NRU talking points on ways to reduce the 2010 to 2011 BPA Power Rate Increase

Background:

BPA's Initial Proposal showed a rate increase for FY 2010 and 2011 of 10% compared to 2009 rates. The rate increase in the Initial Proposal was largely due to increased costs (Columbia Generating Station, Augmentation costs, Fish and Wildlife, and an increase in Minimum Required Net Revenues).

Since the Initial Proposal, BPA's financial condition has deteriorated significantly due to poor snowpack, and declining market prices for power, largely indicated by falling natural gas prices. For example, BPA's financial reserves are projected to drop another $250 million by the end of FY 2009 assuming that natural gas prices stay at the $4 per MmBtu level.

This could lead not only to a greater increase in the rates than we saw in the Initial Proposal, but also could lead to the potential for a CRAC Triggering in FY 2010 based on FY 2009 results.

Putting it all together, rates for FY 2010 and 2011 could be 17% higher than FY 2009 and an additional 8% higher in FY 2010 due to the CRAC triggering based on FY 2009 actuals. Therefore we could see a 20 to 25% rate increase in FY 2010 (CRAC plus base rates). Rates in FY 2011 could be 17% higher compared to FY 2009 assuming we move back to normal water in FY 2010.

Action needs to be taken by BPA and the customers to bring the potential for this size of a rate increase down, especially given the economic malaise. BPA will be holding a meeting at the Rates Hearing Room on March 18th from 1 to 5 p.m. to address this topic (*to participate by phone, call Suzanne Lawrence at (503) 230-3320*). You are urged to participate since BPA really needs to hear from managers and board members.

The actions being taken:

To address this problem the customers have come together and have proposed the following steps to BPA staff with the goal of bringing the rate increase back down to single digits.

First step: Cost reductions

BPA and the customers need to do a thorough review of its costs given the economic malaise that we are now in and the possibility of a double digit rate increase if immediate action is not taken.

- Other entities that are funded through BPA's revenue requirement are now actively looking at their costs. Savings from Energy Northwest are expected to be $20 to $25 million per year.
- Similar cost reductions are requested BPA-wide with a target of 5% of non-debt service related costs. We are suggesting that a further $25 to $30 million of saving per year come from the non-CGS related costs. More cost reductions may be needed if we cannot bring the rate increase below the increase stated in the Initial Proposal.
- BPA also needs to reassess the rate of spending implied in its revenue requirement for FY 2009, 2010 and 2011. BPA's actual spending in areas like fish and wildlife are below budgeted levels. Given the state of the level of spending in the rates should be adjusted to reflect actuals. We should not base rates on spending levels that are not going to be achieved.
- Augmentation costs are clearly overstated and need to be reduced. This is not included in the suggested overall agency $50 million cost reduction discussed above. Loads are down and the CGS outage has been reduced by 10 days in 2011 and market prices are lower.

The Second Step: Addressing risk

- BPA needs to look at its overall agency reserves when it assesses risk. Currently, BPA looks at each business line on its own when it assesses the probability of U.S. Treasury payments. Its 95% rate period Treasury Payment Probability goal is based on the Power side reserves. However, BPA will make its Treasury payment based on overall agency reserves (power and transmission). Transmission reserves are healthy (above $400 million) and much less variable then Power side reserves. Concerns about each business line standing on its own could be handled through inter-functional loans between power and transmission.

- BPA has a new $300M short term line of credit from the U.S. Treasury. This should be modeled as available to make Treasury payments and should be increased.

- For FY 2010 and 2011, BPA should resume the Flexible PF program. The flexible PF Program allows BPA to turn to its larger customers in a cash crunch situation and request pre-payment of power bills. The availability of this program reduced missed Treasury payment risk in the last rate period and should be assumed for the upcoming rate period, if a sufficient number of utilities sign up for this program. A number of utilities have already expressed interest if the costs of participating in the program are reasonable.

- BPA may need to reduce the 95% Treasury probability standard given the state of the economy.

The Third Step: Stepped rates

- BPA's costs are significantly higher in FY 2011 than 2010. The Power revenue requirement in the Initial Proposal is $2.814 billion for FY 2010 and $3.093 billion for 2011. When BPA sets rates for a two year rate period it averages the revenue requirement for the two years. In doing so the revenues collected in the first year are higher than they need to be in order to have sufficient funds for the second year. Also, risk recovery is higher because the uncertainty of looking ahead two years is greater than looking ahead a year at a time. We are expecting that FY 2010 will still be recessionary while in FY 2011 the economy will be in better condition (we hope). Given the above situation an option would be to have a smaller rate increase from 2009 into 2010 with a larger rate increase if deemed necessary for 2011. A rate would be posted for 2010 and a "rate range" would be posted for 2011. The rate for 2011 would be established for good once FY 2010 performance becomes clearer.

Bottom line

If all of the above actions are taken we expect that BPA can bring down the rate increase to a reasonable level for 2011 and have a smaller rate increase in 2010. The triggering of the CRAC in 2010 based on FY 2009 financial results is a more difficult matter. We will have to urge BPA to get its costs down in order to get its net revenues up as we approach the end of FY 2009. And hope for more snow and higher power market prices.