since 2009, FCRPS hydro power train equipment has declined from 7.8 to 7.3 on a scale of 1-10, and that four out of five of BPA's most critical power plants have 30% or more of their equipment in marginal to poor condition. NRU questions if the implementation of the reduction to the hydro capital program for FY 2014-2015 are prudent if we are to avoid a serious outage or equipment failure at one of these critical plants.

Transmission Strategies

BPA needs a balance between ensuring the current system is reliable and pressure to expand the system while maintaining an Affordability Cap that is in line with customer's ability to pay. BPA's priority should be on "core sustain" and compliance investments while policy and discretionary projects must meet stringent cost-benefit thresholds.

Additionally, as discussed in the Transmission workshop, BPA should continue to implement the "Guidelines for Direct Assignment Facilities." If other commenters wish to revisit this policy, any changes should be made through a separate workshop and not through the CIR process.

Energy Efficiency

The energy efficiency incentive and BPA managed programs represent a $1 billion investment over a 10-year period; however, these investments are excluded from the prioritization process. While NRU recognizes that these investments are influenced by entities outside the FCRPS, BPA should work to incorporate these investments into the Affordability Cap and Prioritization Process so that they can be evaluated side by side with BPA's other investments.

NRU recognizes that the Energy Efficiency Post 2011 process is running concurrently with the CIR process and that any changes to the energy efficiency program design that emerge from that process may necessitate a CIR 2 workshop. NRU supports the concept of allowing utilities to self-fund the Energy Efficiency Incentive portion of the Energy Efficiency capital program, provided that there are no direct or indirect adverse consequences to utilities that continue to fund Energy Efficiency Incentives through BPA. Additionally, NRU recommends that BPA continue to capitalize Energy Efficiency funding for FY 2016-2017 in light of the size of the proposed rate increase.

Fish and Wildlife

NRU supports BPA's continued funding to meet its legal obligations under the Biological Opinion (BiOp) and the Fish Accords; however, we oppose any expansions to this program. Given BPA's success in achieving the performance metrics laid out in the BiOp, the favorable ocean conditions, and the record returns of 2013, any increased spending for Fish and Wildlife is not justified at this time.

Information Technology

NRU recognizes that the IT asset strategy is evolving as BPA faces increased requirements for NERC-CIP Regulation and cyber security. However, as more IT costs are shifted to expense and O&M, it is difficult to compare the total rate impacts of BPA's IT program without first comparing both capital and expense expenditures.

Recommended Next Steps:

BPA needs to keep the CIR Process open for the basic reason that the customers have not seen enough information regarding anticipated additional financing tools and related rate impacts to draw reasonable conclusions about the level of spending and financing strategies that have been presented thus far in the CIR process.

Working in conjunction with Energy Northwest, BPA should closely examine the debt structure of ENW, focusing on the debt associated with both Columbia Generating Station and WNP #1 and WNP #3. The opportunities associated with restructuring this debt could relieve significant pressure on BPA's Access to Capital strategy. Debt restructuring could materially impact power rates, both in the short term and over time. Restructuring could also create flexibility in the use of Treasury borrowing authority, the general access to capital, and the overall affordability of BPA's capital program. BPA should examine the options associated with Energy Northwest Debt restructuring over the next 60 days and then return to the CIR issues, including the Affordability Cap.

Regarding ENW debt, we would encourage BPA to present more than one alternative to debt restructuring that is intended to emphasize different priorities, such as:

- Best economic value to BPA's customers
- Best approach for funding an affordable capital program over time
- Best option to achieving immediate rate relief
- Best approach for securing a combination of rate relief and rate stability over time, and

- Best likelihood of being politically sustainable

In the event that a reconfiguration of ENW debt can produce an additional access to capital tool for BPA, and/or net interest savings, such a tool should not be considered as a "blank check" to undertake new or expanded capital projects. The use of such a tool, and whether it is supported will require joint agreement between ENW, BPA and the customers.

We would also like to see an alternative where Energy Efficiency that BPA would otherwise capitalize through a third party is expensed, not in FY 2016 – FY 2017, but beginning in FY 2018 and continuing into the future. This is contingent upon BPA's preliminary information that a rate increase beginning in FY 2018 – FY 2019 would be in the 0% to 1% range prior to considering this funding change for Energy Efficiency.

The "Affordability Cap" as a concept should be set aside for the time being. It is a distraction and has no clearly demonstrated application in this process because it is not directly tied to rates. Instead, BPA and its customers should focus on the appropriate size of a capital program with a projection of how rates are impacted. As currently designed, the affordability cap appears to be "front loaded" and over time could constrain priority investments in the federal hydro-electric system.

While BPA needs additional access to capital tools, NRU expressed skeptical reservations regarding the PrePay Program, and we cannot support revenue financing in the face of a significant rate increase even without the inclusion of revenue financing. The region needs to focus on a more robust capital tool.

Finally, there is limited time for analysis and public discussion before the region needs to lock in financial decisions in advance of the FY 2016 – FY 2017 rate case. We urge you to have immediate and candid discussions with public power representatives to help ensure that BPA and its customers are pursuing a mutually agreeable agenda.

Thank you for the opportunity to participate in the CIR workshop process and to provide comment. We look forward to working with your staff and other customer representatives to ensure BPA's long term financial integrity.

Best Regards,

John D Saven

John D. Saven
Chief Executive Officer

CC: Members of NRU
Scott Corwin, Public Power Council
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